

**Commentary**

**Thoughts on Where the Aerospace & Defense Sector is Headed**

Investors have been getting plenty of mixed signals over the past months with bulls and bears debating endlessly. The defense and aerospace sector is no different. On one side are the bears highlighting that the Department of Defense budget has peaked and at best we will see flat budgets. On the other side are analysts that comment, "While there are great concerns about the Obama administration's views toward military spending, many external threats seem unlikely to dissipate in the coming decade, meaning that the aerospace and defense sector may be one of the most stable American industries."

So what do I think?

\* Changes in the defense sector will impact different companies in different ways. The most recent 3Q09 quarterly earnings statements saw Lockheed Martin anticipate a difficult 2010 while Northrop Grumman saw strength in many areas.

\* There is a shift in strategy at the Department of Defense with large programs coming under increasing pressure. Related to this is the apparent philosophical

change at the agency where long-standing contracts and those awarded to the largest defense contractors are no longer safe. There is a willingness to give contracts to smaller and mid-size firms, foreign companies, or whoever is deemed the best for a particular job. As evidence is the recent switch of the KC-10 support after 10 years from Boeing to Northrop Grumman and recent wins by Oshkosh Truck over the incumbent BAE. Determining who will be the winners in this new environment will require added research.

\* The White House has stated several times that they are committed to resolving issues in Afghanistan and the region and firmly supports military action there. The anticipated troop build-up has not yet occurred but we can anticipate substantial funding in 2010 as the shift from Iraq takes place.

\* The last several months have seen share prices in many sector stocks react to news that has already been known. Although the flattening DoD budget and spending shifts from major programs have long been known, whenever companies bring this up, their share prices are affected even

*continued on page 2*

**SPADE Defense Index Statistics**

10/30/09 Close: 1749.86  
 All-time Close: 2747.67  
 Date of all-time close: 9 October 2007

	SPADE Defense	S&P500
October	[5.02%]	[1.98%]
YTD	9.74%	14.72%

**Inside Quarterly Earnings**

**A look at what some of the largest defense contractors stated in their third quarterly reporting...**

**General Dynamics** - Gains in defense-related sales led the company to increase full-year profit forecast. Weak demand for business jets at its Gulfstream division reduced profits in the quarter.

**L-3 Communications** - Earnings jumped nearly 20% on growing sales and tax benefits. The company saw strength in ISR and aircraft modernization and maintenance but a decline in government services.

**Textron** - Predicted that full-year earnings would be at the high-end of expectation while reporting a 98% drop in third-quarter profits. The firm estimated \$10.6 billion in sales and earnings of 63 cents. It expects deliveries of the Cessna aircraft and Bell helicopters will decline next year before recovering.

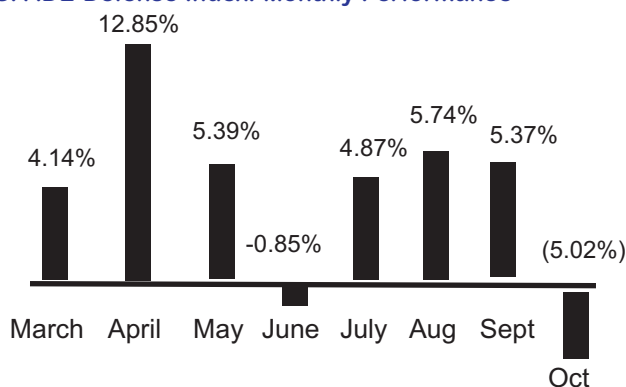
**Raytheon** - Beat Wall Street expectations, raised its outlook for 2009, and predicted another profitable year in 2010. Macquarie Securities Rob Stallard stated that the firm's third quarter results showed "Raytheon's diversified defense portfolio seems to be holding up relatively better than expected despite the numerous program cancellations.

**Northrop Grumman** - Reported higher revenues in all business segments and raised its full-year profit forecast despite a 4.3% decline in earnings due to pension costs. The firm reported a profit of \$490 M, vs. \$512 M in the same quarter last year. The firm is also shedding its TASC division with more than \$1 billion going to buy back shares.

