



Budget Update

Rumors abound as the defense sector awaits the release of specifics from the White House on the budget for the defense sector in fiscal year 2010.

According to the White House (March 31 phone call), Defense Department budget line items are not anticipated to be released until late April and possibly early May.

Defense Secretary Gates: April 6th Speech

At a press conference on April 6th, Defense Secretary Gates presented details on what will be included in the budget that he has drafted for the White House. It is still subject to change and it is likely that Congress will put its own stamp on what changes it will and will not fund.

At first glance, many program gains offset losses
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SPADE Defense Index Statistics

3/31/09 Close: 1344.13
All-time Close: 2747.67
Date of all-time close: 9 October 2007

	SPADE Defense	S&P500
March	3.99%	8.50%
1st Qtr	[13.95%]	[11.70%]
YTD	[13.95%]	[11.70%]

Commentary

The key event that will shape the defense sector for the next year and beyond is when details of the defense budget are released in April (though we are hearing unconfirmed rumors that it could slip into May). While I could add to the budget speculation without any concrete information, instead I've decided to focus this commentary on...Clint Eastwood. Not because many of his characters stand for justice, truth, security, or that his gruff onscreen warrior persona is stereotypical of America's soldiers out to fight the good fight, what comes to mind is the title of one of his movies, "The Good, the Bad, and the Ugly". What better phrase can summarize what goes through the mind of an investment analyst focused on the defense sector these days.

Although the SPADE Defense Index beat the S&P500 for the ninth consecutive year in 2008, it was still down 36% and since January's gains, the sector hasn't fared very well in the market. So when I see that we are 50% below the Index's high of last October, ugly comes to mind.

The fact that the defense budget will see a rise of an estimated \$20 billion in 2010 is good, but for the companies, the rumor that most of the gains will go toward increased personnel costs (salary, medical, retirement, facilities improvements), this is bad.

Overall, the forecasted 2%-3% decline in acquisitions rumored for fiscal year 2010 translates to roughly \$4 billion. At an 8% margin, we're talking about only \$320 million in profits spread among a number of firms. Not as bad as one might initially think.

While the sector's negative performance in February and March has been downright ugly (more than 20% in February), one has to wonder if we are already at

or near the bottom. Statistically, defense companies are trading at valuations normally seen at the bottom after a budget retrenchment that moves some defense spending toward other areas. So once we get more information from the budget as to the direction of the Defense Department, will we see an immediate rebound (good) or further downside (bad) followed by a definitive bottoming?

So if all the anticipated negative news is priced in, that's good for the sector over the next 12 months as long-term contracts continue to generate revenues and cash flow for the sector's firms operating in this area.

The anticipated delay, cancellation, or reduction in size of major programs will be bad for the firm's anticipating the contracts and future revenue stream. However, if the monies from these programs are shifted to other programs and spending on R&D and procurement remains steady, this could offset the perceived decline and that's good. (See page 4 for specifics from Secretary Gates' press conference).

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**Nine Consecutive Years
Outperforming the S&P500
(2000 - 2008)**

**Morningstar Gives the
Powershares Aerospace &
Defense ETF (NYSE: PPA) a
***** 5 Star Rating *****
for Large Growth Funds**

Quarterly Index Rebalancing

The SPADE Defense Index underwent its quarterly rebalancing and reconstitution at the end of March. Changes to the Index are as follows:

Additions

Force Protection (NASDAQ: FRPT) - The firm engages in the manufacture of ballistic and blast protected vehicles primarily used to support armed forces and security personnel.

Herley Industries (NASDAQ: HRLY): For more than 40 years, Herley has been supplying solid, innovative, and sophisticated RF, microwave and millimeter wave components and subsystems to the defense and aerospace industries.

Integral Systems (NASDAQ: ISYS):

The firm builds satellite ground systems and equipment for command and control, integration and test, data processing, and simulation in the United States and internationally and serves government and commercial organizations.

