

Commentary

Even as Merrill Lynch was upgrading the sector with a call that the analyst expected it to approach All-Time-High levels (a gain of roughly 25% from current levels), there were investors will to risk large sums that the sector's best days were behind it placing bets in the opposite direction. Twice in the past two months, someone has gone very short on the sector, tied to what appears to be the hope that a White House speech would provide news that would cause investors to flee. Yet they have been wrong. The first was on the deficit speech where the investor appeared to hope that there was to be a call for a major reduction in defense spending (I listened to the speech and defense was largely ignored). Several days later, the investor exited their short. Then in late May, more than four million shares traded (an ~\$80M bet) anticipated that an announced reduction in troops in Afghanistan would case the sector to plummet. Instead, the Powershares Aerospace & Defense ETF (NYSE: PPA) hit a 52-week high as the market surged upward in the last week of June. Overall, year-to-date, the aerospace and defense sector has outperformed the S&P500 8.85% to 4.99% and outperformed the S&P500 in June, 2Q11, and 1Q11.

In recent newsletters, I've stated that the pullout of troops from Iraq and Afghanistan is not necessarily a negative, contrary to the perception that the mainstream media offers.

1. Most of the spending on overseas operations does not go to private companies. While some goes to firms providing operational support, most of the \$170 billion spent annually goes toward personnel costs, supplies, fuel and transportation, health care, etc. At the height of the spending on Iraq a few years back, several of the public companies addressed the likelihood of peak defense spending at an Cowen & Co. aerospace investor event and they all highlighted that the war effort amounted to less than 5% of annual revenues.

2. A reduction in spending on overseas operations will force a decline in overall defense spending without major cuts to existing non-war procurement and R&D activities. This month's announcement from the White House regarding an initial draw-down of troops from Afghanistan, is estimating reduced war spending of \$50 billion. So without any other changes, the DoD budget will be \$50 billion less in 2012 with an additional \$100 billion 'in savings' that will appear over the next few years. It is key to understand that not all dollars are equal.

In addition, many of the firms found in the SPADE Defense Index are seeing a boost from an expansion in the commercial aerospace cycle and increased spending on cybersecurity and C4ISR.

SPADE Defense Index Statistics

6/30/11 Close: 2315.77
 All-time Close: 2747.67
 Date of all-time close: 9 October 2007

	SPADE Defense	S&P500
June	0.99%	[1.83%]
2Q11	0.22%	[0.39%]
YTD	8.85%	4.99%

Liquidity

Many people comment about the liquidity of ETFs. This past month saw PPA trade \$80M in a day without issues on a fund that currently has roughly \$110M in assets. When it comes to equity ETFs tracking passive indexes, this just goes to show that the ETF process works -- well at least for PPA.

Acquisition

A division of Honeywell, Egret Acquisition announced its intent to buy index constituent EMS Technologies (ELMG) for \$33 per share.

Picking Winners and Losers

This month proves the adage of how difficult it can be to identify the right companies within a sector -- Two of the top four companies with the worst 2011 returns turned in the best returns in June. Among the big 5 prime contractors returns in June ranged from Boeing's decline of 5.25% to Northrop Grumman's gain of 6.22%

New DoD Leadership

The U.S. Senate voted 100 to 0 to confirm Leon Panetta as the new Secretary of Defense succeeding Robert Gates. Stability from the position is expected.

A \$1.5 Billion Bond Sale

General Dynamics sold \$1.5 billion in notes (\$500M in 3.5 year notes, \$500M in 5-year notes, and \$500M in 10-year notes). The company plans to pay off principal on the company's outstanding bonds.