**Lockheed Martin** - Net earnings were better than expected - \$2.07 per share vs. \$1.92 a year earlier and vs. \$1.83 expected by analysts. And although quarterly revenue rose roughly 5% to \$11.06 billion, the company warned that earnings would drop in 2010 with changes to several large DoD programs.

**Boeing** - Lost \$1.6 billion in the third quarter mostly due to charges associated with the development of the 787 and updated 747 jumbo jets. Sales associated with the firm's defense business and which accounts for about half of total revenues, helped to increase total revenues by 9% to \$16.69 billion.

**SPADE Defense Index: Monthly Performance**



**October 2009 Top Gainers**

1	Integral Systems	21.74%
2	VSE Corporation	12.25%
3	Harris Corp.	10.96%
4	Stanley Inc.	9.84%
5	ViaSat	9.67%
6	Mercury Computer	8.52%
7	Esterline Tech.	7.40%
8	OSI Systems	7.33%
9	Oshkosh Truck	1.07%
10	SAIC	0.97%

**October 2009 Laggards**

1	Garmin Ltd	[19.82%]
2	Force Protection	[19.41%]
3	EMS Technologies	[16.28%]
4	L-1 Identity	[15.45%]
5	Moog	[15.36%]
6	Ladish Co.	[14.34%]
7	Orbital Sciences	[13.96%]
8	TASER Int'l	[13.35%]
9	Herley Industries	[13.33%]
10	SRA Int'l	[13.11%]

**YTD 2009 Top Gainers**

1	Oshkosh Truck	251.63%
2	Mercury Computer	69.57%
3	Precision Castparts	60.61%
4	Garmin	57.85%
5	Goodrich Corp	46.81%
6	Computer Sciences	44.31%
7	OSI Systems	41.73%
8	GeoEye	31.93%
9	Elbit Systems	30.19%
10	Rockwell Collins	28.88%

**YTD 2009 Laggards**

1	Orbital Sciences	[34.05%]
2	EMS Technologies	[32.62%]
3	Moog Inc.	[31.72%]
4	Integral Systems	[30.29%]
5	Comtech	[29.90%]
6	Cogent	[28.89%]
7	Aerovironment	[27.57%]
8	Force Protection	[26.42%]
9	Teledyne Tech.	[23.32%]
10	TASER Int'l	[22.54%]

**Largest Defense Prime Contractors**

	October	2009
Lockheed Martin	[11.90%]	[18.19%]
Boeing	[11.73%]	12.02%
General Dynamics	[2.94%]	8.87%
Northrop Grumman	[3.13%]	11.30%
Raytheon	[5.61%]	[11.29%]

Year	SPADE	S&P500
09YTD	9.74%	14.72%
2008	<b>[38.03%]</b>	[38.49%]
2007	<b>22.17%</b>	3.53%
2006	<b>19.33%</b>	13.62%
2005	<b>5.30%</b>	3.00%
2004	<b>20.47%</b>	8.99%
2003	<b>37.27%</b>	26.38%
2002	<b>[2.87%]</b>	[23.37%]
2001	<b>0.94%</b>	[13.04%]
2000	<b>4.98%</b>	[10.14%]
1999	15.31%	19.53%
1998	6.63%	26.67%

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

Exchange / Ticker Symbol: NYSE / PPA  
 Fee 60 basis  
 Assets (10/30/09) \$120.4 M  
 Closing Price (10/30/09) \$ 15.49  
 Yield (12-month yield) 1.20%  
 October 09 Volume 1,191,700  
 3 month Avg Daily Trading Volume 59,252  
 Turnover 9%

source: Yahoo Finance

Avg. Market Cap.	9.53
Portfolio P/E	12.07
Portfolio P/S	0.65
Portfolio P/B	2.28
Portfolio P/Cash Flow	6.41
Earnings Growth Rate (ttm)	11.52

source: Yahoo! Finance (9/30/09)

