



Inside the August Issue...

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- Are A&D Stocks Undervalued?
- \$10 Billion in Prime Defense Orders
- Forecasts and Forthcoming Contracts
- Analysis of Quarterly Earnings Announcements

Are A&D Stocks Undervalued?

Price to Sales Ratio

24 of 53 companies have a P/S < 1.0

Price to Earnings Ratio

27 of 53 companies have a P/E < 13

20 of 53 companies have a P/E < 12

11 of 53 companies have a P/E < 10

SPADE Defense Index Statistics

7/31/08 Close: 2127.77
 All-time Close: 2747.67
 Date of all-time close: 9 October 2007

	SPADE Defense	S&P500
July	0.35%	[0.99%]
2nd Quarter	[4.69%]	[3.23%]
Year to Date	[17.31%]	[13.69%]

Commentary

Since the SPADE Defense Index (AMEX: DXS) peaked in October 2007, the aerospace and defense sector has been stuck in bear market territory for the past several months.

It is a situation that has had more to do with broader stock market issues and perceptions of what will or what might happen to the sector a year or several years out than any specific business issue facing the sector today. In fact, recent quarterly earnings posted by many of the sector's companies have been positive, and in some cases show significant gains in revenues and earnings.

Conversations with many firms at the recent Farnborough Air Show indicated strength in current and near-term operations as they try to fill an ever increasing backlog of business.

For months, I've been saying that the trends are steady, business is strong, and the issues remain the same, yet like you I've watched valuations decline. So why then is the sector mired in a bear market having lost roughly a quarter of its value? And, importantly to investors at this point in time, where is the bottom and when should we see a turn? This is what I plan to address in the coming paragraphs.

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Analyst Comments

Reuters - July 24 - The long boom in defense and commercial aircraft spending shows no immediate signs of bursting... The prospect of Pentagon spending cuts under the next U.S. administration and the risk that cash-strapped airlines will cancel airline orders has not yet shown up on the balance sheets of companies.

Jefferies & Co. analyst Howard Rubel - Aug 1 - Strong order backlogs, solid financial standing, and streamlined operations should allow A&D companies to offset the effect of a likely wind-down of military activity in Iraq.

A spike in potential sales contracts to foreign militaries could provide boosts to several major companies.

The Pentagon announced about \$50 billion in proposed sales deals so far this year with two months remaining. This is more than double the \$22 billion the Pentagon reported last year. These figures represent maximum sales and are not guaranteed contracts.

About 3/4 are sales to Middle East nations.

"A friendly administration, record oil revenues, and a cheap dollar appear to make it a great time for our allies in the region to load up on military goods."

Quarterly Earnings Announcements

	Revenues	Net Income
Boeing Defense	\$7.9 B, flat	\$637 M, down 25%
Boeing Aircraft	\$8.6 B, down 2%	\$777 M, down 19%
DRS	\$939 M, up 18%	\$54.9M up 149%
FLIR Systems	\$261 M, up 42%	\$45.4 M, up 56%
General Dynamics	\$7.3 B, up 11%	\$641 M, up 25%
Goodrich	\$1.8 B, up 17%	\$187 M, up 49%
Honeywell Aerospace	\$3.3 B, up 8%	\$602 M, up 15%
L-3 Communications	\$3.7 B, up 9%	\$207 M, up 10%
Lockheed Martin	\$11.0 B, up 4%	\$882 M, up 13%
ManTech	\$465 M, up 33%	\$21.9 M, up 45%
Northrop Grumman	\$8.6 B, up 10%	\$495 M, up 8%
Orbital Sciences	\$301 M, up 15%	\$27 M, up 27%
Precision Castparts	\$1.8 B, up 11%	\$276 M, up 22%
Raytheon	\$5.9 B, up 11%	\$662 M, up 12%
Rockwell Collins	\$1.2 B, up 7%	\$174 M, up 19%
Textron Cessna	\$1.5 B, up 25%	\$262 M, up 31%
Textron Bell Helicopter	\$698 M, up 17%	\$68 M, up 871%
United Technologies - Pratt & Whitney	\$3.3 B, up 6%	\$546 M, up 5%
United Technologies - Hamilton Sundstrand	\$1.7 B, up 18%	\$280 M, up 14%
United Technologies - Sikorsky	\$1.3 B, up 9%	\$111 M, up 28%

A number of firms, such as Alliant Techsystems and CACI, are scheduled to report in August