June 2011 Top Gainers			June 2011 Laggards			YTD Top Gainers			YTD Laggards		
1	EMS Technologies	26.37%	1	Orbital Sciences	[10.42%]	1	EMS Technologies	66.68%	1	Digital Globe	[19.87%]
2	Aerovironment	17.09%	2	Harris Corp.	[8.86%]	2	LMI Aerospace	52.78%	2	Oshkosh Truck	[17.88%]
3	LMI Aerospace	14.48%	3	American Sci & Eng	[7.55%]	3	SRA International	51.20%	3	Key W Holdings	[15.54%]
4	GeoEye	12.75%	4	FLIR Systems	[6.75%]	4	Aerovironment	31.76%	4	GeoEye	[11.77%]
5	Transdigm	11.21%	5	Elbit Systems	[6.52%]	5	Esterline Tech.	30.40%	5	Elbit Systems	[9.88%]
6	Key W Holding	9.84%	6	Boeing	[5.25%]	6	Transdigm	26.64%	6	Force Protection	[9.80%]
7	Goodrich Corp	9.41%	7	SAIC	[4.21%]	7	Gencorp	24.18%	7	Kratos Defense	[7.67%]
8	OSI Systems	7.55%	8	Ball Corp	[2.66%]	8	L-3 Corporation	24.06%	8	American Sci & Eng	[6.14%]
9	L-3 Communications	7.10%	9	Mercury Computer	[2.30%]	9	Ceradyne	23.66%	9	Ducommun	[5.56%]
10	Triumph Group	6.48%	10	ViaSat	[2.26%]	10	Integral Systems	22.81%	10	Alliant Techsystems	[4.16%]

Largest Defense Prime Contractors		
	June	2011
Lockheed Martin	3.94%	15.82%
Boeing	[5.25%]	13.29%
General Dynamics	0.40%	5.02%
Northrop Grumman	6.22%	7.05%
Raytheon	[1.05%]	7.57%

Powershares Aerospace & Defense ETF (NYSE: PPA)	
<i>Modern Portfolio Theory (vs the S&P500)</i>	
Beta (3 year)	1.09
Alpha (3 year)	[1.36]
R-squared (3 year)	86.39%
<i>Yahoo Finance - 5/31/11</i>	

ETF Statistics (NYSEarca: PPA) Powershares Aerospace & Defense	
Exchange / Ticker Symbol:	NYSE / PPA
Fee	60 basis
Assets (6/30/11)	\$108.0 M
Closing Price (6/30/11)	\$20.38
Yield (Distribution Yield)	1.17%
June 2011 Volume	8,569,900
Turnover	12%
<i>source: Yahoo Finance</i>	

Budget / Deficit / Debt Battle
 According to the White House Office of Management and Budget... Washington spends twice as much on entitlement programs (Social Security, Medicare, Medicaid) then they do on National Defense including spending for Iraq and Afghanistan.

Portfolio Price / Earnings	13.41
Portfolio Price / Book	0.84
Portfolio Price / Sales	9.61
Portfolio Price / Cash Flow	2.24
Earnings Growth Rate	4.28%
<i>Yahoo Finance - 5/31/11</i>	

Commentary

Time will tell who is right, Merrill Lynch or the anonymous hedge fund, but right now, Merrill’s comments are looking awfully good.

Paris Air Show

There was another instance this past month where people’s interpretation of events can differ. Airbus announced a record number of orders and dollars at the Paris Air Show and if you read about the show, it appeared that they left Boeing in the dust. That is unless you know something about the Paris Air Show.

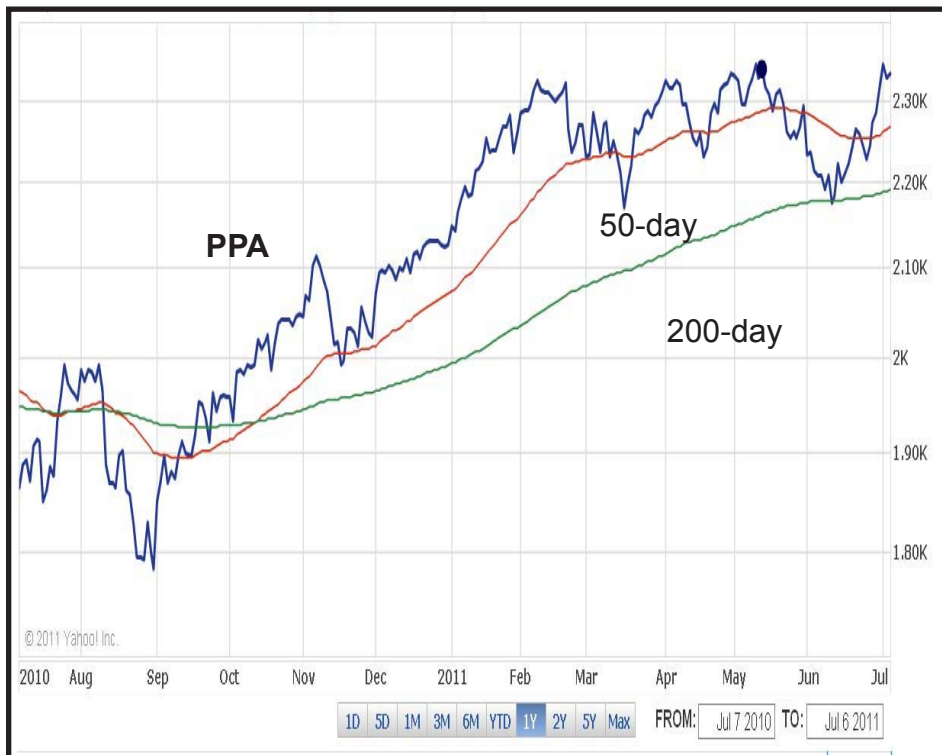
As someone who has attended the show since the 1990s, these results are fairly typical. If you look closer, it is true that Airbus booked significant orders. However, there are five things I took out