Removals

ICx Technologies (NASDAQ: ICXT) was removed when their liquidity/trading volume fell below required levels.

March 2009 Top Gainers

1	URS	30.69%
2	Axsys Technologies	26.59%
3	Garmin	23.89%
4	Herley Industries	23.81%
5	Northrop Grumman	16.81%
6	Teledyne Tech.	16.46%
7	Cogent	14.42%
8	Ducommun	14.31%
9	Viasat	13.77%
10	Boeing	13.17%

March 2009 Laggards

1	Aerovironment	[33.06%]
2	Harris	[24.70%]
3	Esterline Tech.	[20.32%]
4	Mantech	[19.69%]
5	Stanley	[18.12%]
6	Orbital Sciences	[15.97%]
7	CACI	[14.68%]
8	GeoEye	[12.61%]
9	Mercury Computer	[10.81%]
10	American Sci & Eng	[8.06%]

YTD 2009 Top Gainers

1	Applied Signal	14.40%
2	Garmin	10.64%
3	OSI Systems	10.18%
4	Computer Sciences	4.84%
5	Ball Corp.	4.35%
6	Elbit Systems	3.77%
7	GeoEye	2.70%
8	Goodrich	1.22%
9	Precision Castparts	0.71%
10	Argon ST	0.58%

YTD 2009 Laggards

1	Textron	[58.62%]
2	Ladish	[47.59%]
3	Esterline	[46.71%]
4	Aerovironment	[43.22%]
5	Teledyne Tech.	[40.11%]
6	Orbital Sciences	[39.12%]
7	Moog	[37.46%]
8	Flir Systems	[33.25%]
9	VSE Corporation	[31.94%]
10	AAR	[31.88%]

Largest Defense Prime Contractors

	March	2009
Lockheed Martin	9.38%	[17.90%]
Boeing	13.17%	[16.62%]
General Dynamics	[5.09%]	[27.78%]
Northrop Grumman	16.81%	[3.11%]
Raytheon	[2.58%]	[23.71%]

	28 Feb 2009
Avg. Market Cap.	\$8.63 B
Portfolio P/E	9.94
Portfolio P/S	0.59
Portfolio P/B	1.65
Portfolio P/Cash Flow	6.38
Earnings Growth Rate (ttm)	11.87%
(Most recent estimate) source: Yahoo Finance	

ETF Statistics (NYSEarca: PPA)
Powershares Aerospace & Defense

Exchange / Ticker Symbol: NYSE / PPA
 Fee: 60 basis
 Assets (3/31/09): \$ 101.7 M
 Closing Price (3/31/09): \$ 11.83
 Yield (SEC 30-day yield): 1.61%
 March 09 Volume
 3 month Avg Daily Trading Volume** 74,772
 source: Yahoo Finance ** March 27 2009

New Programs

2+2 Program - Associated Press reported that a proposed classified program worth more than \$10 billion is being discussed to produce two new, sophisticated spy satellites. At the same time, the government would also commit to spend enough money on commercial satellite imagery to pay for the construction and launch of the two new commercial satellites.

Aviation Week reported that the U.S. Special Operations Command wants to begin development of a new gunship beginning in 2010. The aircraft would be more flexible than the AC-130H/U for urban warfare. Proposed platforms include L-3's C-27J/Alenia North America and the Lockheed Martin C-130J.

Contracts

\$5 Billion - Lockheed Martin won a 10-year contract to manage logistics for the U.S. Special Operations Command

\$2.13 Billion - The State Department clears India to purchase Boeing's P-8 maritime patrol aircraft, based on the 737 it performs

long-range reconnaissance and antisubmarine activities.

\$1 Billion - Homeland Security Department announced that it will spend \$700 million to acquire systems for detecting explosives in checked bags and \$300 million toward improved screening technologies for passengers and carry-on bags.

\$600 Million - NASA contract to United Launch Alliance, a joint venture of Boeing and Lockheed Martin for a series of satellite launches beginning in 2011.