**Powershares Aerospace & Defense ETF (NYSE: PPA)**

**Modern Portfolio Theory (vs the S&P500)**

Beta (3 month) 1.10  
 Alpha (3 month) 6.14  
 R-squared (3 month) 85.05

source: Yahoo! Finance (9/30/09)

**New ETFs in the Market**

Since the last newsletter, OOK Advisors launched ETFs designed to track the SPADE Oklahoma Index (NYSEarca: OOK) and the SPADE Texas Index (NYSEarca: TXF). Both indexes were created to provide a benchmark for companies headquartered in the state. Additional information can be found at <http://www.spadeindexes.com>

**Commentary (continued)**

though the impact of the news has already been priced in. Several rallies in the sector have been thwarted although nothing 'new' has really been said.

\* A successful test flight of the Boeing 787 by year's end will bring a close to the negative news surrounding the delays in its development; which for those that follow the sector know that schedule impacts on a major new system happen more regularly than not. Even with the delays, backlog for this plane remains very strong and only a few order cancellations have been placed. The shift from development to manufacturing will reduce the capital required for R&D and lead to increased profits at Boeing and throughout the aerospace supplier base.

\* The Defense 2010 Quadrennial Defense Review will shift spending in a number of areas but should not impact what the total budget is. The Administration and the Pentagon has stated (and we believe them until they change their position) that spending on defense will remain consistent with current levels.

\* Large companies have lagged the index and the broader markets for most of 2009. A reversion to the mean should lead to further upside potential for the index.

\* There are a number of new and evolving programs and markets that will benefit companies over the next several years with cybersecurity and unmanned vehicles to name but two. In addition, several multi-billion programs recently cancelled are expected to see new life in the next few years. According to Air Force Secretary Michael Donley, the Air Force will seek R&D funds for the Long Range Strike Aircraft and will restart the initiative after more analytical work is done on what the requirements of the plane will be. In addition, in 'one or two years', there is money in the out-year budgets to begin a new, less ambitious effort for a search and rescue helicopter and replace the cancelled CSAR-X program.

**About**

The SPADE Defense Index (NYSEarca: 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**

Licensed to Powershares, their 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

**Contact Information**

SPADE Indexes  
 1725 'I' Street, NW, Suite 300  
 Washington, DC 20006  
 Tel: (202) 349-3917  
 info@spadeindex.com  
 http://www.spadeindex.com  
 Scott Sacknoff: Index Manager

**Legal & Disclaimers**

© 2009 ISBC -- SPADE, the SPADE icon, and "The SPADE Investor" newsletter are registered trademarks of the ISBC. The ISBC is the owner of the trademark, service marks, and copyrights related to its indices. This newsletter does not constitute an offer of an investment product. The ISBC makes no representation regarding the advisability of investing in vehicles based on the SPADE Defense Index. All information is provided 'as is' for informational purposes only and is not intended for trading purposes or advice. Neither the ISBC nor any related party is liable for any informational error, incompleteness or for any actions taken based on information contained herein.

**Contracts**

**\$4 Billion** - NASA plans to open a competition for a series of service contracts including five projects to consolidate the agency's IT and data services. - *Washington Technology*

**\$3.8 Billion** - Northrop Grumman was awarded a \$3.8 billion contract for logistics support to the USAF KC-10 aerial tanker fleet, ousting Boeing which has held the contract since 1998.

**\$800 Million** - Lockheed Martin and Computer Sciences were 2 of 4 companies that applied its defense skillset to capture part of the Health and Human Services IT services contract.

**\$500 Million** - Computer Sciences Corp. won a Transportation Safety Administration contract held by incumbent Unisys since TSA formed in 2002. - *Washington Technology*

**\$400 Million** - Pentagon contract to Oshkosh to deliver 923 all-terrain trucks for use in Afghanistan. Delivery is expected by March.

**\$355 Million** - Stimulus funds guaranteed for six airport security projects with about \$254 million going toward inline baggage screen systems; about 60% going to Washington Dulles.