of the numbers.

1. Companies have ‘complained’ for years that since the Paris Air Show is Airbus’ “home show”, they tend to hold off officially announcing orders until the week of the event as compared to Boeing which announces them throughout the year. This year there were some orders Airbus announced that were unknown to the industry but.
2. Boeing’s manufacturing lines are reportedly booked through nearly 2016 meaning even if any firm wanted a plane, they couldn’t get it.
3. Boeing received an order from Russia’s Aeroflot for the first time and an executive from the organization has some disparaging comments about Airbus.
4. Many of the planes were for mid-size

planes, not the larger jumbo jets.

5. Most of the orders are for a new Airbus plane that will allow for different engines. The plane is not due until 2020 (assuming no delays in contrary to recent Boeing and Airbus development efforts.) Competing against this plane will either be an updated version of the Boeing 737 or a new plane. However, Boeing decided that since deliveries are nearly a decade away and they are essentially sold out for the next decade there was no rush to announce anything until the business case was further studied. At some point, after a new plane is announced, Boeing could see a similar surge in bookings as well.

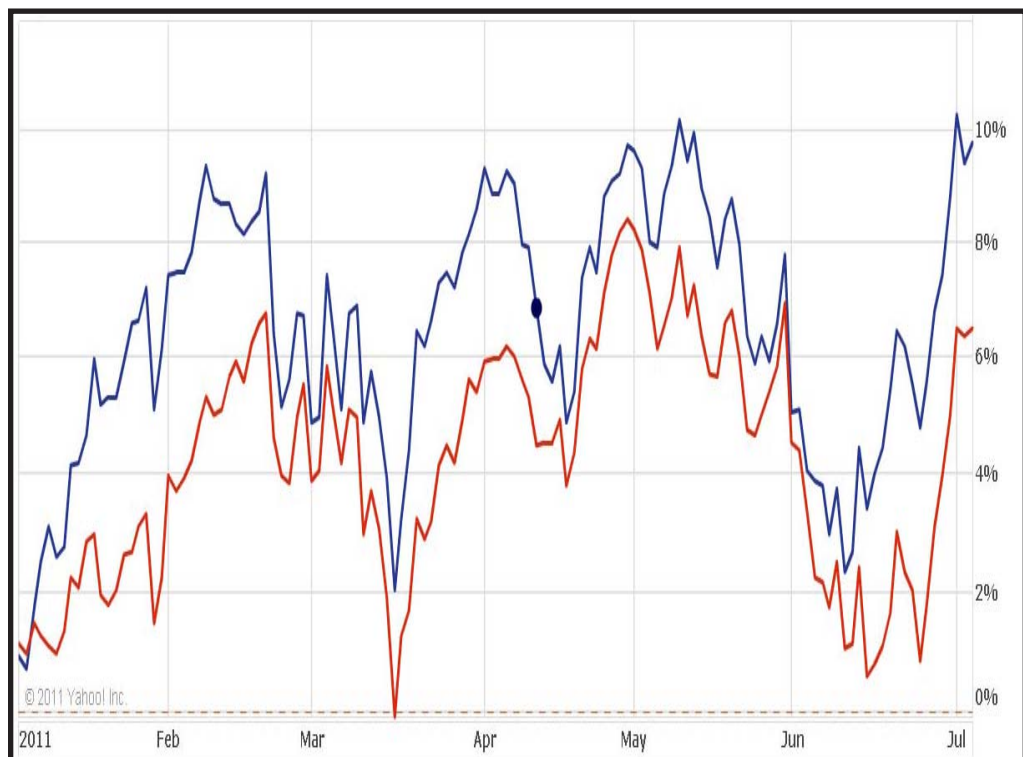


NYSE: PPA (blue) bounced off the the 200-day moving average, rebounded past the 50-day moving average on its way to hitting year-to-date highs. (green).

PPA = Powershares Aerospace & Defense ETF

Year-to-date, PPA (blue) continues to outperform the S&P500 (red).

PPA = Powershares Aerospace & Defense ETF



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Paris Air Show Totals

There are conflicting totals out there.

Boeing reported 142 orders valued at \$22 billion. Airbus announced 418 deals valued at \$44 billion with 312 MOUs valued at \$28.2 billion.

According to the blog... *AllThings787*

Airbus - 914 orders

- A319neo - 40 (Republic Airways-40)
- A320 - 63 - (SAS-30, Garuda-15, Indigo-30, Avianca/Taca-18)
- A320neo - 755(Republic-40, GECAS-60, Air Lease-20, CIT-50, JetBlue-40, Garuda-10, Indigo-150, LAN-20, Republic-40, Avianca/Taca-33, ALAFCO-30, GoAir-72, Air Asia-200)
- A321neo - 22 (Air Lease-16, TransAsia Air-6)

