

SPADE INVESTOR



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Defense * Homeland Security * Space

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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

Index and ETF options are traded by the American Stock Exchange using the underlying symbols.

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

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SPADE Defense Index Statistics

YTD Return: 7.30%
May Return: <3.96%>
5/31/06 Close: 1893.81

All-time High*: 2026.75
Date: 21 April 2006

ETF Statistics (AMEX: PPA)

Powershares Aerospace & Defense Portfolio
Exchange / Ticker Symbol: AMEX / PPA
Fee: 60 basis
Assets (5/31/06): \$83.4 M
Closing Price 5/31/06: \$16.61
Trading Volume (May 06)*: 2,405,200
* source: Yahoo Finance

Is Now the Time to Buy the Defense Sector?

The last several weeks have seen a global pullback in the equity markets as well as in bonds, commodities, precious metals, etc. Investors in all products groups -- the defense and homeland security sector included -- have been rattled. But as the Federal Reserve deals with issues related to inflation, the direction of interest rates and the health of the broader U.S. economy, investors have for the first time in several years begun to question their portfolio diversification, shifting many positions to capture the gains they hopefully had and maintain a more conservative, 'defensive' approach in a time of uncertainty.

For those who have invested or are thinking of investing in the defense sector, let's put some things into perspective.

1. Even with the markets decline, the SPADE Defense Index is up 7.30% in 2006, more than triple the 1.75% of the S&P500 and nearly 8.50% better than the NASDAQ. Investors who purchased the Powershares Aerospace & Defense Portfolio ETF, which tracks the SPADE, at its October 2005 IPO, have even after this decline seen a gain of more than 11%.
2. Although the SPADE dropped 3.96% in May, the stocks and sectors that gained the most over the last year+ (energy, oil services, materials and commodities) saw declines of 10%-20% or more. For the month, the Dow lost 1.7%, S&P500 declined 3.1%, and the Nasdaq declined 6.2%. Compared with the gains by the SPADE over the last several years, this decline is relatively moderate.
3. Overall, defense and homeland security stocks, as benchmarked by the SPADE Defense Index have outperformed the S&P500 in each of the last six years and in 19 of the last 23 quarters -- driven by increased government spending to combat terrorism and protect its citizen's and the interests of the nation as a whole.

Six Reasons Why the Run is Not Likely Over

1. The reasons behind the current market decline -- inflation fears and a slowing economy -- are independent of the driving factors behind the performance of companies involved with defense and homeland security. Terrorism around the world is like to remain a concern for the foreseeable future. Canada's identification last week of plots to bomb several buildings and facilities within its borders by local terrorists highlight this global issue.

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YTD Top Gainers

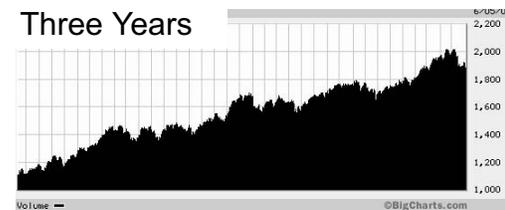
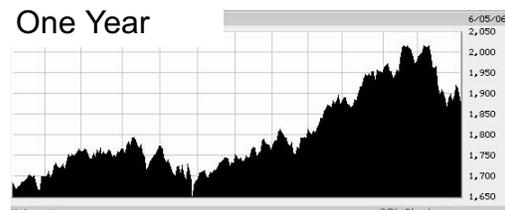
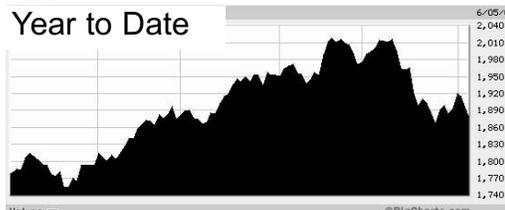
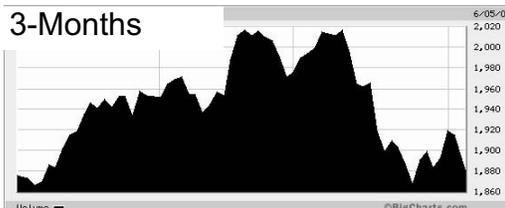
1. Ladish Co	76.24%
2. Garmin	40.60%
3. Armor Holdings	33.93%
4. Taser	33.91%
5. Trimble	29.44%
6. DirecTV	24.36%

April's Top Gainers

1. Ladish Co	10.43%
2. Garmin	8.02%
3. KVH Industries	5.28%
4. FLIR Systems	4.74%
5. OSI Systems	4.46%
6. Raytheon	3.57%

April's Top Decliners

1. American Science	-32.95%
2. XM Satellite	-28.88%
3. United Industrial	-25.18%
4. Visage Techn.	-20.10%
5. Integraph	-19.24%
6. Cubic Corp.	-18.44%



News of Note

Kudos to the Forbes Investment Guide

Among the sectors that the 5 June 2006 issue of Forbes offers in its annual Investment Guide is Defense. Here is a snapshot of what they had to say.

‘The SPADE Defense Index’, a benchmark for defense, homeland security, and aerospace stocks, has risen an average of 15% a year for the past five years, versus a 2% decline for the broader S&P 500. Too late to get on board? Yes, if you think terrorism will recede and the troops will be returning soon from Baghdad. No, if you think the reverse.

Appropriations for defense and antiterrorism for the current fiscal year (ending Sept. 30) are \$532 billion. But that doesn't include all the Iraq war and homeland security spending tucked into “supplemental” appropriation bills. Throw those in, and we're probably spending at least \$648 billion, estimates the Cato Institute. In real terms this is the highest that defense spending has been since the Korean War.