See Page 5 for Analysis

July 2008 Top Gainers

1	Ceradyne	35.13%
2	Teledyne Tech.	28.92%
3	AAR Corp.	27.05%
4	GeoEye	22.25%
5	AeroVironment	20.05%
6	Cubic Corp.	19.93%
7	Ducommun	19.38%
8	Moog	19.36%
9	Gencorp	17.04%
10	Mantech Int'l	16.04%

July 2008 Laggards

1	Garmin	[16.74%]
2	Oshkosh Truck	[12.81%]
3	SI International	[12.70%]
4	Cogent	[10.82%]
5	Elbit Systems	[10.34%]
6	Textron	[9.31%]
7	SAIC	[9.23%]
8	Boeing	[7.01%]
9	Trimble Navigation	[7.00%]
10	Stanley	[6.83%]

YTD Top Gainers

1	DRS Technologies	45.20%
2	AeroVironment	34.83%
3	Argon ST	33.51%
4	FLIR Systems	30.16%
5	Mantech Int'l	27.43%
6	Teledyne Tech.	17.94%
7	Trimble Navigation	9.79%
8	Applied Signal Tech.	7.81%
9	Orbital Sciences	2.00%
10	ITT Industries	1.39%

YTD Laggards

1	Taser	[64.98%]
2	Garmin	[63.23%]
3	Oshkosh Truck	[61.83%]
4	AAR Corp.	[54.80%]
5	Ladish	[54.16%]
6	Mercury Computer	[52.58%]
7	DynCorp	[41.44%]
8	Textron	[39.03%]
9	Triumph Group	[35.69%]
10	GeoEye	[35.66%]

Index and Industry Statistics

ETF Statistics (AMEX: PPA)
Powershares Aerospace & Defense
 Exchange / Ticker Symbol: AMEX / PPA
 Fee: 60 basis
 Assets (7/31/08): \$192.9 M
 Closing Price (7/31/08): \$18.67
 July 08 Volume: 2,052,500

Powershares Aerospace & Defense ETF(AMEX: PPA)
 Average Portfolio Market Cap*: \$14.04 Billion
 Portfolio P/E*: 14.51
 Portfolio P/S*: 1.04
 Portfolio P/B*: 2.53
 Portfolio P/Cash Flow*: 10.58
 Earnings Growth Rate (ttm)*: 13.11%
 3 month Avg Daily Trading Volume**: 86,541
source: Yahoo! Finance, [30 June 08 data] - [** 31 July 08]*

SPADE Defense Index

	2007	2006	2005	2004
June	0.63%	[1.04%]	1.34%	3.41%
July	0.60%	[0.12%]	3.62%	[2.35%]
August	3.14%	0.27%	0.46%	0.60%
Sept	6.35%	3.65%	0.33%	4.65%

S&P 500

	2007	2006	2005	2004
June	[1.78%]	0.01%	[0.01%]	[1.68%]
July	[3.20%]	0.51%	3.60%	1.21%
August	1.29%	2.13%	[1.12%]	[1.41%]

Alpha Return of SPADE (vs S&P500)

	2007	2006	2005	2004
June	241 bps	[105] bps	135 bps	509 bps
July	380 bps	[63] bps	2 bps	[356] bps
August	185 bps	[190] bps	158 bps	201 bps
Sept	278 bps	119 bps	[36] bps	553 bps

Largest Defense Prime Contractors

	July	YTD
Lockheed Martin	3.21%	[0.88%]
Boeing	[7.01%]	[30.13%]
General Dynamics	5.87%	0.17%
Northrop Grumman	0.73%	[14.31%]
Raytheon	1.15%	[6.21%]

The next president will inherit the most daunting security environment an incoming commander in chief has ever been handled.

Michele Flournoy, former Pentagon strategy planner during the Clinton administration

Commentary (continued)

First, why does the sector remain near its recent lows?

1. Poor market conditions

Although the issues affecting the stock market and driving it downward (a weak dollar, banking/housing crisis, recessionary talk) do not have a direct relationship to the defense sector, investors have pulled out of A&D to capture the substantial gains they have seen over the previous eight years and presently just aren't comfortable yet with coming back in.

2. Boeing

It's unusual to pin a decline on a single company but as one of the largest firms in the sector, a 30% decline in its valuation has had a major impact on the sector. In this case, production and delivery delays for the new 787 have affected not just Boeing but a number of

its suppliers. Although this will likely only shift revenues and earnings to future quarters, a backlog that extends through the middle of the next decade remains. In the short-term it has been a drag on the sector but it is a situation that should rectify itself over time.