- A321 - 1 (Air Lease-1)
- A330 - 15 (Saudi Arabian Airlines-4, Air Lease-11)
- A350 - 6 (AFLACO-6)
- A380 - 12 (Skymark-2, Hong Kong Air-10)

Boeing

- 737 - 87
- 737 - 19
- 787 - 4
- 777 - 27
- 767 - 1

- 6 x 777-300ER (Qatar Airways)
- 2 x 747-8I - Undisclosed
- 4 x 787-9 Air Lease Corp
- 2 x 737-800 MIAT Mongolian Air
- 15 x 737-800 Norwegian Air
- 10 x 737-800 Malaysia Airlines
- 8 x 777-300ER GECAS
- 7 x 737-900ER UTair
- 15 x 747-81 - Hong Kong Air
- 20 x 737-800 Air Lease Corp
- 5 x 777-300ER Air Lease
- 1 x 767-300 MIAT Mongolian
- 8 x 777-300ER Aeroflot
- 2 x 747-8F GECAS
- 33 x 737-800 UTair

Excerpts from the Senate Armed Services Bill (Defense News 20 June 11)

Add \$322M to upgrade 40 M1A2 Abrams tanks to keep the production line open longer.

Cut funding for the MEADS Medium Extended Air Defense System joint effort with Italy and Germany.

\$884 for the Army to develop a Ground Combat vehicle

Cut \$452M for the Army EMARSS (Enhanced Medium Altitude

Recon and Surveillance System) citing program delays

Cut \$200M from the Joint Tactical Radio System JTRS reflecting program delays

Cut \$35M to replace an AH-64 Apache aircraft that won't be delivered until after the war effort is completed.

\$500M for counterterrorism efforts in East Africa and Yemen.

Require Lockheed Martin in the next contract for the F-35 JSF Fighter to be responsible for 100% of cost overruns.

\$2.7 Billion Deal - The U.S. decided to sell Israel F-35 JSF fighter jets to be delivered in late 2016.

\$1.1 Billion - United Launch Alliance, a joint venture of Lockheed and Boeing received a contract to launch the EELV launch vehicle from July 11 to Sept 12.

F-16 Jets - The UAE is considering buying F-16 fighter jets from Lockheed Martin instead of the Rafale jets it was expected to purchase.

Smart Microgrid Market - According to *National Defense* magazine, Lockheed and Boeing are planning to enter this market to integrate renewable and conventional energy networks.

Exoatmospheric Kill Vehicle - The Missile Defense Agency got support from the Senate Armed Services Committee to halt production after several test failures

Humvee Changes - The Pentagon asked to shift \$182 million from buying new Humvees toward improving survivability and mobility enhancements of existing vehicles.

