NOESIS CAPITAL MANAGEMENT

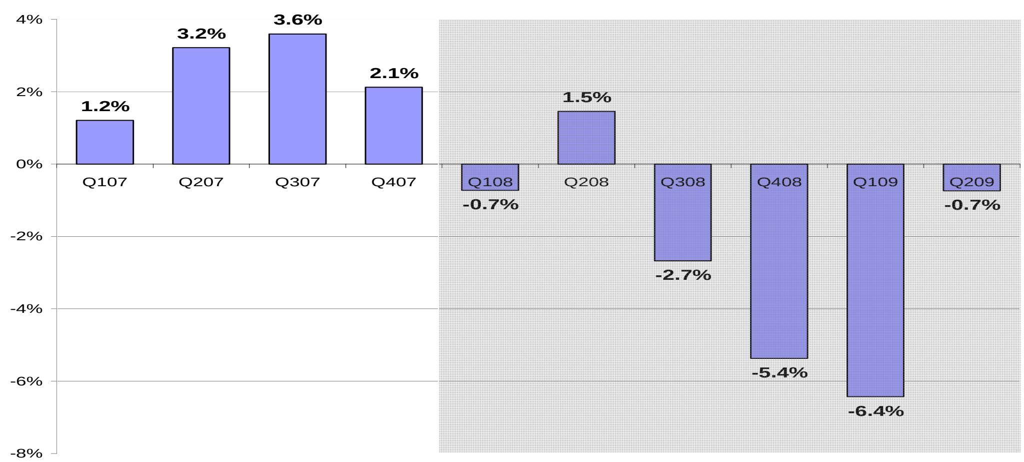
A REGISTERED INVESTMENT ADVISOR

October 15, 2009

Dear Client:

Although GDP declined 0.7% in the second quarter, recent data suggests that the recessionary down trend has slowed (see Chart 1 below). Assuming this trend continues, the end of the "Great Recession" may be near, which appears to be Wall Street's current consensus. The combination of the Fed's extremely loose monetary policy and the government's massive fiscal stimulus have worked well, at least up to this point.

Chart 1: Real Gross Domestic Product (%)



Note: Shaded area indicates US recession. Source: U.S. Department of Commerce: Bureau of Economic Analysis

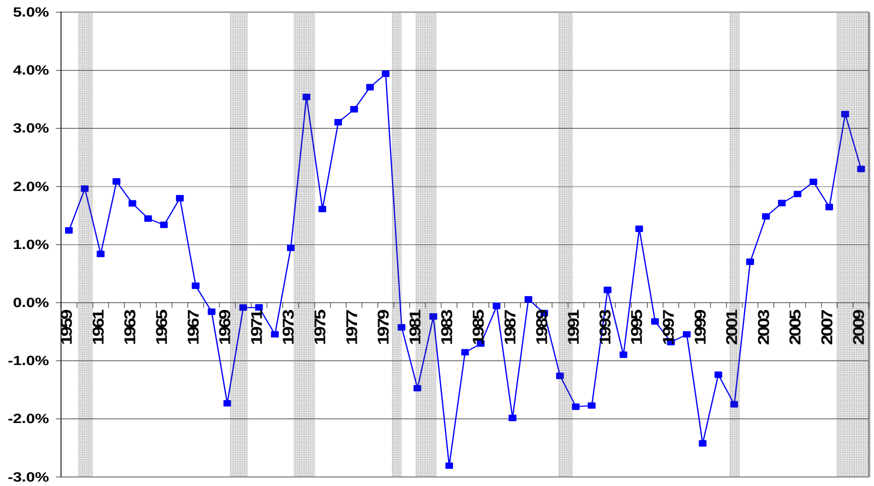
As our economic recovery continues, the road ahead might not be smooth. The most serious challenge with respect to exiting fiscal and monetary stimulus is timing - if implemented too soon, we could face a serious and prolonged deflation; and if too late, we could face a hyper-inflation environment.

Another issue is that U.S. economic growth over the past two decades has been driven primarily by consumption, which was fueled in large part with debt. With household income declining, rising unemployment and debt levels, coupled with a dramatic loss of accumulated wealth, the current deleveraging and savings is likely to lead to a new trend of lifestyle for the U.S. Furthermore, "Baby Boomers", a key group of consumers, are approaching the retirement stage and will need to learn quickly to save for their retirement.

On the other hand, emerging markets such as China have manufactured, saved, and lent money to America. As the populations in these emerging markets amass wealth, their consumption will increase which should help continue their fast growth for the coming years.

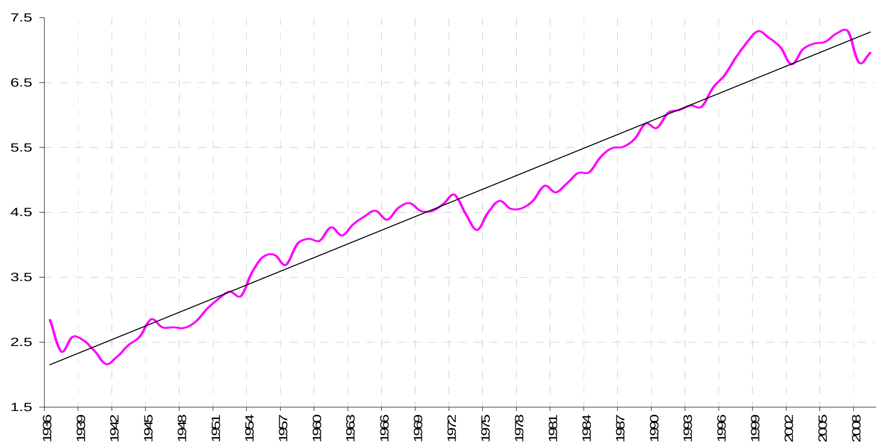
In terms of our investment strategy, we see greater opportunity in equities versus bonds in the long term. Chart 2 below shows the "Fed Model" which compares the yields on the 10-year Treasury and the S&P 500 earnings. Differences in these yields are thought to identify an over-priced or under-priced equity market. Based upon this model, the equity market looks relatively attractive. Furthermore, the long-term chart of Standard & Poor's 500 Index (see Chart 3) reflects that the equity market is below its trend line, another indication that the market is undervalued. Note that we do not use these models as a timing tool.

