

FY-08 Defense Budget Released

Numbers Show Continued Strength

Monday February 5th was a day of reckoning as President Bush submitted his FY-08 budget to Congress. In contrast to the days leading up the release of the FY-07 budget when analysts began revising their expectations upwards after anticipated budget declines did not materialize, this year, industry executives and analysts, were expecting the defense budget to remain consistent with prior years and it did.

There are still a number of issues that will arise including review by the Congress and the fact that the President's budget calls for large increases while holding steady or declining social programs. Still defense spending including the supplementals for the war in Iraq and on terrorism remains near historic lows at about 5% GDP. Yes, that is not a typo. Funding on defense is now only slightly higher than 1991 Desert Storm levels and well below the near 44% of GDP that the U.S. spent in World War II.

"In our judgment, with a \$14.2 trillion economy, the nation has a lot to protect, and we might see even more funds flow in," Bob Stevens, Lockheed Martin's Chairman/CEO

Budget Highlights

* A 10.5% Increase in the Pentagon's Regular Budget to \$481 Billion

* \$100 Billion more in supplemental funding for the wars in Iraq and Afghanistan for FY2007.

FY-2008 Department of Defense Budget (\$B)

	FY07	FY08
Operations & Maintenance	149.2	164.7
Procurement	81.3	101.7
RDT&E	75.1	75.1
Personnel	111.1	116.3
Construction	9.3	18.2
Family Housing	4.0	2.9
Working Operating Fund	2.4	2.5
TOTAL	432.4	481.4

Assets Under Management (AUM) Surge in January 2007

Powershares Aerospace & Defense ETF (PPA):

- AUM rise 42% in January
- Increase of \$45.4 Million to \$154.7 M

Index hits new All-Time Highs seven more times in January -- closing at the high

* \$145 Billion in supplemental funding for FY 2008

* \$50 Billion in supplemental funding for FY2009.

The total in supplemental funding for FY-2007 will be \$170 billion (the \$100 billion request plus \$70 billion that Congress has already appropriated).

Challenges on the Horizon

Analysts have stated that a 'fight is looming' over the budget plan which would limit domestic spending for fiscal year 2008.

In addition, plans to boost funding for the Army and Marine Corps could lead to an interservice battle if it significantly impacts Navy and Air Force modernization efforts.

Winners and Losers

Analysts have commented that the biggest winners in this budget will be those companies that have already done well, namely those involved

FY-2008 Department of Defense Budget (\$B) - By Services

	FY07	FY08
Army	109.7	130.1
Navy	110.3	119.3
Marines	16.2	20.5
Air Force	128.4	136.6
Defense Wide	70.9	74.9
BRAC	<3.1>	
TOTAL	432.4	481.4

SPADE Defense Index Statistics

YTD Return: 3.02%
 January Return: 3.02%
 1/31/07 Close: 2169.71

Intraday All-time High*: 2173.61
 Date: 31 Jan 2007

Index Performance Summary

	SPADE (DXS)	S&P500
2006	19.33%	13.62%
4Q06	8.79%	6.17%
3Q06	3.21%	5.17%
2Q06	[4.03%]	[1.91%]
1Q06	10.65%	3.73%

with supplying equipment and supporting the ground force efforts in Iraq, improving their capabilities to defend against IEDs, and replacing/upgrading equipment that has been lost or damaged. In contrast, the companies that did well early this decade by focusing on Department of Defense efforts to transform the military -- ie. utilizing digital age technologies to expand networking with the units in the field, provide them with better intelligence, operate at a distance, and take people and equipment further out of harm's way -- have seen their efforts slowed as resources have shifted toward funding efforts in Iraq. Although President Bush has indicated a desire, if not a critical need, to continue funding these development efforts that will benefit the military for years to come, it will take several more weeks before the DoD releases all of their budget request documentation so that analysts can evaluate what part, if any, of the 10.5% increase in the regular budget will go toward these efforts.

Overall, while Congress will suggest a number of changes before the signing of the budget in September/October, the White House budget request release today is a positive for the sector. Dramatic changes to the bottom line are still seen as unlikely in advance of the 2008 Presidential elections.

The above budget represents an 11.3% increase in the core funding for the Department of Defense. The 'plan' is that supplemental budgets will decline with FY-08.

