



Commentary

The U.S. stock market has seen its ups and downs over the past year as investor sentiment flip-flops from recovery to anticipations of a double dip and back again.

Investors focused on defense and aerospace should have been able to look at the recent market action and chuckle knowing that its largest customer (the U.S. government) provides high visibility of its order flow; giving it a clarity that other industries do not and cannot have. With most U.S. government budget details known 12 to 18 months in advance and contracts set for several quarters, you'd think that the sector would act independent of the market and have a low correlation. And we'd be wrong.

Following a 10-year run which saw the SPADE Defense Index outperform the S&P500 annually from 2000 to 2008 and which gave investors more than 16,000 basis points of alpha (161%) [a \$10,000 investment would have returned \$26,150 vs. \$9,990 for the S&P500], investors sold out at the beginning of the 2008 market decline as they sought to capture gains in one of the top performing sectors of the previous decade. Since that time, the Index and the Powershares Aerospace & Defense ETF (NYSE: PPA) that tracks it, have mimicked the rises and falls of the broader market with a better than 90% correlation. News regarding unemployment and European budgetary issues, for example, have little direct bearing on whether the U.S. feels it is more or less safe in the world. Spending on defense and homeland security is after all a form of insurance. Yet these news events have directly impacted the share prices of companies involved with defense.

How long this correlation will continue is an unknown but the sector is likely to diverge soon and hence increase the attention by investors. The divergence, and its direction, will be driven by the interplay of two actions.

One. The defense budget. The prevailing wisdom is that Defense Secretary Gates will stay on through the 2012 budget cycle and that Congress and the White House will approve his plans for trying to cap defense spending near the current levels with money saved from operational efficiency gains going toward acquisitions and development. This is considered a net positive for the industry. A number of events could change this plan. Gates leaving early and replaced with someone without his credibility; a philosophical shift in Congress; or a significant decline in the U.S. economic situation that mandates severe budget reductions and you could see the sector head lower.

Two. A steady defense budget anticipated through 2013 combined with the beginning of a decade-long expansion in commercial aerospace activities will boost the top and bottom lines of many of the sector's public companies. Combined with recent acquisitions funded with company's cash reserves and the sector

SPADE Defense Index Statistics

8/31/10 Close: 1783.86
 All-time Close: 2747.67
 Date of all-time close: 9 October 2007

	SPADE Defense	S&P500
August	[7.47%]	[4.74%]
QTD	[2.60%]	[1.81%]
YTD	[8.08%]	[5.90%]

could see upward gains that better the market's performance over the next year.

With the aerospace and defense sector more than 35% below its October 2007 peak, company valuations are near historic lows. This potentially offers investors in the sector some downside protection from a further significant decline with an obvious upside and room to run before a rebound in the sector reaches its 52-week peak and all-time high levels. From a risk/reward perspective, the recent decline in the sector may in hindsight show that today's valuations represents a good entry point.

Acquisitions on the Rise

The past month has seen several acquisitions (and closings) of companies found in the SPADE Defense Index:

- Cerberus buys DynCorp (DCP) for \$1.5 Billion
- CGI Group acquires Stanley (SXE) for \$1.1 Billion
- FLIR buys ICx Technologies (ICXT) for \$274 Million
- 3M acquires Cogent (COGT) for \$943 Million
- Boeing bought Argon ST (STST) for \$775 Million

Iraq Combat Mission Ends

Troops in Iraq declined to 49,000 with 67,000 in Afghanistan and 9700 in Kuwait according to an Aug 17th memo by the Army on global commitments. The last of the "full combat brigade left Iraq -- two combat aviation brigades and the soldiers will stay.

How Big is the Defense Industrial Base Really?

It is interesting to note that combined market cap of Boeing, Lockheed Martin, General Dynamics, Northrop Grumman, and Raytheon is roughly HALF that of Apple. In addition, these five defense firms employ more than 587,000 people vs. just 34,300 at Apple.*

* Apple 9/26/09

August 2010 Top Gainers

1	Cogent	22.36%
2	L-1 Identity	10.17%
3	GeoEye	5.56%
4	ICX Technologies	[0.52%]
5	Alliant Techsystems	[1.88%]
6	ViaSat	[3.29%]
7	Ball	[3.71%]
8	Raytheon	[5.08%]
9	Applied Signal Tech	[5.49%]
10	Comtech	[5.56%]

August 2010 Laggards

1	Oshkosh	[27.63%]
2	VSEC	[20.92%]
3	NCI Technologies	[18.72%]
4	Texton	[17.77%]
5	Gencorp	[16.73%]
6	Mercury Computing	[16.14%]
7	Ladish	[15.37%]
8	FLIR	[15.66%]
9	Force Protection	[13.42%]
10	SRA International	[13.37%]