\$TBD - The Navy awarded Lockheed Martin a contract for a second Littoral Combat Ship after years of delays and negotiations. An earlier contract was cancelled after costs for the first ship doubled from the planned \$220 million. Terms were not announced but a fixed price incentive fee contract is anticipated.

Powershares Aerospace & Defense ETF (PPA)

Morningstar Rating (3-yr, Large Growth): **5-Star**

Modern Portfolio Theory (vs the S&P500)

Beta (3 month): 1.20
 Alpha (3 month): 9.03
 R-squared (3 month): 85.64
 source: Yahoo! Finance (2/29/09)

Positioning for the Global Economic Downturn

Northrop Grumman announced plans to lay off as many as 750 employees in Southern California as it combines administrative offices.

General Dynamics lowered its 2009 earnings guidance by roughly 10% and announced 1200 job cuts due to weak sales at its Gulfstream Aerospace operation.

United Technologies announced that it would shed 11,600 jobs this year, reducing its workforce by 5%.

About

The SPADE Defense Index (**ticker: DXS**) provides an investment benchmark for companies involved with defense, homeland security, and space.

The Index is designed to reflect the broad diversity of activities that is representative of companies involved with defense, homeland security, and space – including industrial firms that manufacture aircraft, tanks, ships, and missiles and those involved with current and next generation systems related to network centric warfare and information technology; intelligence, surveillance, and reconnaissance; satellites; border security; and defense systems that protect the lives of our servicemen and service-women.

Licensed Products

Exchange Traded Fund - ETF

Licensed to Powershares, their Aerospace & Defense Portfolio ETF (NYSEarca: PPA) is designed to track the performance of the SPADE Defense Index.

Rules

The Index was designed to be RIC (Registered Investment Company) compliant for the purpose of enabling financial products. Companies are required to meet a variety of eligibility criteria including market valuation, liquidity, and listing on a major U.S. exchange. Full details are available on our website.

- * Market Cap: Minimum \$100M
- * Share Price: Minimum \$5.00
- * Liquidity: 50,000 shares/day avg

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Commentary (continued)

Of course, even with new details provided by the Pentagon, there will still be significant debate by the House of Representatives and the Senate as to which of their recommendations will be incorporated and which will not. Bad news today could become good news after Congress makes its decisions.

Now you understand my thinking behind ‘the good, the bad, and the ugly.

So that you can draw your own conclusions, here are some other items for you to consider -- news broken down by “The Good, The Bad, and the Ugly”

Good: Analyst Pierre Chao stated at the recent Cowen & Company event that valuations of defense companies are at levels typically seen after a defense budget decline.

Good: Raytheon votes to increase its dividend by nearly 11% - a positive sign on the health of the firm and the sector

Good: Afghan Surge - Charlotte Observer: President Obama has already announced plans to send 17,000 additional troops to Afghanistan but the top U.S. commander there is asking for more aircraft and civilian support as well.

Good: Russia working on anti-satellite weapons -- *Int'l Herald Tribune*: Gen. Valentin Popovkin said that Russia has developed “basic, key elements” of anti-satellite weapons system though he insists they are against an arms race in space

Good: Despite the rhetoric coming from the White House, Congress has a history of fighting for weapons programs that are proven job creators.

Good: Electronic warfare gains -- *BusinessWeek* stated that although a number of big-ticket weapon systems could be in trouble, a new emphasis on electronic warfare could be a boon to defense contractors -- high-tech electronics are seen key to both traditional wars and wars of terror. ITT has already landing some \$1.75 billion in contracts for jammers used against IEDs.

Bad/Ugly: *Forbes* stated that the Defense Department is looking to shave 2% to 3% from this year’s \$181.2 billion weapons procurement budget for the FY 2010 budget with deeper cuts in 2011.