Index and Industry Statistics

ETF Statistics (AMEX: PPA)

Powershares Aerospace & Defense

Exchange / Ticker Symbol:	AMEX / PPA
Fee	60 basis
Assets (1/31/07)	\$154.8 M
Closing Price 1/31/07	\$19.13 (up \$0.56)
Trading Volume (Jan 07)	2,919,600

Powershares Aerospace & Defense ETF(PPA)

Average Portfolio Market Cap*	\$12.61 Billion
Portfolio P/E*	18.80
Portfolio P/S*	1.22
Portfolio P/B*	2.87
Portfolio P/Cash Flow*	9.50
Earnings Growth Rate (ttm)*	14.15%
3 month Avg Daily Trading Volume	108,468

source: Yahoo! Finance - ETF Center * 31 Dec06

Jan 2007 Leading Gainers

1	OSI Systems	14.57%
2	Precision Castparts	13.55%
3	Trimble Navigation	11.53%
4	Harris Corporation	10.82%
5	ViaSat	10.60%
6	Armor Holdings	10.30%
7	Ladish	9.76%
8	Oshkosk Truck	9.05%

Jan 2007 Laggards

1	CACI Int'l	<16.76%>
2	SI International	<11.01%>
3	Garmin	<9.77%>
4	American Science & Eng.	<8.10%>
5	Orbital Sciences	<7.48%>
6	Mantech	<7.36%>
7	SRA Int'l	<5.39%>
8	KVHI Industries	<5.28%>

Next Month in the SPADE Investor...

- Analysis of the FY-08 Budget
- Commentary from the Cowen & Co. Investor Conference
- Scott Sacknoff to keynote **NYSSA Homeland Security Investor Conference** - 13 March 07 (NYC)

2007: A Look Ahead

The **drivers in 2007** continue to be much of the same that we've seen in past years with performance gains attributed to five factors:

1. Across-the-board increases in government spending
2. Rising budgets for defense and homeland security
3. Supplemental spending to cover the estimated \$7-8 billion monthly cost of the wars in Iraq and Afghanistan
4. An ongoing rebound in the commercial aircraft manufacturing business
5. Continued expansion of the space and satellite industry.

The **biggest question mark** as we head into 2007 is politics. While everyone from analysts to Congress see stability and growth in the near-term defense sector forecast, one can never truly predict politics with absolute certainty.

The release of the FY-08 budget proposal should provide further guidance for this year and next. At the beginning of '07, quarterly earnings remained strong among the large contractors and could provide a bounce.

Contrarian investors are likely to look at two areas -- defense information technology and biometrics/homeland security firms which were both out-of-favor in 2006. The question mark is whether spending on Iraq will drain resources in these areas or whether a return to mid- and small-cap firms may be what's in store for 2007. It is also likely that the ETF that tracks our Index will see steady inflows as professional money managers use it to preserve 2006 gains from investments in individual companies as well as for the diversification it provides with smaller companies.

Specifically, some reasons why the run may still has some strength left in it.

1. Supplemental budget requests of nearly \$300 billion over the next 2 1/2 years to cover the cost of the War in Iraq.
2. The politics of the 2008 Presidential election dictate that the Democratic leadership in Congress will support defense and homeland security initiatives

3. Defense and government service companies are flush with cash (\$7B and \$40B in borrowing capacity) and buying power and one can expect acquisitions to position their companies and meet Wall Street expectations.

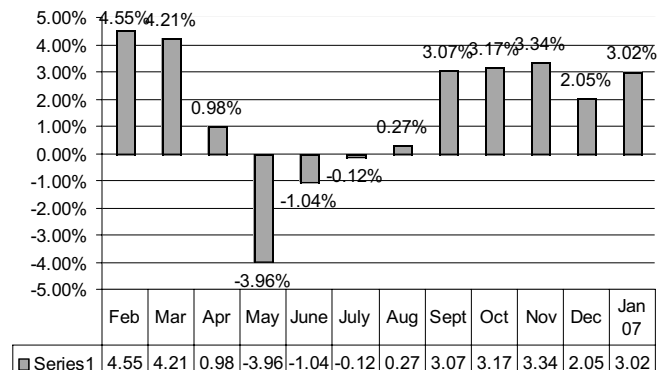
4. With regards to national security, the world has become different. In the years following 9-11, those in western nations and the United States would be hard to argue against the increased visibility that defense and homeland security receive.