YTD Top Gainers

1	Ladish	65.38%
2	Argon ST	58.77%
3	Triumph Group	37.58%
4	Stanley Inc	36.26%
5	GeoEye	30.70%
6	Digital Globe	26.74%
7	Dyncorp	22.09%
8	L1 Identity	20.03%
9	Ceradyne	13.63%
10	Boeing	12.93%

YTD Laggards

1	Comtech	[41.87%]
2	Gencorp	[37.43%]
3	NCI Technologies	[30.74%]
4	VSEC	[37.71%]
5	Oshkosh	[32.81%]
6	Computer Sciences	[30.80%]
7	AAR Corp.	[33.16%]
8	Mantech	[26.79%]
9	Force Protection	[25.72%]
10	Alliant Techsystems	[25.34%]



**ETF Statistics (NYSEarca: PPA)
Powershares Aerospace & Defense**

Exchange / Ticker Symbol:	NYSE / PPA
Fee	60 basis
Assets (8/31/10)	\$97.9 M
Closing Price (8/31/10)	\$15.79
Yield (12-month yield)	1.18%
August 10 Volume	913,800
Turnover	9%

source: Yahoo Finance

Portfolio Price / Earnings	11.72
Portfolio Price / Book	2.04
Portfolio Price / Sales	0.70
Earnings Growth Rate	10.61%
3 mo Average Volume	36,649

* Yahoo Finance 9/3/10



Powershares Aerospace & Defense ETF (NYSE: PPA)

Modern Portfolio Theory (vs the S&P500)

Beta (3 month)	1.11
Alpha (3 month)	2.03
R-squared (3 month)	87.39

source: Yahoo! Finance (9/3/10)

Largest Defense Prime Contractors

	August	YTD
Lockheed Martin	[7.49%]	[7.74%]
Boeing	[10.29%]	12.93%
General Dynamics	[8.78%]	[18.04%]
Northrop Grumman	[7.71%]	[3.10%]
Raytheon	[5.08%]	[14.75%]

PPA by Sector

	PPA
Industrial	79.77%
Info Tech.	17.77%
Materials	2.46%

source: Powershares

Year	SPADE	S&P500
2009	21.71%	23.45%
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%

Gates is viewed as the sector's biggest ally

- A recent interview with *Foreign Policy* magazine stated that Defense Secretary Gates expects to retire no later than late 2011. His plan is to stay through July 2011 until Congress' appropriations panels finish the FY-12 spending bill. This would mean that any cuts in the defense sector would be delayed until the 2013 budget cycle. The date of his departure will depend on conditions in Afghanistan and whether his budget-tightening initiatives are on track. According to John Bennett's article in *Defense News*, three 'favorite' options to replace Mr. Gates are CIA boss Leon Panetta; U.S. Navy Secretary Ray Mabus; and former Senator Sam Nunn.

Congressional Budget Debate

According to a recent *Defense News* article:

- 2010 military spending in FY10 was roughly \$661B and is expected to surpass \$700B in FY11
- Currently, the dueling House and Senate versions of the 2011 defense appropriations are calling for nominal reductions in the Obama defense spending request by \$6B and \$8B, respectively.

- Tea Party Republicans are calling for sizeable reductions in defense spending.

- SAC-d (Senate appropriations defense subcommittee) Republicans want deeper cuts.

- "Gates is the best best for insulating [investment accounts] from deeper cuts", Loren Thompson, Lexington Institute. "The next defense secretary is far more likely to look to make cuts and less likely to possess the clout to stop others from cutting."

Washington Technology - August 2010

In an article from analyst, Bill Loomis of Stifel Nicolaus, "[There is rising] investor interest in the sector with the acquisition of Stanley and DynCorp...however concerns about federal budget pressures, insourcing, and margin pressure have pushed stock valuations *down to levels last seen in the mid-1990s*.

He highlighted that many investors have not been patient enough to wait 12-24 months until new investments start paying off. Examples:

When ICF filed a shelf offering in the fall of 2009, it resulted in dilution to earnings and a 18% decline in the stock price. ICF used the proceeds to pay down debt with the intent of using attractive business valuations to make acquisitions.

The stock of NCI dropped 23% after announcing a new strategy to grow so that it could compete for and win some forthcoming larger contracts.

Farnborough Air Show Statistics

- * \$47 Billion of contracts announced
- * 120,000 trade visitors
- * 228,000 total visitors
- * 1,455 exhibitions from 40 countries
- * 22 international pavilions

About the SPADE Defense Index

The SPADE Defense Index (NYSE-amex: DXS) provides an investment benchmark for the value that the market ascribes to 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 the sector – 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 servicewomen.