3. The November Presidential Election

In a prior newsletter we addressed the perception that a Democratic president would be bad for the defense sector showing research that indicated that the size of the defense budget had as much to do with the world the President governs in than the political party in charge (ie. it's more a matter of timing than policy). FBR and LBJ, both Democrats, presided over a period of increased defense spending to fight WWII and the Vietnam War. Initial defense spending declines under Bill Clinton occurred as the military restructured to determine who and what we'd be fighting but by the end of his presidency overall spend-

ing on defense began to rise. While the perception remains that a McCain presidency would be good for the defense sector and an Obama presidency is an unknown or a negative, the reality is that no president can reduce spending on homeland security without significant backlash. What we hear is that an Obama defense budget will likely remain consistent with current projections -- although a shift in strategy is likely and individual programs might be impacted. A flattening of the budget is already taking place and it is a major concern of the Obama camp not be seen as weak on defense and security during the election as well as in the initial years of his presidency. So budget declines appear unlikely but a negative perception remains.

Which brings us to the question of has the decline left aerospace and defense stocks undervalued?

Historically, bear market declines in any sector

Year	SPADE	S&P500
YTD	[17.31%]	[13.69%]
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
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%]
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%

Commentary (continued)

or style occur when there has been a philosophical shift. Little has actually changed in the A&D sector during the past year and defense stocks are being driven more by the perception of investors rather than internal fundamentals.

Statistically speaking, there is evidence that the sector is undervalued. A review of the fundamental values of the 53 companies that comprise the SPADE Defense Index shows that 24, nearly half and representing a weighting of more than 37% of the Index, has a price-to-sales ratio less than one. In addition, more than half the Index trades with a forward P/E of less than 13 and more than a quarter of the companies now have a P/E less than 10.

24 of 53 companies have a P/S < 1.0

20 of 53 companies have a P/E < 12

11 of 53 companies have a P/E < 10

So what does all this mean? Arguably the aerospace and defense sector is the healthiest that it has ever been, with valuations that are highly attractive, all while the sector hovers more than 20% below its all-time highs.

Reasons We Could See an End-of-the-year Upswing

1. Any impact from the November elections will likely not be felt on the corporate bottom lines until 3Q09 or possibly 2010 at the earliest.
2. The effect of the airline recession and the rise in global oil prices on new plane deliveries will not be felt for several years. Airlines in the middle-East and Asia have been the drivers of the current boom and the clients for many of the early deliveries. These carriers are much healthier than U.S. airlines.
3. The global terrorism threat remains high from extremist nations and terrorists.
4. September and October will see a flurry of defense contracts that are issued at the end of the fiscal year and produce positive news for companies.
5. Nations in regions of turmoil that benefit from high oil, energy, and commodity prices, combined with a weak dollar, have made the acquisition of U.S. defense equipment attractive.
6. A forthcoming shift to a production phase for new military and commercial aircraft will reduce R&D expenditures in 2009 and boost the bottom lines of prime contractors and the supplier base.
7. Political rhetoric for the presidential elections will highlight the likelihood of a stable defense budget regardless of who wins the Presidential election.
8. Much of the unknown or negative news has already been priced into the current valuation.

About

The SPADE Defense Index (AMEX: 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 servicewomen.

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 ticker.

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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New Defense Prime Contracts

The end of the budget year is coming and contracts are starting to be issued...

\$3.1 billion - Air Force contract to General Dynamics for information technology, maintenance, and technical support of hardware and inventory management.

\$1.9 billion for a proposed sale by Lockheed Martin to Israel of four Littoral Combat ships. The sale may include General Dynamics and Raytheon weapons systems.

\$1.4 billion contract extension to Lockheed Martin for the EELV launch vehicle.

\$1.2 billion to Lockheed Martin to manage employee payroll for the Transportation Security Administration (TSA). The contract includes an option to use more of the company's human resource services that would boost the value to up to \$3 billion over 8.5 years.

\$1 billion released by the DOD to Lockheed Martin to proceed with production on the first six F-35B Lightning II aircraft. The money had been withheld pending a review process and completion of the first test flight.

\$766 million to General Dynamics for amphibious armed vehicle prototypes for the Marines.

\$240 million to Northrop Grumman to develop an Airborne and Maritime/Fixed Station and Joint Tactical Radio system. This was a subcontract to Lockheed Martin.

\$234 million from Morocco to Lockheed Martin for 24 F-16 fighter jets including mission equipment and a support package.