Chart 2: S&P 500 earnings yield minus 10-year Treasury yield



Source: Board of Governors of the Federal Reserve System; Bloomberg

Chart 3: S&P 500 Index (Log scale)



As such, we believe that long-term, there are good opportunities in the equity market and especially with companies operating in emerging markets. During the first half of the year, we aggressively added positions in companies such as Google, HSBC Holdings, Pepsi, Baxter, C.R. Bard, Fluor, Wal-Mart, Canadian National Railway, and Delta Electronics. These companies have similar characteristics in that they are all: global, well-managed, socially-responsible organizations with honest management, great business perspectives, solid balance sheets and have strong cash flow generation. Let me explain a little why we like these companies.

Google is a clear leader in the online search market with approximately 65% market share and, amazingly, it continues to gain market share. We believe Google has a strong competitive advantage as the industry moves toward cheaper, measurable and performance-based display advertising. International revenue accounts for 51% of Google's revenue and, therefore, the growth opportunity remains high.

HSBC is a top-quality bank which dominates the Asian markets. With its outstanding reputation and long operating history in Asia, HSBC should benefit exceptionally from this region's high growth.

PepsiCo is a top-tier consumer staples company with best-in-class management and a diversified portfolio of market leading brands, including, Gatorade, Quaker and Tropicana. The company has paid close attention to changing consumer tastes and developed new products to meet the demand. With only 48% of its revenues coming from international sales, PepsiCo has excellent long-term growth prospects as it focuses on global expansion.

Fluor is one of the world's largest engineering and construction companies. The company serves diversified industries and geographic markets. With a strong exposure in emerging markets and about half of its revenue deriving from international markets, Fluor is well positioned to take advantage of the strong demand from emerging markets.

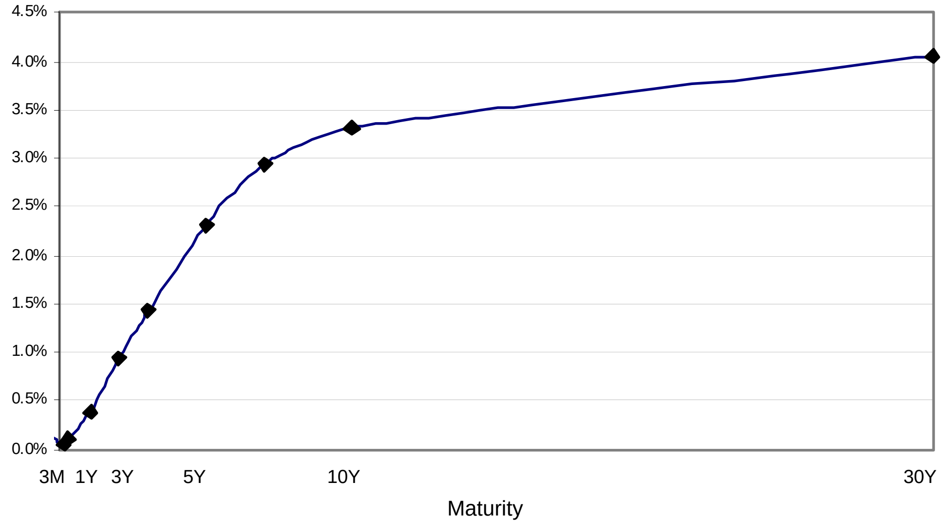
Canadian National Railway has an exceptional management team and is one of the industry's most profitable and productive companies. We believe the railroad industry is well positioned to benefit from being cheaper and greener relative to other transportation operators.

Delta Electronics is the world's largest merchant switching power supply manufacturer, whose mission has long been environmental protection. Their long-term investments all center on the same theme – clean and efficient energy. Delta's management team is highly regarded in Asia as disciplined, ethical and socially responsible.

FIXED-INCOME UPDATE

At the end of the quarter, the 3-month T-Bill was at 0.11% while the 10-year Treasury Note was at 3.31%. The Fed recently reaffirmed its expectations for a "subdued inflation for some time". While interest rates remain low, the Treasury yield curve (see Chart 4 below) shows sharply a positive slope.

Chart 4: The Treasury Yield Curve



With the federal funds rate close to zero, the risk of a further rate decrease is improbable, whereas the prospect of a future rate increase is more likely. Therefore, we prefer to maintain our exposure to shorter-term maturities. As we are facing an uncertain economic environment with the risk of a prolonged deflation or hyper-inflation as possible outcomes, we remain focused on high credit quality issuers.

The year-over-year CPI (consumer price index) is currently negative and has been since March 2009. Inflation is expected to remain low for the immediate future. Many floating rate income securities have coupons that adjust according to this index. Consequently, the cash flows from these securities have been very low as the index has been negative, but could increase in the coming months. As such, we are also considering floating rate income securities.

In general, investor confidence has improved over the past several months according to many surveys. This is increasing the demand for assets other than CDs and money market funds. If you are in a high tax bracket, the after tax CD return is extremely low. We can use municipal bonds for the income ladder in order to increase after tax return and only marginally increase credit risk.

We encourage you to call us any time to discuss your portfolio and also thank you for the referrals you have directed our way.

Sincerely,

Joseph Lai, CFA
Chief Portfolio Manager

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

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