**\$22 Million** - from the Department of Homeland Security to General Dynamics for the development of secure ID cards for immigrants seeking U.S. employment.

**Follow-on** - Homeland Security is considering a follow-on contract to a \$45 billion IT governmentwide acquisition contract that would eliminate functional categories and open competition across the board. - *Washington Technology*

**FY-2010 Budget**

Signed by President Obama on October 28th, the National Defense Authorization Act totals \$680.2 billion including \$170 billion for the wars in Iraq and Afghanistan. The QDR and 2011 budget is expected to continue to address persistent shortfalls and in-theater equipment needs such as rotary wing, lift, civil affairs, persistent ISR and the exploitation and dissemination; and intratheatre lift.

**News & Notes**

**27% Boost** - Cybersecurity efforts under the Department of Homeland Security spending bill approved by the Senate will receive \$397 million up from \$313 million in 2009. The controversial Real ID program will see its budget reduced to \$60 million from \$100 million.

**A \$40 Billion Market** - *Aerospace Daily & Defense Report* stated that several recent studies have pegged global military demand for UAVs at \$16 billion to \$18 billion over the next 10 years with an additional \$20 billion in R&D spending. More than 60% will be from U.S. companies.

Honeywell Aerospace's 18th annual **Business Aviation Outlook**, based on interviews conducted in 2Q09 and 3Q09 with more than 1200 corporate flight departments worldwide, anticipates 700 business jet deliveries in 2009, a decline of nearly 50% in 2008 but that 11,000 new jets worth \$200 billion will be delivered between 2009 and 2019, ramping up as the decade progresses.

Boeing, Lockheed Martin, and Raytheon are making a *push into smart grid and renewable energy -- a potential \$20 billion market*. According to Boeing's defense chief Dennis Mullenberg, experience in networking and integration expertise in missile defense Army combat systems could be applied to adjacent markets. Lockheed Martin is already working with several utilities on various smart grid initiatives.

A forecast released October 20th by the industry group TechAmerica predicted that government IT spending will grow at an average rate of 3.1% per year between 2010 and 2015, **rising from \$78 billion to \$91 billion**.

**Analyst Comments**

With core defense spending expected to slow, U.S. defense contractors need to identify additional revenue sources for the coming years. 2009/10 holds potential for interesting M&A activity, mostly smaller deals by larger firms to fill in capability gaps--particularly in the security, defense electronics, and aftermarket service business areas. U.S. defense firms may see opportunities in credit-squeezed markets to pick up U.S. assets at historically low price-to-earnings multiples.

Some large companies are expanding into the adjacent markets of mission support and services, such as performance-based logistics, which can provide more consistent -- albeit riskier though perhaps more profitable -- revenue stream.

Companies are also leveraging strong balance sheets to grow organically and acquire new services business. Shifting defense priorities could prove to be a boon for some manufacturers.