Some budget shaving is all but inevitable in fiscal 2007. In April, Merrill Lynch warned investors that the Pentagon has reduced its five-year spending plans by \$5 billion. This is on top of \$10 billion of cutbacks already announced. Still, the important spending can creep back in via the supplementals. Cato budget guru Stephen Slivinski reckons the percentage of discretionary military spending that is funded outside the main budget rose 13 points to 22% between fiscal 2001 and fiscal 2006.

For the full article, including companies SunTrust Robinson Humphrey analyst Chris Donaghey thinks will prosper, get a copy of the 5 June 06 issue of Forbes or sign-up to Forbes.com

BB&T to Expand Coverage

Had lunch with Michael Lewis and Nicholas Bundy of BB&T Capital Markets and they mentioned that they are planning to expand their coverage of small and mid-cap companies operating in the sector.

Kudos to Defense News

For those interested in defense sector consolidation over the years, if you haven't seen the 22 May issue, it features a fascinating set of charts showing who bought who and when for the last 20 years.

DoD to Cut '08 Budget by 1%

The Pentagon has asked each of the services to cut proposed future budgets by 1% starting in 2008 in order to cut rising costs.

Secure Border Initiative Network

Four teams are lining up to compete for the Department of Homeland Security's \$2 billion project. The system will include cameras, sensors, networks and communications systems at the Mexico and Canadian borders. The contract is expected to be awarded in September.

Teams include:

- Northrop Grumann team: Anteon, SRA, General Dynamics, L-3 Titan;
- Raytheon team: IBM, BAE, Bechtel
- Ericsson team: Computer Sciences, L-3 Communications, MTC, Univ. of Texas
- Lockheed Martin: team not announced.

European Interest in U.S. Defense Sector Investing

The 25 April 2006 cover story in L'Agefi, a Swiss financial newspaper, focused on the SPADE Defense Index. For those that can read French, it will be posted on our website -- www.spadeindex.com

Index Factoid
 The SPADE Defense Index has outperformed the S&P 500 in each of the last six years and in 19 of 23 quarters !

Year	SPADE	S&P500
2006 YTD	7.30%	1.75%
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
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%

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2. U.S. troops in the Middle East, even with a pullback, are likely to remain in the region in some capacity for another 18 months or longer (or so both the Iraq and U.S. leadership are forecasting). Even after the soldiers return, money (perhaps in greater sums once DoD can reallocate resources devoted to combat pay) will be devoted to replacing and upgrading materials consumed in the war effort -- trucks, artillery, body armor, etc.

3. The U.S. is the world's largest exporter of aerospace and defense equipment. It contributes more to a positive trade balance (sales vs. buys) than any other U.S. economic sector. Earlier this week, the Bush Administration advocated sales of commercial aircraft equipment to Iran as part of a potential economic deal regarding the cessation of nuclear materials. With global defense and military spending exceeding \$1 Trillion (yes that is a 'T') and the U.S. highly competitive in commercial sales of equipment related to airplanes, satellites, and software and hardware for homeland security applications, non-government sales are on the rise.

4. Spending on "non-defense" budget items, such as homeland security, are expected to continue rising regardless of what happens to the defense budget. Supplemental appropriations for specific items continues to add to the official budget spent on defense-related equipment and services.

5. A large percentage of Department of Defense contracts are issued as multi-year

purchases, many with inflation escalators. This provides a measure of stability to companies operating in the sector and reduces the impact that an environment of rising interest rates and inflation has on firms operating in other sectors.

6. When we looked at the performance of the SPADE Defense Index on a quarterly basis, it turned out that the 3rd Quarter is the only quarter that has outperformed the S&P500 in each of the last six years. The quarter (July - September) is generally a quiet time but it typically sees agreement on the defense budget for the coming fiscal year (eg. Oct 06 - Sept 07) and the announcement and release of contracts to companies.

Perhaps the best statistic for long-term investors, is that over the last 33 quarters (since 1998), the Index has never declined for more than two quarters in a row and every calendar year when the Index had a quarter with a double digit decline it also had a quarter with a double digit gain.

While some budget shaving is inevitable, analysts see relative stability in the budget through the next presidential election cycle (2009). With multi-year budgets in place, even if the forthcoming November election leads to a change in the leadership of Congress, any impact would not be felt until the 2008/2009 timeframe.

Defense and homeland security may be the 'defensive' play investors are looking for.

News of Note (continued)

Business2.0 - The 100 Fastest Growing Tech Companies

The June 06 issue cited the following SPADE Defense Index constituents:

- Ceradyne (12)
- Anteon (30)
- Armor Holdings (47)
- DRS (49)
- ManTech (64)
- Orbital Sci (77)
- Trimble (80)
- L-3 (86)
- Esterline (100)

New Report Issued

The "Structure and Dynamics of the U.S. Federal Professional Services Industrial Branch" was released by the Center for Strategic and International Studies (CSIS), a Washington DC think tank on June 5th. The report, written by former Wall Street defense analyst Pierre Chao, discusses the U.S. government's increasing reliance on the private sector to perform a wide range of professional and support services. In the past decade, providing professional services has grown from \$102 billion in contracts awarded in 1995 to \$167 billion in 2004. Among the reasons are increased complexity of missions and the loss of skills within the government caused by workforce reductions and retirements. Copies can be downloaded at

http://www.diig-csis.org/resources/view.asp?RESOURCE_ID=81