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SPADE Indexes publishes a variety of sector and regional indexes. These include the SPADE Oklahoma Index (OKLAH) licensed to Geary Companies for its OOK Oklahoma ETF (NYSE: OOK) and the SPADE Texas Index (TEXAS) for its TXF Texas ETF (NYSE: TXF).

Licensed Products

Exchange Traded Fund - ETF

Licensed to Invesco Powershares, the Powershares Aerospace & Defense Portfolio ETF (NYSE: 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
- * Sufficient Liquidity

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Sep-10		55 SPADE Defense Index					Market	Forward	Price/	Price/	PEG	
Company	Ticker	Float %	Price	Price	% Ch	% Ch	Cap	P/E	Sales	Book	5 yr	Div Yld
		31-Aug-10	30-Jul-10	31-Aug-10	YTD	MTD	intraday	(ttm)	ttm	mrq	expected	forward %
United Technologies	UTX	6.97%	71.10	65.21	-6.05%	-8.28%	60.58	12.19	1.14	3.05	1.33	2.60%
Honeywell Intl	HON	6.81%	42.86	39.06	-0.36%	-8.87%	30.16	12.81	0.95	3.33	1.37	3.10%
Boeing Co	BA	6.45%	68.14	61.13	12.93%	-10.29%	44.73	12.55	0.69	14.76	1.80	2.70%
Lockheed Martin	LMT	6.18%	75.15	69.52	-7.74%	-7.49%	25.20	8.98	0.56	6.82	1.15	3.60%
General Dynamics	GD	5.17%	61.25	55.87	-18.04%	-8.78%	21.25	7.90	0.68	1.68	1.18	3.00%
Precision Castparts	PCP	5.14%	122.19	113.18	2.56%	-7.37%	16.10	13.15	2.91	2.64	1.52	0.10%
Northrop Grumman	NOC	4.56%	58.64	54.12	-3.10%	-7.71%	15.92	8.08	0.46	1.24	0.76	3.50%
Goodrich Corp	GR	4.38%	72.87	68.48	6.58%	-6.02%	8.58	13.25	1.29	2.92	1.82	1.60%
Raytheon Co	RTN	4.30%	46.27	43.92	-14.75%	-5.08%	16.43	8.38	0.66	1.67	1.28	3.40%
Rockwell Collins	COL	4.21%	57.16	53.93	-2.58%	-5.65%	8.48	13.55	1.89	5.48	1.59	1.70%
Itt Indus	ITT	3.98%	47.12	42.50	-14.56%	-9.80%	7.79	9.34	0.72	1.96	0.89	2.30%
L-3 Communications Hldgs	LLL	3.90%	73.04	66.60	-23.40%	-8.82%	7.62	7.49	0.49	1.13	1.00	2.40%
Computer Sciences	CSC	3.64%	45.33	39.81	-30.80%	-12.18%	6.15	7.08	0.38	0.96	1.14	1.50%
SAIC	SAI	3.39%	16.63	14.88	-21.44%	-10.52%	5.65	9.85	0.53	2.60	0.86	
Harris Corp	HRS	3.27%	44.53	42.07	-11.52%	-5.52%	5.37	8.99	1.04	2.48	0.60	2.10%
Ball Corp	BLL	3.10%	58.24	56.08	8.47%	-3.71%	5.14	10.83	0.65	3.52	1.40	0.70%
Textron	TXT	2.80%	20.76	17.07	-9.25%	-17.77%	4.68	12.11	0.48	1.68	1.37	0.40%
Flir Systems	FLIR	2.31%	29.76	25.10	-23.31%	-15.66%	3.97	14.34	3.25	2.98	0.96	
URS Corporation	URS	1.77%	40.39	35.67	-19.88%	-11.69%	2.90	9.75	0.33	0.72	0.93	
Oshkosh Truck	OSK	1.34%	34.38	24.88	-32.81%	-27.63%	2.25	7.21	0.25	1.96	0.23	
Alliant Techsystems	ATK	1.31%	67.16	65.90	-25.34%	-1.88%	2.19	7.49	0.46	2.57	0.50	
Eibit Systems	ESLT	1.26%	55.01	49.35	-24.14%	-10.29%	2.11	9.49	0.80	2.37	1.02	2.40%