Excerpted from Zack's Equity Research 4 Nov 09

Nov-09		SPADEF Defense Index					Market	Forward	Price/	Price/	PEG	
Company	Ticker	Float %	Price	Price	% Ch	% Ch	Cap	P/E	Sales	Book	5 yr	Div Yld
			30-Sep-09	30-Oct-09	YTD	MTD	intraday	(ttm)	ttm	mrq	expected	forward %
United Technologies	UTX	6.88%	60.93	61.45	14.65%	0.85%	57.61	13.60	1.14	3.22	1.61	2.40%
Boeing Co	BA	6.39%	54.15	47.80	12.02%	-11.73%	33.35	10.89	0.54		4.78	3.40%
Honeywell Intl	HON	6.15%	37.15	35.89	9.32%	-3.39%	27.39	13.80	0.90	2.99	1.55	3.30%
Lockheed Martin	LMT	6.02%	78.08	68.79	-18.19%	-11.90%	26.00	9.35	0.60	8.37	0.85	3.60%
General Dynamics	GD	5.50%	64.60	62.70	8.87%	-2.94%	24.15	9.65	0.78	2.23	1.24	2.40%
Northrop Grumman	NOC	4.58%	51.75	50.13	11.30%	-3.13%	15.73	9.05	0.45	1.28	0.85	3.40%
Precision Castparts	PCP	4.44%	101.87	95.53	60.61%	-6.22%	13.40	12.47	2.33	2.63	0.95	0.10%
Raytheon Co	RTN	4.43%	47.97	45.28	-11.29%	-5.61%	17.35	9.11	0.72	1.84	0.89	2.70%
Rockwell Collins	COL	4.19%	50.80	50.38	28.88%	-0.83%	7.94	14.39	1.78	4.69	0.96	1.90%
Itt Indus	ITT	4.08%	52.15	50.70	10.24%	-2.78%	9.18	13.17	0.88	2.85	2.01	1.60%
Computer Sciences	CSC	4.06%	52.71	50.71	44.31%	-3.79%	7.69	10.02	0.48	1.30	1.19	
L-3 Communications Hldgs	LLL	3.79%	80.32	72.29	-2.02%	-10.00%	8.41	9.02	0.56	1.36	1.06	1.90%
SAIC	SAI	3.72%	17.54	17.71	-9.09%	0.97%	7.04	12.65	0.69	3.39	1.13	
Goodrich Corp	GR	3.56%	54.34	54.35	46.81%	0.02%	6.76	12.32	1.03	2.40	1.44	1.90%
Garmin Ltd	GRMN	3.20%	37.74	30.26	57.85%	-19.82%	6.07	12.56	2.05	2.51	1.09	2.40%
Harris Corp	HRS	2.89%	37.60	41.72	9.65%	10.96%	5.50	10.33	1.11	2.90	1.08	2.10%
Textron	TXT	2.54%	18.98	17.78	28.19%	-6.32%	4.95	20.92	0.46	1.79	17.64	0.40%
Ball Corp	BLL	2.45%	49.20	49.33	18.61%	0.26%	4.64	11.31	0.65	3.63	1.85	0.80%
Flir Systems	FLIR	2.22%	27.97	27.81	-9.35%	-0.57%	4.22	18.06	3.81	3.84	1.14	
URS Corporation	URS	1.73%	43.65	38.86	-4.68%	-10.97%	3.28	11.96	0.33	0.86	1.20	
Oshkosh Truck	OSK	1.48%	30.93	31.26	251.63%	1.07%	2.33	9.77	0.40	24.29		
Ebit Systems	ESLT	1.35%	68.15	60.51	30.19%	-11.21%						2.13%
Alliant Techsystems	ATK	1.35%	77.85	77.78	-9.31%	-0.09%	2.56	8.59	0.55	3.39	0.87	
Trimble Navigation Ltd	TRMB	1.33%	23.91	20.97	-2.96%	-12.30%	2.52	16.13	2.32	2.07	1.13	
Mantech International'a'	MANT	0.83%	47.10	43.86	-19.06%	-6.88%	1.56	13.09	0.82	2.15	1.00	
Caci Intl	CACI	0.75%	47.27	47.62	5.61%	0.74%	1.43	12.77	0.52	1.42	1.09	
Esterline Technologies	ESL	0.66%	39.21	42.11	11.14%	7.40%	1.25	11.96	0.87	1.01	1.02	
Teledyne Technologies	TDY	0.65%	35.99	34.16	-23.32%	-5.08%	1.25	10.91	0.72	2.12	1.82	
