NOESIS CAPITAL MANAGEMENT

A REGISTERED INVESTMENT ADVISOR

October 15, 2007

Dear Client:

The well publicized weakness in the housing market and subprime mortgages, with a reactive effect on the credit markets, have created serious concerns about a possible impact on the current U.S. economic expansion. Despite these concerns, the equity market showed positive signs towards the end of the quarter following a very turbulent July and August, mainly due to optimism about prospective third quarter earnings reports and expectations that the Federal Reserve will make further interest rate cuts if needed to avert a recession.

Large losses in subprime mortgages and mortgage-linked securities have had a disruptive effect on the credit markets and on M&A activity. Loans made to finance leveraged buyout deals, for example, have been cut back supposedly creating a backlog of possible future deals to be done pending stabilization in the credit markets. Similarly, private equity firms are believed to have several hundred billion dollars available for investment which is not being used aggressively due to credit market conditions. Similar to corporations with highly liquid balance sheets that are underutilized, many consumers unaffected by mortgage market problems have adequate liquidity, but appear to have become more cautious in utilizing it.

There is one factor of considerable importance that has had the effect of offsetting part of the impact of weakness in the housing and credit markets. Exports have become an increasingly important contributor to domestic economic growth, reflecting weakness in the U.S. dollar combined with strength in the global economy. Conversely, a slowdown in U.S. demand together with the weaker dollar's effect on the cost of foreign goods has reduced imports. The combined effect caused a reduction in the U.S. trade deficit and this change becomes an addition to GDP.

Over the past year, a narrowing U.S. trade deficit made its largest contribution to GDP growth in fourteen years and this trend may continue this year and in 2008. A cut in the trade deficit added 1.4 percentage points to second quarter growth in GDP, the largest quarterly contribution in about ten years. While this pace is not expected to be sustainable, many economists generally expect a narrowing trade gap to add at least half a percentage point to GDP growth in 2007 and 2008.

Clearly reflecting the benefit of globalization, the expansion of international trade has become an increasingly powerful force fueling growth in the U.S. economy. This at least partially offsets a slower pace of consumer spending and capital expenditures, but to a large extent relates to dollar weakness which is likely to continue as a result of lower U.S. interest rates. Putting this in perspective, the U.S. Dollar Index is down about 34% from its 2002 high. The U.S. Dollar Index is the average of the exchange rates of the U.S. Dollar and six major world currencies.

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U.S. export growth to Europe represented the largest portion of the total increase due to the combination of Europe being one of our largest markets, strength in the European economies and U.S. dollar weakness against the Euro and other local currencies. On the other hand, since many currencies in Asia and other developing areas are pegged to the dollar, current strong export growth to many of these markets reflects economic expansion rather than dollar weakness.

Increased exports obviously will favorably affect many companies. Aside from exports, U.S. companies with foreign operations will also benefit significantly from dollar weakness inasmuch as profits earned in foreign countries convert into more dollars when they are included in consolidated earnings reports.

With the exception of housing related companies and financial services companies involved with subprime lending, the growth of corporate profits continues at a healthy pace. Corporate liquidity remains at a high level, with the capability of cash being used for further stock repurchases or other purposes. Capital spending has been at a low level relative to corporate earnings resulting in many companies having the strongest balance sheets in decades. While it may not be realistic to anticipate a strengthening of business spending in the light of uncertainties in the near term economic outlook, having this potential available is a positive factor that could prove to be important at an appropriate time in the future.

Although the credit crisis and the resulting market turmoil during the quarter had an impact on the prices of many of the stocks in our portfolios, we are confident about the overall quality of the companies that we hold. We took advantage of the volatility, particularly in July and August when the market bottomed, by adding several solid companies to our portfolios, which are summarized the “New Purchases” below. We were able to purchase these new positions at attractive prices and, as such, these companies have been solid performers since the market rebounded towards the end of the quarter. We will continue to take advantage of globalization by focusing on companies that are increasingly benefiting from the global economy. Most of the U.S. companies that we hold derive significant revenue outside of the U.S. and are actively expanding their operations abroad. We also have increased our exposure to foreign companies, which currently comprise approximately 18% of our equity portfolios. Our foreign holdings are geographically diverse and include such names as: Toyota and Honda (Japan), HSBC (UK), Novartis and Logitech (Switzerland), Suntech (China), Amdocs (Israel) and National Bank of Greece (Greece). As we have done during this quarter, we will continue to upgrade our portfolios as there are opportunities in order to achieve the performance that we expect, with long term results remaining our principal objective.