Bad: *CQPolitics.com* stated that the White House negotiates with DoD over budget trade-offs, the administration is planning to delay an aerial refueling tanker by five years while cancelling plans for a long-range bomber to replace the B-52. Cancelling the bomber may prove easier since it is still in its infancy.

Bad: *Defense News* reported that the 2010 supplemental will include only \$20 billion for procurement versus \$60 billion in 2009. A number of big weapons programs including one Navy aircraft carrier, the Army Future Combat System, the Air Force TSAT, and the Marines’ Expeditionary Fighting Vehicle, have been getting funds from the supplemental spending packages.

Ugly: Missile defense spending reportedly may see cuts

by an estimated \$2 billion (10%). Vulnerable programs include Boeing’s Airborne Laser, Lockheed Martin’s Multiple Kill Vehicle and the Space-Based Surveillance & Tracking System being developed by Northrop Grumman and Raytheon according to the Missile Defense Advocacy Alliance. Boeing has stated that budget cuts could endanger 55,000 “well-paying, clean industry” jobs in 36 states.

Ugly: A March 19th article in *The Economist* highlighted that shares in defense companies have fallen significantly as compared to the S&P500, proof that President Barack Obama’s repeated criticisms of the industry are a “cloud hanging over the industry”. The magazine states, “With a military budget almost as big as the rest of the world’s combined, even quite small changes in American (defense) spending have big consequences for the industry”.

Good (maybe): According to *Aviation Week*, the Pentagon has been finding little support for its request for 60 more F-22 stealth fighters although a reduced order for 20 planes could postpone an ultimate decision until next year.

Bad: The Government Accountability Office found that NASA went \$1.1 billion over budget on nine recent projects and that the agency had to simply guess at the cost of some programs.

Good: Flush with cash, defense firms are acquiring niche technology players in high-priority areas such as intelligence and surveillance in order to acquire intellectual property.

TBD: John Murtha (D-Pa), the chief defense appropriator in the House of Representatives, has been lobbying the Obama administration for a scaled-based Marine One chopper program. A simpler version will cost \$6.8 billion for the entire fleet vs. \$13 billion for the full-featured version. (*The Hill*)

Good: Boeing debated analysts gloom and doom forecast stating that its \$270 billion backlog makes its well-positioned to ride out the global downturn in commercial aviation. (*USA Today*)

Good: The *Wall Street Journal* reported that the federal government is expected to spend \$6 billion this year, a figure that could rise to as much as \$30 billion in the next five years.

Good: Boeing announced plans for a new lines of F-15s with stealth technology that could generate up to 190 orders from foreign countries. The \$100 million Silent Eagle would provide new work for its St. Louis assembly plant.

Good: According to the Aerospace Industries Association, stated that industry sales are on pace to reach \$204 billion, an increase of 2.1%, a record level for the fifth straight year.

Good: The GeoEye-1 satellite was certified by the National Geospatial Intelligence Agency and will begin receiving \$12.5 million per month in contracts from the agency.

Year	SPADE	S&P500
2008	[38.03%]	[38.49%]
2007	22.17%	3.53%
2006	19.33%	13.62%
2005	5.30%	3.00%
2004	20.47%	8.99%
2003	37.27%	26.38%
2002	[2.87%]	[23.37%]
2001	0.94%	[13.04%]
2000	4.98%	[10.14%]
1999	15.31%	19.53%
1998	6.63%	26.67%

Quarter	SPADE	S&P500
4Q08	[18.14%]	[22.45%]
3Q08	[8.13%]	[9.00%]
2Q08	[4.69%]	[3.23%]
1Q08	[13.53%]	[9.92%]
4Q07	[4.22%]	[3.82%]
3Q07	[2.39%]	[2.99%]
2Q07	10.76%	5.81%
1Q07	4.37%	0.18%
4Q06	8.79%	6.17%
3Q06	3.21%	5.17%
2Q06	[4.03%]	[1.91%]
1Q06	10.65%	3.73%
4Q05	[0.47%]	1.59%
3Q05	4.44%	3.15%
2Q05	3.91%	0.91%
1Q05	[2.52%]	[2.59%]