Moog Inc.	MOGA	0.59%	29.50	24.97	-31.72%	-15.36%	1.06	10.76	0.62	1.07	1.34	
Sra International'a'	SRX	0.56%	21.59	18.76	8.75%	-13.11%	1.06	14.00	0.71	1.46	1.21	
Digital Globe	DGI	0.53%	22.37	22.33	-2.91%	-0.18%	1	27.23	3.67	2.27	1.60	
DynCorp	DCP	0.50%	18.00	17.00	12.06%	-5.56%	0.95	9.44	0.30	1.86	0.83	
Cubic Corp	CUB	0.49%	39.47	34.71	27.61%	-12.06%	0.93	14.90	0.98	2.25	1.45	0.50%
Viasat Inc	VSAT	0.49%	26.58	29.15	21.05%	9.67%	0.92	15.42	1.47	1.95	1.31	
Comtech	CTL	0.48%	33.22	32.12	-29.90%	-3.31%	0.91	14.15	1.59	1.48	0.60	
Cogent Inc.	COGT	0.46%	10.10	9.65	-28.89%	-4.46%	0.87	18.21	6.26	1.60	1.72	
Triumph Group	TGI	0.41%	47.99	46.81	10.24%	-2.46%	0.78	9.88	0.65	0.95	0.97	0.30%
AAR Corp	AIR	0.40%	21.94	19.61	6.52%	-10.62%	0.75	10.54	0.55	1.09	1.14	
Orbital Sciences Corp	ORB	0.38%	14.97	12.88	-34.05%	-13.96%	0.73	17.17	0.63	1.47	1.36	
Stanley Inc.	SXE	0.36%	25.72	28.25	-17.42%	9.84%	0.68	14.79	0.76	2.66	0.98	
American Science & Engineering	ASEI	0.31%	68.04	66.12	-10.60%	-2.82%	0.59	18.95	2.53	3.10	1.18	1.20%
AeroVironment	AVAV	0.30%	28.09	26.66	-27.57%	-5.09%	0.57	18.91	2.55	2.88	1.10	
L-1 Identity Solutions	ID	0.28%	6.99	5.91	-12.31%	-15.45%	0.54	84.43	0.91	0.78	15.58	
GeoEye	GEOY	0.25%	26.80	25.37	31.93%	-5.34%	0.47	15.38	2.51	2.03	1.05	
Ceradyne Inc	CRDN	0.22%	18.33	16.12	-20.63%	-12.06%	0.41	21.78	0.96	0.66	2.67	
Argon St	STST	0.21%	19.05	18.60	-1.38%	-2.36%	0.40	15.12	1.10	1.29	1.17	
NCI Information Technology	NCIT	0.19%	28.66	26.91	-10.69%	-6.11%	0.36	15.47	0.86	3.23	1.08	
Osi Systems	OSIS	0.18%	18.29	19.63	41.73%	7.33%	0.35	13.63	0.61	1.25	0.85	
Force Protection	FRPT	0.16%	5.46	4.40	-26.42%	-19.41%	0.31	8.80	0.33	1.11	0.54	
EMS Tech	ELMG	0.14%	20.82	17.43	-32.62%	-16.28%	0.26	10.38	0.77	1.14	0.68	
Applied Signal Technology	APSG	0.14%	23.27	20.49	14.21%	-11.95%	0.27	17.36	1.42	2.05	1.01	2.40%
TASER International Inc.	TASR	0.13%	4.72	4.09	-22.54%	-13.35%	0.25	37.18	2.72	2.33		
Mercury Computer Sys	MRCY	0.13%	9.86	10.70	69.57%	8.52%	0.25	17.26	1.38	1.66	1.86	
VSE Corporation	VSEC	0.12%	39.01	43.79	11.62%	12.25%	0.22	10.18	0.20	2.56		0.50%
Ladish Co	LDSH	0.11%	15.13	12.96	-6.45%	-14.34%	0.21	15.25	0.51	0.98	3.18	
Ducommun	DCO	0.09%	18.91	17.02	1.92%	-9.99%	0.18	7.81	0.44	0.79	0.65	1.70%
Herley Industries	HRLY	0.08%	13.05	11.31	-7.90%	-13.33%	0.15	9.05	1.00	1.06	3.44	
Integral Systems	ISYS	0.08%	6.90	8.40	-30.29%	21.74%	0.15	24.00	0.89	1.28	2.86	

Data Provided by Yahoo Finance & Capital IQ, and Forward P/E by Thompson