

Commentary

Before the market turned, aerospace and defense stocks had touched 52-week highs in May. What? Really? But isn't the flattening of the defense budget supposed to decimate the sector? Shouldn't stocks be plunging? Perhaps, but even as some people exit their positions, analysts are raising the forecasts.

For the moment, the aerospace and defense sector continues to outperform the S&P500 in 2011 and analysts have recently started raising the outlook of firms such as General Dynamics, Lockheed Martin, and Boeing to buys.

More than likely, the ebb and flow of the market will have much to say about the direction of the sector. For the past two years, the SPADE Defense Index has roughly tracked the direction of the S&P 500. Yet since the market bottom in March 2009, investors in aerospace and defense stocks have seen their investments gain 99.5%.

Even as the market comes under near-term pressure, and the adage of sell in May and go away looks to hold true, there are three reasons why the sector could benefit through the summer months.

1. **The improvement in the commercial aerospace.** Global travel and the need for modern aircraft continues to rise. The first deliveries of the Boeing 787 later this summer will provide a pop to the sector and will keep manufacturing facilities at U.S. aerospace suppliers humming.

2. **The Paris Air Show.** Part conference, part trade show, and part bazaar, the show gets more than 100,000 visitors from around the world and the week features the announcement of billions in new military and commercial contracts. Many of the sector's firms have exposure to the commercial aerospace sector -- including passenger transport (Boeing and the sector's suppliers such as Goodrich, Precision Castparts, Harris, Rockwell Collins, Honeywell, etc.), small private aircraft (ex. General Dynamics which owns Gulfstream), and helicopters (Textron and United Technologies). From mid-to-late June, look for major contract announcements from these firms and others as positive news on the sector to be picked up by the world media outlets.

3. **International Exports.** Besides the estimated \$50 - \$100 billion in orders that will be announced in Paris, the Pentagon has stated that it is processing a record backlog of \$327 billion to 165 countries, with \$46.1 billion to be completed in 2011. The \$327 billion figure represents more than half the total core annual budget of the Department of Defense and roughly three years worth of DoD procurement.

SPADE Defense Index Statistics

5/31/11 Close: 2293.02
 All-time Close: 2747.67
 Date of all-time close: 9 October 2007

	SPADE Defense	S&P500
May	[1.78%]	[1.35%]
2Q11	[0.77%]	1.46%
YTD	7.78%	6.96%

Robert Gates, Defense Secretary

"The lessons of history tell us we must not diminish our ability or our determination to deal with the threats and challenges on the horizon".

Speech at Notre Dame, 22 May 2011.

Leon Panetta, Director of CIA & Defense Secretary nominee to the Senate Armed Services Committee

"[North Korea's military programs are a] growing and direct threat [to the U.S. and] I intend to monitor the security situation closely and maintain the capabilities necessary to protect our interests, defend our allies, and deter North Korea."

Bill Loomis, Stifel Nicolaus

"Public stock investors are generally reluctant to invest in the federal IT services industry today, given constant headlines about government spending cuts, increasing pricing pressure, budget delays, slowing growth and other factors. As a result, the forward P/E ratio of the group has fallen from over 20 times a few years ago to 12 times. But a longer-term view can take advantage of the **near 20-year lows** of valuation in the group.

Washington Technology, Page 11, April 2011

May 2011 Top Gainers			May 2011 Laggards			YTD Top Gainers			YTD Laggards		
1	Viasat	10.90%	1	Computer Sciences	[27.64%]	1	SRA International	51.34%	1	Computer Sciences	[25.63%]
2	Triumph Group	8.59%	2	Digital Globe	[15.10%]	2	Ceradyne	41.96%	2	KEY W Holding	[23.11%]
3	Force Protection	7.80%	3	Ducommun	[13.71%]	3	LMI Aerospace	33.46%	3	Digital Globe	[22.36%]
4	LMI Aerospace	6.43%	4	Oshkosh Truck	[12.51%]	4	EMS Technologies	31.90%	4	GeoEye	[21.75%]
5	Ball Corp.	5.90%	5	Textron	[12.34%]	5	Esterline Tech.	29.07%	5	Oshkosh Truck	[21.40%]
6	AeroVironment	5.38%	6	Kratos Defense	11.19%	6	FLIR Systems	21.51%	6	Force Protection	[12.16%]
7	Esterline Tech.	5.32%	7	GeoEye	[10.57%]	7	Gencorp	21.47%	7	Ducommun	[9.87%]
8	CACI	4.45%	8	Elbit Systems	[8.40%]	8	Integral Systems	19.78%	8	Kratos Defense	[7.82%]
9	OSI Systems	4.14%	9	NCI Information	[7.76%]	9	Boeing	19.57%	9	Booz Allen	[7.41%]
10	Raytheon	3.77%	10	Booz Allen	[6.98%]	10	CACI	18.64%	10	L-1 Identity	[6.63%]