Triumph Group	TGI	0.96%	75.90	66.38	37.58%	-12.54%	1.61	9.21	1.18	1.19	3.32	0.20%
Moog Inc.	MOGA	0.85%	35.81	31.20	6.74%	-12.87%	1.54	12.51	0.76	1.40	1.16	
Digital Globe	DGI	0.84%	27.26	30.67	26.74%	12.51%	1.40	23.41	4.64	2.86	6.28	
Viasat Inc	VSAT	0.84%	36.14	34.95	9.97%	-3.29%	1.42	21.44	1.93	1.80	2.29	
Esterline Technologies	ESL	0.83%	51.33	46.00	12.83%	-10.38%	1.38	11.70	0.94	1.08	1.17	
Teledyne Technologies	TDY	0.79%	41.03	36.18	-5.68%	-11.82%	1.31	11.24	0.75	1.83	4.30	
Mantech International'a'	MANT	0.77%	39.65	35.39	-26.79%	-10.74%	1.29	9.39	0.56	1.45	0.96	
Caci Intl	CACI	0.74%	47.02	40.81	-16.46%	-13.21%	1.24	9.98	0.41	1.09	0.86	
Sra International'a'	SRX	0.66%	22.22	19.25	0.79%	-13.37%	1.10	12.58	0.66	1.43	0.95	
Cubic Corp	CUB	0.61%	40.52	38.19	2.39%	-5.75%	1.02	15.15	0.90	2.15	1.64	0.50%
Cogent Inc.	COGT	0.59%	8.99	11.00	5.87%	22.36%	0.98	22.92	8.45	1.78	1.93	
L-1 Identity Solutions	ID	0.50%	8.16	8.99	20.03%	10.17%	0.84	56.19	1.30	1.14	43.95	
GeoEye	GEQY	0.48%	34.52	36.44	30.70%	5.56%	0.81	17.44	2.60	2.60	1.00	
Orbital Sciences Corp	ORB	0.45%	14.64	12.99	-14.88%	-11.27%	0.75	11.01	0.62	1.39	1.40	
American Science & Engineering	ASEI	0.38%	79.18	70.97	-6.42%	-10.37%	0.63	16.20	2.62	2.78	1.03	1.70%
AAR Corp	AIR	0.36%	16.80	15.36	-33.16%	-8.57%	0.61	8.88	0.46	0.80	0.90	
Comtech	CMTL	0.35%	21.57	20.37	-41.87%	-5.56%	0.58	10.55	0.92	0.86	0.46	
Ceradyne Inc	CRDN	0.33%	23.25	21.84	13.63%	-6.06%	0.55	17.61	1.33	0.87	3.40	
Osi Systems	OSIS	0.32%	27.79	29.58	8.43%	6.44%	0.56	13.69	0.93	1.76	0.83	
AeroVironment	AVAV	0.29%	23.91	22.60	-22.28%	-5.48%	0.49	18.37	1.98	2.09	0.87	
Ladish Co	LDSH	0.23%	29.41	24.89	65.38%	-15.37%	0.39	13.60	1.09	1.70	2.71	
Applied Signal Technology	APSG	0.16%	20.76	19.62	1.76%	-5.49%	0.26	17.36	1.24	1.82	1.29	2.60%
Force Protection	FRPT	0.16%	4.47	3.87	-25.72%	-13.42%	0.27	8.06	0.32	0.87	0.16	
ICX Technologies	ICXT	0.16%	7.69	7.65	-19.64%	-0.52%	0.27	95.62	1.59	1.6		
Mercury Computer Sys	MRCY	0.16%	13.20	11.07	0.54%	-16.14%	0.26	13.50	1.30	1.39	1.72	
NCI Information Technology	NCIT	0.16%	23.56	19.15	-30.74%	-18.72%	0.26	10.46	0.53	1.90	0.81	
Gencorp	GY	0.15%	5.26	4.38	-37.43%	-16.73%	0.26	17.52	0.31			
TASER International Inc.	TASR	0.14%	4.10	3.63	-17.12%	-11.46%	0.23	45.38	2.26	1.92		
EMS Tech	ELMG	0.13%	16.64	14.52	0.14%	-12.74%	0.22	12.20	0.66	0.94	0.87	
Ducommun	DCO	0.12%	20.89	19.20	2.62%	-8.09%	0.20	8.35	0.48	0.83	0.73	1.50%
Kratos Defense & Security	KTOS	0.09%	11.06	9.90	-6.16%	-10.49%	0.16	30.94	0.46	1.09	0.34	
VSE Corporation	VSEC	0.09%	35.51	28.08	-37.71%	-20.92%	0.15	5.55	0.15	1.29	0.57	0.90%
Integral Systems	ISYS	0.07%	7.56	6.76	-21.94%	-10.58%	0.12	27.04	0.76	1.06		