5. Past cycles of defense build-ups have lasted 10-15 years as new technologies and systems were developed to meet emerging or evolving threats. If anything, the war in Iraq has likely extended this cycle.

6. The conclusion of efforts in Iraq will not usher in an era of peace with the accompanying dividend experienced after prior conflicts. The likelihood of continued Congressional spending on defense and to secure our borders is likely to remain high through the beginning of the next decade.

Overall, it is widely believed that, while short-term dips will appear from time-to-time as investors adjust to economic and financial issues, but long-term, the sector appears to be stable and sound.

Previous 12-Month Performance of the SPADE Defense Index



Year	SPADE	S&P500
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
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%]
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%]
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%

Defense Supplemental Funding (1999 - 2008 est)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Budget	273.2	295.5	315.7	344.8	382.7	400.5	420.0	441.5	442.8	481.0*
Supplemental	19.1	8.6	19.8	17.3	72.6	65.3	75.9	65.8	170*	145*
Total	292.3	304.1	335.1	362.1	455.3	465.8	520.9	557.3	612.8+*	626.0*

Source: OMB / Defense News (Dec 06), * Feb08 White House Announcement

Forecasted Cost for Additional Troops

According to the non-partisan Congressional Budget Office, the price tag could reach \$13 billion for a four-month mission. The approximately 20,000 combat soldiers Bush said he is going to deploy to Iraq might have to be augmented by 28,000 support troops. In January, the Bush Administration estimated the cost of \$5.6 billion to dispatch 21,500 troops.

Selected 4th Quarter Results Announcement

Raytheon

4th quarter profits climbed 32% to \$365M. Revenue rose to \$5.72 billion from \$5.12 billion.

Boeing

4th quarter profits rose to \$989 million, more than double the \$460 million a year earlier. Revenue rose 26% to \$17.54 billion. Boeing raised profit forecasts for 2007.

Armor Holdings

Profit rose slightly to \$37.8 million from \$27.6 million. The company says strong demand for body armor, up-armored Humvees and Army vehicles pushed up revenue 77% to \$801M.

Goodrich

4th quarter profit of \$99 million up from \$70 million. Strong sales helped results.

Lockheed Martin

Earnings per share in 2006 were \$5.80, up from \$4.10 the year. Yearly operating profit was \$3.95 billion up from \$3 billion.

Northrop Grumman

Reported a quarterly profit of 453 M, up from \$331M. Earnings in 2006 rose to \$4.44 per share up from \$3.83 per share. Operating profit rose 13% to \$1.6 billion

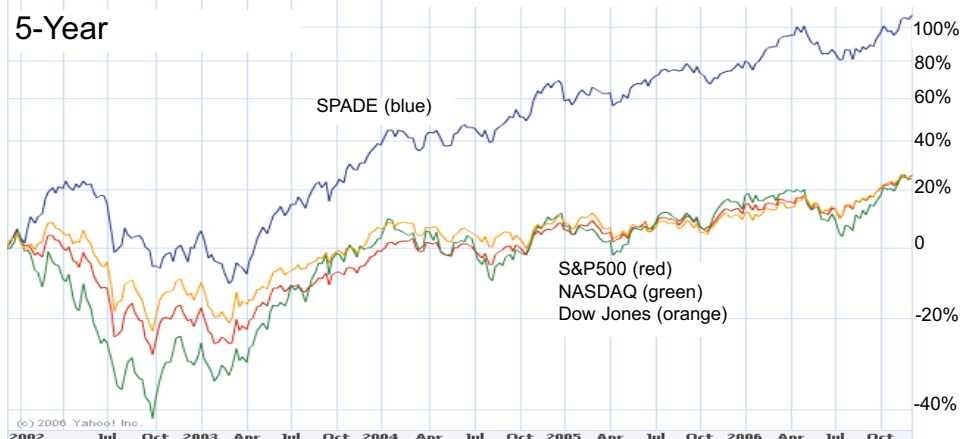
General Dynamics

Sales rose 13% to \$6.51 billion from 5.76B. Income rose to \$408 million from \$406M.