Largest Defense Prime Contractors		
	May	2011
Lockheed Martin	[1.70%]	11.43%
Boeing	[2.19%]	19.57%
General Dynamics	1.92%	4.59%
Northrop Grumman	2.64%	0.79%
Raytheon	3.77%	8.72%

Powershares Aerospace & Defense ETF (NYSE: PPA)

Modern Portfolio Theory (vs the S&P500)

Beta (3 month)	1.09
Alpha (3 month)	[0.62]
R-squared (3 month)	86.23%
Sharpe Ratio	0.13
Std Deviation	25.65

Yahoo Finance - 4/30/11

ETF Statistics (NYSEarca: PPA)
Powershares Aerospace & Defense

Exchange / Ticker Symbol:	NYSE / PPA
Fee	60 basis
Assets (5/31/11)	\$103.2 M
Closing Price (5/31/11)	\$20.23
Yield (Distribution Yield)	0.84%
May 2011 Volume	2,170,700
Turnover	17%

source: Yahoo Finance

Portfolio Price / Earnings	13.61
Portfolio Price / Book	2.30
Portfolio Price / Sales	0.86
Portfolio Price / Cash Flow	9.85
Earnings Growth Rate	4.12%

Yahoo Finance - 4/30/11

Market Notes

Surging Sales: Boeing said that its Chinook helicopter is seeing the highest rate of production in 20 years. The firm recently invested \$120 million to bring production up to six aircraft per month.

Surging Profit: Esterline Technologies raised its earning outlook for the third time this year after reporting a 55% increase in quarterly profit. The company's avionics and controls segment received a boost from the commercial aircraft sector.

First Dreamliner Delivery: Boeing announced plans to deliver its first 787 in August or September. At present the firm has 835 orders for the plane.

New International Sales: Reuters reported that Lockheed announced plans to sign sales contracts with Iraq and Oman for as many as 18 F-16 fighter jets by early next year and 100 additional orders by the end of the decade.

New Vertical Lift Aircraft Concept. The US Army stated it is looking for a new vehicle that by 2030 could carry a 9-person squad at 200 knots, fly twice as far as current helicopters and which could be piloted or automated.

Increasing Production: Boeing raised the production rate for the 777 aircraft from 5 to 7 per month. In the first quarter of 2013, Boeing anticipates being able to increase the rate to 8.3 per month for the plane which operates in the 300-400 passenger seat market.

Threat Watch: China: On May 19th, it revealed a new AMRAAM, a next generation air-to-air missile that the People's Daily called a "trump card" and a "secret weapon for gaining air superiority".

Threat Watch: The Arctic: Commented on in the last issue, China is looking at the polar ice cap melting as an opportunity including new shipping routes and oil and gas development. Beijing is concerned about access with the Northeast Passage controlled by Russia and the Northwest Passage by the U.S. and Canada.

'Should-Cost' Programs – In the 2May11 *Defense News*, details on a new DoD cost estimating strategy for 14 major acquisitions programs were announced. In an attempt to make estimates more realistic, the strategy will attempt to reduce a gap between should-cost and will-cost.

