NOESIS CAPITAL MANAGEMENT

A REGISTERED INVESTMENT ADVISOR

August 17, 2004

Dear Client,

Recent economic data has provided mixed indications relative to the strength and direction of the domestic economy, with the less encouraging numbers receiving the most attention. Although below previous expectations, we believe that a broader and more balanced perspective shows a more upbeat reading on current conditions and the prospects for the balance of 2004.

The payroll survey, reported on Friday, August 6th, showed a disappointing 32,000 new jobs in July, far below expectations in the 200,000 to 250,000 range. Conversely, the household survey showed job creation of 629,000. The latter is more volatile than the payroll survey but also includes independent contractors and the self employed that are added later to the payroll survey on a lagging basis. Neither is an accurate indicator of the economic trend on a month-to-month basis and the two probably bracket actuality.

Sluggish employment growth, a matter of significant concern, is primarily attributable to rising productivity combined with intense global competition, motivating many U.S. companies to establish offshore facilities as well as to take advantage of job outsourcing opportunities. These impediments to domestic job growth may well prove to be longer term problems that will not disappear anytime soon and could therefore turn out to be more secular than cyclical factors, compounding the normal difficulty of short term economic analysis.

The Commerce Department reported that consumer spending grew at a very sluggish annual rate of only 1% in the second quarter, the weakest performance in three years. Notwithstanding, second quarter GDP grew 3%, with consumer spending accounting for only 0.7 percentage points of the overall growth. While thus far in the current economic cycle consumer spending had been the growth engine, there clearly has been a turnabout. During the past two years there had been unfulfilled hopes of a pickup in business spending for capital equipment and inventory building, which had lagged apparently due to reservations about the sustainability of the economic recovery. In the second quarter, however, capital expenditures for new equipment grew at a 10% annual rate and construction spending for new warehouses and offices increased at a 5.1% rate. In addition, there was an acceleration in the investment in business inventories, which could extend further, and exports experienced a vigorous 13.2% increase.

Another favorable indicator of momentum in the economy was exhibited by industrial companies, which displayed an increase in manufacturing activity in recent months and created 10,000 new jobs in July. While this was a smaller gain than many expected, it was the fifth increase in the past six months. Moreover, new orders rose in July both for durable goods and non-durables. The Institute for Supply Management [ISM] Index of Manufacturing Activity, a composite of orders, production, employment, inventories and delivery times, increased from 61.1% in June to 62% in July. This index has been over

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60% since late last year, a significant streak since any reading over 50% is regarded as a measure of manufacturing expansion. A cautionary note worthy of attention is the fact that non-farm productivity growth slowed to an annual rate of 2.9% in the second quarter versus 3.7% in the first quarter; a decline from an exceptionally high 4% average over the previous three years. Related data shows that labor costs per unit of output rose 1.9% in the second quarter, the fastest pace in two years.

Sharply higher oil prices are clearly having a negative effect on consumer spending, by reducing the amount of cash available for other purchases and it is not possible to forecast when this situation may improve, or possibly become more severe. As reported in *The Wall Street Journal* on August 13, 2004, some economists thought oil prices would have to rise even higher, perhaps to $60 per barrel, to seriously jeopardize the economic recovery, but they believe that rising oil prices have clearly played an important role in slowing consumer spending. Nevertheless, the Commerce Department said that retail sales bounced back in July and that the decline in June was not as large as originally reported. Consistent with this, some economists now believe there could be an upward revision in second quarter growth later in August.

As we indicated earlier, we remain cautiously optimistic about prospects for continued economic growth in 2004, although the pace is unlikely to meet earlier consensus expectations, which have proved to be overly ambitious. It is important to bear in mind, however, that a moderate pace of less inflationary expansion is usually more sustainable and therefore preferable to sharp uptrends that create excesses and cannot be maintained. It is also clear that the war in Iraq and continuing unrest throughout the region could have further effects on the supply of oil and the price level.

As in the past, our policy is to avoid being unduly influenced by short term events, positive as well as negative. We continue to be confident about our portfolio holdings, based upon sound company fundamentals and valuations that we consider attractive in this current beaten-down market. Our disciplined investment philosophy has served our clients well in the past and we remain firmly committed to continued application of the long term investment practices that we believe will be the most rewarding in the future.

Please do not hesitate to contact us as we are always available to respond to any questions you may have.

Sincerely,