2006 Comparative Results

SPADE Defense	Up 19.33%
S&P 500	Up 13.62%
Dow 30	Up 16.29%

YAHOO! FINANCE From 2000-2006, the SPADE Defense Index was up 113.86% vs. a 3.47% decline for the S&P 500



About the Chart to the Right

Five-year returns by the Dow 30, S&P500 and NASDAQ have all converged to a return of slightly more than 20%...whereas the SPADE Defense Index was up in excess of 100%!

If you didn't receive an email alert that the latest newsletter is available and want to get on our list. Email us at: info@spadeindex.com

About

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

The Index value is available through financial websites using the ticker symbol 'DXS' with historical data and charting back to December 30, 1997. Some sites may require a character (eg. ^ on Yahoo) to identify it as an Index.

Licensed Products

Exchange Traded Fund (ETF)

The Powershares Aerospace & Defense Portfolio ETF (AMEX: PPA) is designed to track the performance of the SPADE Defense Index

Options

ETF options are traded by the American Stock Exchange using the underlying symbol.

Rules

The Index was designed to be RIC (Registered Investment Company) compliant for the purpose of enabling financial products. Full details can be found at www.spadeindex.com

- * Market Cap: Minimum \$100M
- * Share Price: Minimum \$5.00
- * Liquidity: 50,000 avg daily trading

Contact Information

SPADE Indexes
 1725 'I' Street, NW, Suite 300
 Washington, DC 20006
 Tel: (202) 349-3917
info@spadeindex.com
<http://www.spadeindex.com>
 Scott Sacknoff: Index Manager

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CNBC

Defense - One of their "Seven Investments for '07"

(Scott Sacknoff, Manger, SPADE Defense Index is on the upper left)



Department of Homeland Security 2007 - Top Six Priorities

1. Control of U.S. borders (includes initiatives such as Secure Border Initiative, US-VISIT, biometric technology, and improving internal enforcement of immigration laws.
2. Defending the country against weapons of mass destruction and new detection technologies
3. Strengthen screening of travelers and workers
4. Securing critical infrastructure systems (including rail and chemicals)
5. Build a nimble, efficient, and effective emergency response system
6. Encourage national culture of preparedness

Homeland Security Market

	2006
U.S. Federal	\$18.2B
U.S. State and Local	\$3.5B
U.S. Private Sector	\$9.3B
Total U.S.	\$31.0B
Total Rest of World	\$24.6B

The homeland security market has grown by 29% to \$55 billion in the last two years.

source: Civitas

2007 Forecast - Aerospace Industry Sales

	2003	2004	2005	2006P	2007E
Civil Aircraft	\$32.4	\$32.5	\$39.2	\$47.5	\$54.6
Related Products	\$24.4	\$26.0	\$28.3	\$30.7	\$32.2
Space	\$35.9	\$35.9	\$37.3	\$38.6	\$39.4
Military Aircraft	\$40.4	\$46.6	\$50.0	\$52.8	\$53.5
Missiles	\$13.5	\$14.7	\$15.3	\$14.9	\$15.8
TOTAL	\$144.5	\$155.7	\$170.1	\$184.4	\$195.4

Source: Aerospace Industries Association
 Then-year dollars, not adjusted for inflation
 (AIA definition of market)

Homeland Security Market

U.S. Homeland Security Missions and Market Opportunities, 2006-10	
Intelligence	21%
Law Enforcement & Counterterrorism	17%
Aviation Security	7%
Port Security	6%
Ground Transportation Security	2%
Border Security	6%
Physical Security	8%
Cyber Security	8%
Emergency Preparedness & Response	10%
Bioterrorism & Chemical Agent Prevention	12%
Nuclear, Radiological Prevention	2%
source: Civitas	

Signs of a Changing World?

Contrarians hoping that a pull-out of Iraq in 2007 would bring a more stable world only needed to read the *Washington Post*¹ and *Financial Times*² on 1-3 Feb07 to see troubles around the globe.