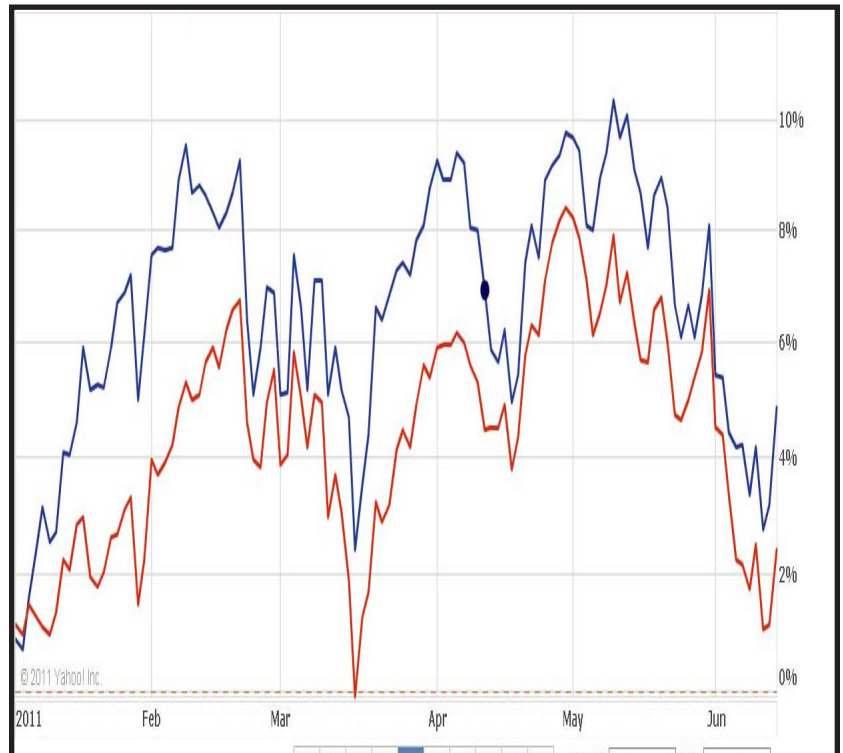


NYSE: PPA (blue) passed through the 50-day moving average but bounced off of the 200-day level (green).

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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By the Numbers

\$1 Trillion - Pentagon estimate of the cost to operate Lockheed Martin's F-35 Joint Strike Fighter over the next 50 years. This amount is in addition to the \$385 billion purchase price.

\$327 Billion - Arms export backlog at the Pentagon amounting to 13,000 active cases with more than 165 countries and institutions.

\$46.1 Billion - Amount forecasted by the Defense Security Cooperation Agency which is a 45% increase from the previous year.

\$15 Billion - Boeing estimate to upgrade the Northrop Grumman's E-8C JOINT STARS. This compares to the Air Force and Northrop estimate of \$2.9 Billion

\$10 Billion – US firms were eliminated from India's competition for 126 new combat jets.

\$3.5 Billion - Sikosky (a division of UTX) will supply Turkey with 109 T-70 helicopters, the Turkish version of the S-70 Black Hawk International.

\$744 Million - Contract by the Navy to General Dynamics NASSCO to build two auxiliary ships. The Navy is also looking into a contract to build a Mobile Landing Platform vessel. The cash infusion according to the Wall Street Journal is to keep NASSCO from laying off workers.

\$6 Billion - GAO estimate of the value of the Joint Air-to-Ground Missile program over the next two decades. Lockheed Martin and Raytheon have submitted proposals and are competing for a 4-year contract for development and production.

\$4.1 Billion - Amount the Indian government plans to spend on 10 C-17 Globemaster III planes from Boeing. There is an option for an additional six planes

\$3 Billion - Value of a lawsuit tossed out by the Supreme Court which would have required Boeing and General Dynamics to pay the government two decades after the cancellation of a stealth fighter jet contract.

\$1.2 B – Amount Norway has requested for special military projects including the acquisition of 4 F-35 fighter trainer aircraft (\$873M, delivery in 2016) and \$187M to cover Phase II for the Joint Strike Missile project.

\$550 Million - The cost per plane for a new long-range bomber DoD is studying which would carry nuclear weapons and fly with or without a pilot.

\$141 Million - A DoD contract to Northrop Grumman to expand the military's Automatic Biometric ID System, a database of terrorist suspects.

1500 - The number of UAVs that India is planning to acquire within the next four years to deal with issues including insurgency in the NE of the country and tensions with Pakistan.