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NEW PURCHASES IN THIRD QUARTER OF 2007

C.R. Bard, Inc. (BCR)

C. R. Bard, Inc., founded over 100 years ago, is a leading developer, manufacturer and marketer of innovative, life-enhancing medical technologies, focusing on vascular, urology, oncology and specialty surgical products. The company has a well-diversified product portfolio and its business model is solid and stable. Management has compiled an outstanding track record thanks in large part to their discipline in capital deployment and a low-profile company culture.

Donaldson Company (DCI)

Donaldson Company is a leading worldwide manufacturer of filtration systems and replacement parts. The company operates in two segments: Engine Products and Industrial Products. A significant portion of the Company's sales (53%) are derived from overseas markets, up from 39% in 2002. Donaldson has delivered record earnings for 17 consecutive years with a 16% compounded annual growth rate during this period. The company's consistent track record has been driven primarily by geographic and product diversification.

Google Inc. (GOOG)

Google, based in Mountain View, California, is the leader in Internet search and online advertising. Google generates revenue by delivering online advertising on its Google website and partner's websites. With more than a 50% market share and a portfolio of revolutionary products, Google is well positioned to leverage on its immense user base and technology leads. With 23% returns on average equity, no debt and high cash flows, Google's financial performance is among the best in the industry.

Logitech International S.A. (LOGI)

Based in Switzerland, Logitech is the worldwide leader in personal interface devices for computers and other digital platforms. Logitech has manufacturing facilities in China and R&D centers throughout Europe, Australia and Asia. With a strong brand name, diversified product portfolios, excellent innovation capability and well-established sales channels, Logitech is the undisputed industry leader. The company has had double-digit sales growth for the past 34 consecutive quarters and a compounded EPS growth rate of 23% for the past 10 years.

National Bank of Greece SA (NBG)

NBG is Greece's largest bank and possesses a strong presence in emerging economies in the Southeast-European region as well as Turkey. Low banking penetration paired with strong economic expansion and improved stability in these markets leads to very attractive growth opportunities for the company. NBG already generates 28% of its profit abroad and is well positioned to become one of the leading financial institutions in Southeast Europe. A highly loyal and inelastic deposit base provides the company a strong foundation for further lending growth at competitive funding costs.

FIXED INCOME UPDATE

During the quarter both short term and long term interest rates moved lower. The yield curve between the 3-month Treasury Bill and the 10-year Treasury Note steepened, finishing the quarter at 3.82% and 4.59%, respectively. This interest rate move was in response to the credit market turmoil that occurred during the quarter.

Globally, financial market participants have become fearful of any type of asset backed security that may contain subprime mortgages or leveraged buyout loans. This has severely impacted the subprime mortgage and the leveraged loan markets and has led to the cost of credit increasing for many participants in the economy, not just the marginal home buyer and leveraged buyout firms. Also, the reduction of credit extended to lower credit quality home buyers, along with the weakened demand and increased supply of homes, has led to further weakening in the housing market. The Federal Reserve has changed its monetary policy stance and lowered the federal funds target rate by 0.50% to 4.75% during the quarter. The Fed's growth forecast has been reduced with the expectation that this will relieve inflationary pressure. Near term, we appear to be in an inflation deceleration period. As mentioned earlier, this will allow the Fed to lower rates further, if needed.

Of the three income segments in which we invest, preferred stocks were impacted the most by the credit market turmoil during the quarter. This segment is especially sensitive to credit trends. The other two segments, equity-related income and corporate/government bonds, performed relatively well during the quarter. This highlights one of the comparative advantages of our fixed income strategy, namely asset class diversification.

The income securities in our portfolios that have performed poorly during the quarter continue to have attractive risk-adjusted returns going forward. We believe much of the negative performance that was experienced in the quarter will reverse at some point in the future. We do not believe the cash flows of these securities are permanently impaired and therefore prices should rebound and the returns that we originally expected should be realized.

We are always available to discuss your portfolio and/or address any questions.

Sincerely,

Richard M. Brown, CFA
Chief Investment Strategist

Our most recent Form ADV, Part II is available upon request

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