"Bombs in Boston? A terrorism scare led authorities to close roads, bridges and a train station when electronic light boxes promotion a cartoon show were found."¹

"Nine held in UK on terrorism charges"²

"Turkey weighs cross-border attack on PKK"²

"Somalia militants regrouping in region"²

"Belligerence is not the answer on Iran"²

"The Afghanistan Surge"¹

"Factions struggle to aver war in Gaza"²

"Bush Denies Plan to launch Iran attack"²

January 2007 Close	SPADE Defense Index						Market	Forward	Price/	Price/	
Company	Ticker	Float %	Price	Price	% Ch	% Ch	Cap	P/E	Sales	Book	Div Yld
		approx.	28-Dec-06	31-Jan-07	YTD	MTD	intraday	(ttm, intraday)	ttm	mrq	forward %
United Technologies	UTX	7.13%	62.52	68.02	8.80%	8.80%	66.12	14.44	1.36	3.76	1.60%
Boeing Co	BA	6.68%	88.84	89.56	0.81%	0.81%	70.82	18.85	1.15	6.17	1.60%
Lockheed Martin	LMT	6.61%	92.07	97.19	5.56%	5.56%	40.95	14.82	1.02	5.95	1.50%
Honeywell Intl	HON	5.98%	45.24	45.69	0.99%	0.99%	37.31	13.80	1.18	3.79	2.10%
Genl Dynamics	GD	5.07%	74.35	78.15	5.11%	5.11%	31.71	14.83	1.30	3.29	1.20%
Directv Group	DTV	4.79%	24.94	24.39	-2.21%	-2.21%	29.84	18.07	2.10	4.78	
Northrop Grumman	NOC	4.57%	67.70	70.94	4.79%	4.79%	24.54	13.11	0.81	1.48	1.70%
Raytheon Co	RTN	4.25%	52.80	51.90	-1.70%	-1.70%	23.08	17.65	1.01	2.01	1.90%
Echostar Communications'a'	DISH	4.14%	38.03	40.34	6.07%	6.07%	17.95	20.90	1.85		
Rockwell Collins	COL	4.19%	63.29	68.21	7.77%	7.77%	11.47	18.44	2.86	8.71	0.90%
Itt Indus	ITT	4.08%	56.82	59.65	4.98%	4.98%	11.02	17.65	1.36	3.44	0.80%
Precision Castparts	PCP	4.38%	78.28	88.89	13.55%	13.55%	12.1	16.90	2.54	4.91	0.10%
L-3 Communications Hldgs	LLL	3.95%	81.78	82.34	0.68%	0.68%	10.29	14.76	0.85	2.01	0.90%
Garmin Ltd	GRMN	3.56%	55.66	50.22	-9.77%	-9.77%	10.84	21.19	7.16	7.88	1.00%
Computer Sciences	CSC	3.55%	53.37	52.46	-1.71%	-1.71%	9.02	12.43	0.62	1.49	
Harris Corp	HRS	2.69%	45.86	50.82	10.82%	10.82%	6.82	16.39	1.75	3.65	0.90%
Goodrich Corp	GR	2.41%	45.55	49.02	7.62%	7.62%	6.12	16.02	1.05	2.88	1.70%
Sirius Satellite Radio	SIRI	2.05%	3.54	3.69	4.24%	4.24%	5.19		9.96		
Ball Corp	BLL	1.90%	43.60	46.32	6.24%	6.24%	4.83	12.39	0.72	4.09	0.90%
Xm Satellite Radio Holdings'a'	XMSR	1.50%	14.45	14.21	-1.66%	-1.66%	3.82		4.37		
Oshkosh Truck	OSK	1.54%	48.42	52.80	9.05%	9.05%	3.9	11.48	1.13	3.64	0.80%
Trimble Navigation Ltd	TRMB	1.24%	50.73	56.58	11.53%	11.53%	3.34	22.10	3.54	4.45	
Alliant Techsystems	ATK	1.05%	78.19	81.00	3.59%	3.59%	2.67	13.82	0.79	5.23	
Drs Technologies	DRS	0.88%	52.68	55.40	5.16%	5.16%	2.23	16.64	0.93	1.57	0.20%