400% - Increase in Special Operations Command spending for equipment and services from 2001 (\$194.8M) to 2010 (\$949.9M) to leading defense contractors. Among the beneficiaries have been Raytheon, Harris, and Boeing.

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

Jun-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	
		31-May-11	30-Apr-11	31-May-11	YTD	MTD	intraday	(ttm)	ttm	mrq	expected	forward %	
Boeing Co	BA	7.20%	79.78	78.03	19.57%	-2.19%	57.61	14.75	0.89	14.52	1.73	2.20%	
United Technologies	UTX	7.07%	89.58	87.77	11.50%	-2.02%	80.33	14.25	1.42	3.57	1.57	2.20%	
Honeywell Intl	HON	6.90%	61.23	59.55	12.02%	-2.74%	46.87	13.09	1.35	3.98	0.92	2.20%	
General Dynamics	GD	5.43%	72.82	74.22	4.59%	1.92%	27.61	9.69	0.82	1.91	1.24	2.60%	
Lockheed Martin	LMT	5.37%	79.25	77.90	11.43%	-1.70%	27.05	8.99	0.58	7.08	1.18	3.90%	
Precision Castparts	PCP	4.87%	154.52	157.10	12.85%	1.67%	22.54	15.74	3.61	3.30	1.62	0.10%	
Raytheon Co	RTN	4.50%	48.55	50.38	8.72%	3.77%	17.94	9.08	0.71	1.69	1.10	3.40%	
Northrop Grumman	NOC	4.35%	63.61	65.29	0.79%	2.64%	19.11	9.14	0.55	1.50	0.87	3.10%	
Goodrich Corp	GR	4.14%	88.37	87.29	-0.89%	-1.22%	10.90	13.62	1.51	3.02	1.25	1.30%	
Itt Indus	ITT	3.99%	57.79	57.62	10.57%	-0.29%	10.61	11.17	0.94	2.21	1.21	1.80%	
L-3 Communications Hldgs	LLL	3.97%	80.19	81.65	15.83%	1.82%	8.67	9.12	0.55	1.28	1.24	2.20%	
Rockwell Collins	COL	3.87%	63.10	61.13	4.98%	-3.12%	9.42	13.23	1.92	5.90	1.58	1.60%	
Ball Corp	BLL	3.05%	37.31	39.51	16.12%	5.90%	6.64	12.23	0.82	4.32	1.39	0.70%	
SAIC	SAI	2.87%	17.40	17.56	10.72%	0.92%	6.28	11.86	0.53	2.51	1.51		
Harris Corp	HRS	2.86%	53.13	49.44	9.14%	-6.95%	6.29	9.58	1.09	2.46	1.13	2.00%	
Textron	TXT	2.86%	26.10	22.88	-3.21%	-12.34%	6.32	12.50	0.57	2.04	0.86	0.40%	
Computer Sciences	CSC	2.83%	50.98	36.89	-25.63%	-27.64%	6.18	7.32	0.39	0.82	1.07	2.00%	
Flir Systems	FLIR	2.60%	35.22	36.15	21.51%	2.64%	5.77	17.99	3.85	3.53	1.42	0.70%	
Transdigm	TDG	1.88%	83.30	82.00	13.87%	-1.56%	4.10	16.5	4.08	6.03	1.36		
URS Corporation	URS	1.61%	44.75	44.06	5.89%	-1.54%	3.46	10.99	0.37	0.85	1.28		
Booz Allen & Hamilton	BAH	1.17%	19.34	17.99	-7.41%	-6.98%	2.30	11.84	0.42	2.62	0.85		
Oshkosh Truck	OSK	1.14%	31.66	27.70	-21.40%	-12.51%	2.52	7.80	0.32	1.64	0.77		
Alliant Techsystems	ATK	1.09%	70.65	71.53	-3.90%	1.25%	2.40	8.16	0.49	2.06	2.31	1.10%	
Esterline Technologies	ESL	1.04%	71.80	75.62	29.07%	5.32%	2.30	14.11	1.46	1.57	2.17		