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.

 SPADE Indexes publishes a variety of private and public sector and regional indexes. Public indexes listed on the NYSEamex include: the SPADE Defense Index (ticker: DXS), the SPADE Oklahoma Index (ticker: OKLAH); and the SPADE Texas Index (ticker: TEXAS).

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

Jul-11	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
		30-Jun-11	31-May-11	30-Jun-11	YTD	MTD	intraday	(ttm)	ttm	mrq	expected	forward %
AAR Corp	AIR	0.49%	26.39	27.09	-1.38%	2.65%	1.06	12.75	0.61	1.29	1.24	1.10%
American Science & Engineering	ASEI	0.33%	86.53	80.00	-6.14%	-7.55%	0.74	16.29	2.64	2.75	1.01	1.50%
Alliant Techsystems	ATK	1.08%	71.53	71.33	-4.16%	-0.28%	2.41	8.16	0.49	2.07	2.28	1.10%
AeroVironment	AVAV	0.35%	30.19	35.35	31.76%	17.09%	0.77	27.23	2.62	2.91	1.56	
Boeing Co	BA	6.82%	78.03	73.93	13.29%	-5.25%	54.86	14.24	0.85	13.95	1.51	2.30%
Booz Allen & Hamilton	BAH	1.21%	17.99	19.11	-1.65%	6.23%	2.44	10.97	0.44	2.69	0.64	
Ball Corp	BLL	2.92%	39.51	38.46	13.03%	-2.66%	6.54	12.05	0.80	4.25	1.35	0.70%
Caci Intl	CACI	0.86%	63.83	63.08	17.25%	-1.17%	1.96	14.38	0.55	1.51	1.26	
Comtech	CMTL	0.33%	27.79	28.04	1.01%	0.90%	0.74	26.85	1.00	1.09	0.36	3.60%
Rockwell Collins	COL	3.99%	61.13	60.84	4.48%	-0.47%	9.61	13.50	1.97	6.05	1.59	1.60%
Ceradyne Inc	CRDN	0.44%	44.76	38.99	23.66%	-12.89%	0.95	11.46	2.19	1.41	0.76	
Computer Sciences	CSC	2.66%	36.89	37.96	-23.47%	2.90%	5.94	7.50	0.37	0.78	0.88	2.10%
Cubic Corp	CUB	0.62%	51.24	50.20	6.47%	-2.03%	1.37	16.09	1.05	2.64	1.81	0.40%
Ducommun	DCO	0.10%	19.63	20.57	-5.56%	4.79%	0.22	8.89	0.54	0.84	0.59	1.50%
Digital Globe	DGI	0.53%	24.62	25.41	-19.87%	3.21%	1.18	29.38	3.64	2.34	9.18	
EMS Tech	ELMG	0.23%	26.09	32.97	66.68%	26.37%	0.51	23.54	1.42	1.92	1.39	
Esterline Technologies	ESL	1.05%	75.62	76.40	30.40%	1.03%	2.37	14.00	1.45	1.47	1.62	
Eibit Systems	ESLT	0.92%	51.22	47.88	-9.88%	-6.52%	2.03	9.89	0.77	2.18	0.99	0.70%
Flir Systems	FLIR	2.42%	36.15	33.71	13.31%	-6.75%	5.43	16.91	3.66	3.55	1.30	0.70%
Force Protection	FRPT	0.16%	4.84	4.97	-9.80%	2.69%	0.36	10.87	0.53	1.07	1.26	
General Dynamics	GD	5.41%	74.22	74.52	5.02%	0.40%	27.98	9.82	0.85	2.00	1.30	2.50%
GeoEye	GEOY	0.37%	33.17	37.40	-11.77%	12.75%	0.83	15.39	2.46	1.81	1.03	
Goodrich Corp	GR	3.97%	87.29	95.50	8.44%	9.41%	12.02	14.90	1.66	3.33	1.46	1.20%
Gencorp	GY	0.17%	6.28	6.42	24.18%	2.23%	0.38	13.80	0.43			