Quarter	SPADE	S&P500
4Q04	9.80%	8.73%
3Q04	2.81%	[2.30%]
2Q04	6.34%	1.30%
1Q04	0.36%	1.29%
4Q03	18.97%	11.64%
3Q03	5.27%	2.20%
2Q03	19.03%	14.89%
1Q03	[7.92%]	[3.60%]
4Q02	3.39%	7.92%
3Q02	[17.04%]	[17.63%]
2Q02	[2.86%]	[13.73%]
1Q02	16.57%	[0.06%]
4Q01	14.59%	10.29%
3Q01	[10.40%]	[14.29%]

Quarter	SPADE	S&P500
2Q01	5.91%	5.52%
1Q01	[7.18%]	[12.11%]
4Q00	[0.05%]	[8.09%]
3Q00	12.14%	[1.24%]
2Q00	[7.11%]	[2.93%]
1Q00	0.83%	2.00%
4Q99	7.57%	14.54%
3Q99	[10.18%]	[6.56%]
2Q99	21.39%	6.71%
1Q99	[1.68%]	4.65%
4Q98	13.70%	20.87%
3Q98	[16.88%]	[10.30%]
2Q98	[1.88%]	2.91%
1Q98	14.99%	13.53%

Notes from Defense Secretary Gates press conference 6 April 2009 --

Winners & Losers

- * Increase C4ISR spending by \$2 billion including Predator UAVs added permanently to the base budget (will see a 127% increase)
- * Increase manned ISR - Turboprop program
- * Increase \$500M to field and sustain more helicopters
- * Increase by 2800 (5%) Special Operations personnel and support aircraft
- * Increase buy of Littoral Combat Ships from 2 to 3 ships (55 total)
- * Focus on intratheater lift with joint high-speed vehicle
- * Increase buys of fifth generation tactical fighter capability - F35 - from 14 (2009) to 30 (2010). 530 total in five year plan, raising budget from \$6.8 billion to \$11.2 billion, 2443 planes in total
- * 31 FA-18 planes
- * Retire 250 tactical fighters and end the F-22 at 187 planes
- * Increase by \$700M the theater missile defense system - THAAD and Standard Missile 3
- * Increase training of cybersecurity experts from 80 to 250 annually in 2011
- * Keep KC-X tanker schedule and funding and send out bids this summer

- * Replace the Ohio-class submarine
- * No new Air Force Bomber until further study is done
- * Complete C-17 airlifter program at 205 ships
- * Missile Defense spending decline by \$1.4 billion
- * Cancel Air Force search and rescue helicopter
- * Delay Presidential helicopter to 2011 and re-evaluate
- * Terminate TSAT program and buy two more AEHF satellites
- * Cancel 2nd Airborne Laser and shift 1st to R&D
- * Terminate Multiple Kill Vehicle.
- * Compete buy of 2 Navy destroyers DDG-1000
- * Restart DDG-51 program
- * Reduce number of support contractors to 2001 levels (from 39% to 26%) and add government staff
- * Restructure FCS program including cancelling the vehicle component and re-evaluate new Army vehicle modernization to incorporate lessons learned from Iraq and Afghanistan and MRAP buys.

(the above were notes jotted during the press conference)

What's New at SPADE Indexes

For those unaware, the ISBC/SPADE Indexes has been contracted by an Oklahoma-based financial institution to produce an index focused on firms headquartered in the State of the Oklahoma. The Index is currently live and lists under the ticker: OKLAH. An exchange-traded fund is forthcoming pending SEC approval of their application. Additional information on this index as well as future benchmarks can be found on our website.

SPADE Oklahoma Index
<http://oklahoma.spadeindex.com>

SPADE Defense Index (no changes)
<http://www.spadeindex.com>

New Top Level Homepage
<http://www.spadeindexes.com>

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