Triumph Group	TGI	1.03%	86.12	93.52	4.60%	8.59%	2.27	9.83	0.77	1.37	1.10	0.20%	
Elbit Systems	ESLT	1.00%	55.92	51.22	-3.59%	-8.40%	2.19	10.65	0.81	2.30	1.13	0.70%	
Caci Intl	CACI	0.88%	61.11	63.83	18.64%	4.45%	1.92	14.15	0.54	1.50	1.24		
Moog Inc.	MOGA	0.87%	44.12	41.05	3.14%	-6.96%	1.86	12.83	0.83	1.55	1.42		
Viasat Inc	VSAT	0.84%	39.92	44.27	-0.32%	10.90%	1.85	23.80	2.28	2.18	5.03		
Sra International'a'	SRX	0.82%	30.99	30.95	51.34%	-0.13%	1.78	19.71	1.02	2.18	1.41		
Teledyne Technologies	TDY	0.81%	50.49	49.10	11.67%	-2.75%	1.80	13.60	1.04	2.11	2.27		
Mantech International'a'	MANT	0.75%	43.89	45.02	8.93%	2.57%	1.65	11.47	0.60	1.61	1.46	1.90%	
Cubic Corp	CUB	0.62%	54.08	51.24	8.67%	-5.25%	1.37	16.06	1.03	2.59	1.93	0.40%	
Digital Globe	DGI	0.51%	29.00	24.62	-22.36%	-15.10%	1.14	28.3	3.51	2.26	9.37		
Ceradyne Inc	CRDN	0.50%	46.82	44.76	41.96%	-4.40%	1.11	13.32	2.48	1.59	0.90		
Orbital Sciences Corp	ORB	0.49%	18.83	18.81	9.81%	-0.11%	1.10	16.50	0.82	1.85	1.85		
AAR Corp	AIR	0.48%	26.04	26.39	-3.93%	1.34%	1.01	12.16	0.59	1.24	1.23	0.01	
L-1 Identity Solutions	ID	0.47%	11.73	11.12	-6.63%	-5.20%	1.01	65.41	2.25	1.38	56.20		
American Science & Engineering	ASEI	0.36%	88.10	86.53	1.53%	-1.78%	0.79	17.55	2.82	2.95	1.48	1.40%	
Osi Systems	OSIS	0.35%	38.39	39.98	9.96%	4.14%	0.76	17.85	1.17	2.08	1.31		
Comtech	CMTL	0.34%	28.30	27.79	0.11%	-1.80%	0.74	25.26	0.91	1.09	0.38	3.60%	
GeoEye	GEOY	0.34%	37.09	33.17	-21.75%	-10.57%	0.74	13.59	2.22	1.63	0.98		
AeroVironment	AVAV	0.30%	28.65	30.19	12.52%	5.38%	0.65	24.15	2.24	2.63	1.35		
Mercury Computer Sys	MRCY	0.25%	19.31	19.12	4.03%	-0.98%	0.58	26.93	2.44	1.76	2.02		
EMS Tech	ELMG	0.19%	25.26	26.09	31.90%	3.29%	0.40	18.64	1.08	1.47	1.07		
Gencorp	GY	0.17%	6.53	6.28	21.47%	-3.83%	0.37	13.36	0.40				
Force Protection	FRPT	0.15%	4.49	4.84	-12.16%	7.80%	0.34	10.52	0.52	1.06	1.36		
NCI Information Technology	NCIT	0.14%	24.61	22.70	-1.26%	-7.76%	0.31	11.64	0.49	1.91	0.91		
Kratos Defense & Security	KTOS	0.13%	13.67	12.14	-7.82%	-11.19%	0.30	26.98	0.62	1.25	-1.73		
KEY W Holding	KEYW	0.13%	11.19	11.28	-23.11%	0.80%	0.29	18.80	2.23	1.59	1.64		
TASER International Inc.	TASR	0.13%	4.46	4.53	-3.62%	1.57%	0.27	34.85	3.27	2.51	3.07		
LMI Aerospace	LMIA	0.11%	20.05	21.34	33.46%	6.43%	0.25	11.41	1.09	1.58	1.18		
Integral Systems	ISYS	0.10%	12.49	11.87	19.78%	-4.96%	0.21		1.07	1.87	29.58		
Ducommun	DCO	0.09%	22.75	19.63	-9.87%	-13.71%	0.21	8.25	0.50	0.79	0.89	1.60%	