\$218 million to Northrop Grumman to build and support a system that provides instant information about activity during combat operations.

\$210 million to General Dynamics NASSCO ship construction and repair yard unit to modernize two classes of amphibious assault ships through 2014 if all options are exercised.

Forecasts & Forthcoming Contracts

\$16 - \$30 billion over five years for a highly classified national cybersecurity initiative to fight "hostile penetration of key U.S. government and private sector information networks -- according to Paul McHale, assistant secretary of Defense for homeland defense.

\$10.9 billion - Iraq announced plans to purchase weapons from U.S. defense firms

including 140 M1A1 Abrams tanks and weapons made by Boeing, Raytheon, and Textron among others.

\$4 billion - DoD plans to buy and operate one or two commercial imagery satellites capable of spying on enemy troop movements and spotting construction at suspected nuclear sites via the Broad Area Surveillance Intelligence Capability (BASIC) satellite system. BASIC was announced following changes/cancellation of aspects of the Future Imagery Architecture program.

\$3.2 trillion - Boeing market forecast for new commercial airplanes over the next two decades.

New Airborne Missile - Allied Techsystems, Lockheed Martin, and Northrop Grumman announced plans to develop a family of airborne missiles capable of attacking aircraft and ground targets.

More Ships Needed by Navy - *Aerospace Daily* stated that the Navy may have to buy up to 90 Aegis Ballistic Missile Defense ships. The Navy will have a fleet of 18 vessels by the end of the year

Cost of Combat Ships Rises: A Navy official said that the Littoral Combat Ships under development by General Dynamics and Northrop Grumman to counter threats in and near coastal waters will cost \$550 million each, about 2.5 times the initial estimate.

Commercial Space Travel: Virgin Galactic revealed the design of a spaceship that will take tourists into space and that they have commitments from 200 people to spend \$200,000 each (\$40M). The manufacturer of the plane is a division of Northrop Grumman. First test flights are anticipated in late 2009 - 2010.

Air Force to Speed Production: of the Lockheed F-35 Lightning II fighter jet which they hope to have as early as 2010. Lockheed expects additional plane orders in 2011. The Air Force has 24 planes on order for that year.

C-130J: Lockheed Martin now has 221 orders for its C-130J Hercules aircraft and a backlog of 58 planes. The Air Force recently placed a large order for the plane and eased fears about a gap in the plane's production schedule.

Boeing and Raytheon have teamed to compete for the Navy's EP-3 replacement competition for 20 aircraft. An RFP is expected in 3Q08 with a downselect to two designs in 2Q09.

Boeing has partnered with Qinetiq (UK) to develop the **Vulture**, ultra-long endurance

unmanned aerial vehicle for DARPA.

SAIC and Boeing are lobbying for support for the \$160 billion **Future Combat Systems** contract which has come under scrutiny due to the cost and size of the program. Their concern is that key aspects of the Army modernization contract may not receive funding.

The F-22 Raptor - Lockheed Martin currently has 183 orders for the plane, a fighter that the *Wall Street Journal* called, 'so advanced that even U.S. allies may not purchase it'. The Air Force, Australia, and Japan have expressed interested in buying additional craft.

Global Hawk - The State Department gave Northrop Grumman the OK to market the Global Hawk UAV to Spain. Permission to chat to additional countries is seen as likely.

Blackswift Demonstrator - ATK, Boeing and Lockheed Martin Skunk Works have teams to build a hypersonic demonstrator for DARPA.

Boeing has partnered with SkyHook International of Canada to build a blimp capable of carrying a 40-ton load 200 miles without refueling.

DoD Contracts Terminations

The Navy plans to end its new destroyer program after the first two vessels are built. The DDG-1000 Zumwalt is too expensive for the Navy to achieve its goal of a 313-ship fleet. General Dynamics and Northrop Grumman each are building one ship.

See page 5 for news and commentary on the Farnborough Air Show and some comments on companies that have reported their quarterly results.

Terrorism Remains Enemy #1: Updated National Defense Strategy "Released"

Defense Secretary Robert Gates said that even winning the conflicts in Iraq and Afghanistan will not end the "Long War" against violent extremism and that the fight against al Qaeda and other terrorists should be the nation's top military priority over the coming decades.

The 23-page document has not been publicly released but called for the military to master irregular warfare instead of focusing predominantly on conventional conflicts against nations.