URS Corporation	URS	0.88%	42.85	42.97	0.28%	0.28%	2.23	16.85	0.53	1.51	
Armor Holdings	AH	0.85%	54.85	60.50	10.30%	10.30%	2.15	11.96	1.06	2.60	
Flir Systems	FLIR	0.80%	31.83	30.91	-2.89%	-2.89%	2.03	20.47	3.61	5.64	
Caci Intl	CAI	0.57%	56.50	47.03	-16.76%	-16.76%	1.44	16.44	0.79	1.86	
Moog Inc.	MOGA	0.65%	38.19	38.99	2.09%	2.09%	1.65	15.17	1.30	2.22	
Sra International'a'	SRX	0.56%	26.74	25.30	-5.39%	-5.39%	1.42	18.74	1.19	2.57	
SAIC	SAI	0.63%	17.79	18.55	4.27%	4.27%	7.61	21.57	0.94	5.31	
Ceradyne Inc	CRDN	0.58%	56.50	54.08	-4.28%	-4.28%	1.46	11.20	2.36	3.95	
Teledyne Technologies	TDY	0.52%	40.13	38.15	-4.93%	-4.93%	1.32	14.24	0.91	3.00	
Mantech International'a'	MANT	0.45%	36.83	34.12	-7.36%	-7.36%	1.15	18.85	1.03	2.65	
L-1 Identify Solutions	ID	0.41%	15.13	14.44	-4.56%	-4.56%	1.04	131.27	10.24	0.68	
Orbital Sciences Corp	ORB	0.41%	18.44	17.06	-7.48%	-7.48%	1.04	22.16	1.32	2.41	
Cogent Inc.	COGT	0.39%	11.01	10.55	-4.18%	-4.18%	0.99	22.45	9.40	2.08	
Esterline Technologies	ESL	0.40%	40.23	39.97	-0.65%	-0.65%	1.02	13.06	1.03	1.41	
DynCorp	DCP	0.35%	15.87	15.67	-1.26%	-1.26%	0.89	13.51	0.44	2.65	
Viasat Inc	VSAT	0.37%	29.81	32.97	10.60%	10.60%	0.94	21.98	1.94	3.18	
Gencorp	GY	0.33%	14.02	14.96	6.70%	6.70%	0.84	49.87	1.34		
SafeNet Inc.	SFNT	0.27%	23.94	25.01	4.47%	4.47%	0.53	18.80	1.83	0.97	
Cubic Corp	CUB	0.22%	21.70	20.90	-3.69%	-3.69%	0.56	16.33	0.68	1.73	0.90%
United Industrial	UIC	0.22%	50.75	50.51	-0.47%	-0.47%	0.57	17.06	0.96	11.50	0.80%
American Science & Engineering	ASEI	0.20%	59.51	54.69	-8.10%	-8.10%	0.5	17.42	3.62	3.39	
TASER International Inc.	TASR	0.19%	7.61	7.75	1.84%	1.84%	0.48	28.70	7.94	5.01	
Ladish Co	LDSH	0.23%	37.08	40.70	9.76%	9.76%	0.58	16.61	1.58	3.78	
Edo Corp	EDO	0.19%	23.74	23.22	-2.19%	-2.19%	0.49	14.33	0.74	1.87	0.50%
Argon St	STST	0.20%	21.54	22.51	4.50%	4.50%	0.5	18.92	1.94	1.89	
Si International	SINT	0.15%	32.42	28.85	-11.01%	-11.01%	0.37	15.85	0.80	1.60	
MTC Technologies Inc.	MTCT	0.14%	23.55	22.87	-2.89%	-2.89%	0.35	16.82	0.86	1.95	
Osi Systems	OSIS	0.16%	20.93	23.98	14.57%	14.57%	0.4	27.56	0.81	1.54	
Stanley Inc.	SXE	0.14%	16.91	16.18	-4.32%	-4.32%	0.34	18.81	1.01	4.94	
Mercury Computer Sys	MRCY	0.11%	13.36	12.92	-3.29%	-3.29%	0.29	15.95	1.34	1.46	
Herley Industries	HRLY	0.09%	16.19	16.66	2.90%	2.90%	0.23	18.31	1.31	1.16	
Applied Signal Technology	APSG	0.07%	14.06	14.64	4.13%	4.13%	0.17	23.19	1.06	1.63	3.40%
Kvh Industries	KVHI	0.06%	10.61	10.05	-5.28%	-5.28%	0.15	20.51	1.85	1.90	