Heico	HEI	1.03%	54.98	54.74	7.27%	-0.44%	2.31	29.82	3.32	4.48	2.07	0.20%
Honeywell Intl	HON	6.94%	59.55	59.59	12.10%	0.07%	47.41	13.18	1.36	4.01	0.89	2.30%
Harris Corp	HRS	2.57%	49.44	45.06	-0.53%	-8.86%	5.76	8.78	1.00	2.27	1.04	2.20%
L-1 Identity Solutions	ID	0.10%	11.12	11.75	-1.34%	5.67%	1.06	69.18	2.35	1.44	56.85	
Integral Systems	ISYS	4.04%	11.87	12.17	22.81%	2.53%	0.21		1.09	1.91		
Itt Indus	ITT	4.04%	57.62	58.93	13.09%	2.27%	10.95	11.53	0.97	2.28	1.18	1.70%
KEY W Holding	KEYW	0.14%	11.28	12.39	-15.54%	9.84%	0.31	19.97	2.51	1.79	1.85	
Kratos Defense & Security	KTOS	0.13%	12.14	12.16	-7.67%	0.16%	0.28	26.47	0.63	1.25		
L-3 Communications Hldgs	LLL	4.01%	81.65	87.45	24.06%	7.10%	9.34	9.83	0.59	1.37	1.31	2.10%
LMI Aerospace	LMIA	0.13%	21.34	24.43	52.78%	14.48%	0.28	13.1	1.26	1.82	1.26	
Lockheed Martin	LMT	5.49%	77.90	80.97	15.82%	3.94%	28.33	9.40	0.61	7.42	1.20	3.70%
Mantech International'a'	MANT	0.73%	45.02	44.42	7.48%	-1.33%	1.63	11.34	0.60	1.62	1.43	1.90%
Moog Inc.	MOGA	0.89%	41.05	43.52	9.35%	6.02%	2.01	13.84	0.88	1.64	1.43	
Mercury Computer Sys	MRCY	0.25%	19.12	18.68	1.63%	-2.30%	0.58	26.49	2.44	1.76	1.89	
NCI Information Technology	NCIT	0.14%	22.70	22.72	-1.17%	0.09%	0.31	11.69	0.50	1.95	0.89	
Northrop Grumman	NOC	4.52%	65.29	69.35	7.05%	6.22%	20.51	9.81	0.59	1.60	0.92	2.90%
Orbital Sciences Corp	ORB	0.44%	18.81	16.85	-1.63%	-10.42%	1.00	14.99	0.75	1.68	1.69	
Osi Systems	OSIS	0.37%	39.98	43.00	18.26%	7.55%	0.83	19.35	1.28	2.29	1.32	
Oshkosh Truck	OSK	1.19%	27.70	28.94	-17.88%	4.48%	2.94	9.14	0.33	1.71	0.79	
Precision Castparts	PCP	4.63%	157.10	164.65	18.27%	4.81%	23.53	16.39	3.81	3.30	1.66	0.10%
Raytheon Co	RTN	4.50%	50.38	49.85	7.57%	-1.05%	17.78	9.00	0.70	1.67	1.08	3.50%
SAIC	SAI	2.68%	17.56	16.82	6.05%	-4.21%	5.98	11.29	0.53	2.48	1.41	
Sra International'a'	SRX	0.80%	30.95	30.92	51.20%	-0.10%	1.79	19.73	1.02	2.18	1.42	
TASER International Inc.	TASR	0.12%	4.53	4.55	-3.19%	0.44%	0.28	32.65	3.20	2.46	2.85	
Transdigm	TDG	2.06%	82.00	91.19	26.64%	11.21%	4.65	18.65	4.62	6.83	1.52	
Teledyne Technologies	TDY	0.83%	49.10	50.36	14.53%	2.57%	1.87	14.12	1.08	2.20	2.22	
Triumph Group	TGI	1.10%	93.52	99.58	11.37%	6.48%	2.44	10.61	0.83	1.48	0.78	0.20%
Textron	TXT	2.95%	22.88	23.61	-0.13%	3.19%	6.57	13.22	0.60	2.14	0.88	0.30%
URS Corporation	URS	1.59%	44.06	44.74	7.52%	1.54%	3.57	11.32	0.38	0.87	1.26	
United Technologies	UTX	6.86%	87.77	88.51	12.44%	0.84%	82.08	14.53	1.46	3.66	1.49	2.20%