In addition to the statements in this policy, other areas of focus include preventing attacks in cyberspace and anti-satellite technology which would severely impact communications and navigation capabilities. (see Forecast & Forthcoming Contracts for a new \$16-\$30 billion program)

Tanker Contract (update)

The House Defense Appropriations subcommittee approved \$893 million for the Air Force's mid-air refueling tanker on the grounds that the Pentagon look into how the project will affect U.S. jobs and the defense industrial base when it considers criteria for contractors. An amended RFP for the \$100 billion over 20-year contract is expected on August 6th.

Quarterly Results Analysis

Lockheed Martin, General Dynamics, Raytheon, L-3, and Goodrich were among those that raised their full-year earnings forecast.

Raytheon CFO, David Wajsgas, "We feel very positive about the long-term outlook for the company."

Raytheon's profit from continuing operations rose 20% and its sales increased 11% helped by increased missile sales and lower pension expenses.

L-3 raised its forecasts based on strength across its operation.

DRS Technologies CEO, Mark Newman "We see a strong [U.S. defense] budget going forward no matter who wins." and predicted moderate 3-6% spending hikes.

Honeywell stated that growth in aerospace sales pushed its second-quarter profit up 18% and expects double-digit earnings growth for the second half of the year.

Northrop Grumman cited strong aerospace and shipbuilding sales.

Goodrich cited strong aftermarket sales growth that pushed profits up 50%.

United Technologies stated that their growth was due to overseas markets and global aircraft demand.

The exception was Boeing, whose margins declined with an increased delivery percentage of smaller, narrow body jets and a charge for a delays associated with Australia's Wedgetail military aircraft.

FARNBOROUGH

Mid-July saw the weeklong Farnborough Air Show trade show take place and which featured more than 1500 exhibitors and 140,000 trade visitors from 39 countries.

For those familiar with the international trade show circuit, it appears that Farnborough, which alternates annually with the Paris Air Show, has become a poor cousin to its sister show. Probably about a quarter of the size, Farnborough appears to be mostly about commercial aviation these days, with limited displays on defense systems and practically nothing on space, an odd development considering the number of new EU-led policy discussions on new military space programs and the launch of a multi-billion GPS satellite network.

In contrast, the Paris Air Show definitely remains the pre-eminent military show attracting attendees from all corners of the globe. My thought is that some countries tend to shy away due to the the UK's close ties to the U.S. whereas the France's willingness to cooperate and market to regions and countries the U.S. deems 'problematic' is actually a draw to the show.

Overall, Farnborough saw the announcement of \$88.7 billion worth of orders for 480 aircraft and equipment. For many, the highlight of the show was the airshow debut of the F-22 Raptor fighter jet manufactured by Lockheed Martin. The aircraft dipped, dived, completed a back flip, and roared supersonically in a roughly 15-minute exhibition.

Noticeable was the focus on green: reducing fuel costs and environmental factors were front and center. As an example, Boeing displayed a 75-gallon tank of algae to represent a possible substitute for jet fuel. United Technologies' Pratt & Whitney division announced that they are developing an engine that will burn 12% less fuel than today's jumbo jet engines.

In addition, *a range of green efforts* were announced...

United Technologies has developed a new geared turbofan jet engine will burn 25% less fuel, reduce emissions by more than half, and reduce operating costs by \$1.5 million per plane.

Department of Transportation announced a \$10 million prize to encourage the development of renewable fuels and technologies for the aviation industry.

Fed-Ex has begun replacing its *Boeing* 727-200s with the Boeing 757-200 as they cost 25% less to fly and have 20% more cargo room.

Others are urging Boeing to boost production of its 777-300ER which burns 20% less fuel than a 747.

Boeing said that they are being 'deluged' with requests from airlines on tips to save fuel. Replacing traditional brakes on its 737 jet with carbon fiber saves 800 pounds per plane.

Other news announced at Farnborough

Boeing said that the *787* is on track for a first flight in Q4 (late October / early November) with deliveries beginning 3Q09. The 787 has entered a progressive ground test phase after achieving the power-on milestone in early June.

Raytheon unveiled a radar that could boost performance of F-16 and other fighter aircraft that they believe is a multi-billion category for worldwide sales over the next decade.

Startup FlyDubai placed an order for 54 *Boeing* 737-800 jets in a deal valued at \$3.78 billion based on list prices.

Mergers & Acquisitions

Boeing acquired Insitu, Inc, a privately-owned manufacturer of low-cost unmanned aerial vehicles. The firm forecasts revenues of \$150M in 2008 up 70% from 2007.

Boeing acquired a controlling stake in an aircraft parts joint venture with China's Aviation Industry Corp

