



**2006 Returns (High to Low)**

DirecTV	76.63%
Garmin	67.78%
Ladish	65.91%
Precision Castparts	51.09%
Lockheed Martin	44.70%
Orbital Sciences	43.61%
Trimble Navigation	42.94%
FLIR Systems	42.54%
Essex	40.23%
Echostar Communications	39.92%
Teledyne Technologies	37.90%
Rockwell Collins	36.20%
Moog	34.57%
Mantech	32.20%
Raytheon	31.51%
General Dynamics	30.38%
Ceradyne	29.00%
Armor Holdings	28.60%
Boeing	26.48%
United Industrial	22.67%
Honeywell	21.45%
URS Corporation	13.93%
OSI Systems	13.81%
Northrop Grumman	12.63%
United Technologies	11.82%
Viasat	11.52%
Goodrich	10.83%
ITT Industries	10.52%
L-3 Communications	9.99%
Ball Corp.	9.77%
TASER International	9.34%
Cubic	8.72%
Oshkosh Truck	8.59%
KVH Industries	8.38%
Esterline Technologies	8.17%
Harris Corp.	6.63%
SI International	6.05%
DynCorp (YTD from IPO)	5.80%
Computer Sciences	5.39%
Alliant TechSystems	2.65%
DRS Technologies	2.45%
CACI	<1.53>
Herley Industries	<1.94>
American Science & Eng.	<4.59>
Andrew Corp.	<4.66>
EDO Corp	<12.27>
SRA International	<12.44>
MTC Technologies	<13.99>
L-1 Identity Solutions	<14.08>
GenCorp	<21.01>
SafeNet	<25.70>
Argon ST	<30.47>
Mercury Computer	<35.24>
Applied Signal Technology	<38.06>
XM Satellite	<47.03>
Sirius Satellite	<47.16>
Cogent	<51.46>

**Index and Industry Statistics**

**ETF Statistics (AMEX: PPA)**

**Powershares Aerospace & Defense**  
 Exchange / Ticker Symbol: AMEX / PPA  
 Fee 60 basis  
 Assets (12/31/06) \$109.4 M  
 Closing Price 12/29/06 \$18.57 (up \$0.41)  
 Trading Volume (Dec 06) 936.400

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

Average Portfolio Market Cap*	\$12.61 Billion
Portfolio P/E*	18.80
Portfolio P/S*	1.22
Portfolio P/B*	2.87
Portfolio P/Cash Flow*	9.50
Earnings Growth Rate (ttm)*	14.15%
3 month Avg Daily Trading Volume	84,400

source: Yahoo! Finance - ETF Center \* 2Jan07

**2006 (continued)**

defense spending. This did not happen and by mid-January, with word leaking out that the budget would come in higher than forecast and companies reporting better than forecast quarterly earnings and sales, the sector began a four-month, double digit run-up that ended only with the decline in world markets in mid-May. Along with energy and international stocks, the SPADE Defense Index declined more than 10% before rebounding and recapturing all of the losses before the summer was over and reaching new all-time highs.

Late in the year, politics took over as questions arose as to the effect of a Democratic-controlled Congress. This too proved a small bump in the road as analysts and investors realized that the importance of the 2008 Presidential election would keep Congress in check.

The year ended with the Index at all-time-highs as analysts discussed another \$100 billion supplemental budget to cover war-related costs.

**2007 (continued)**

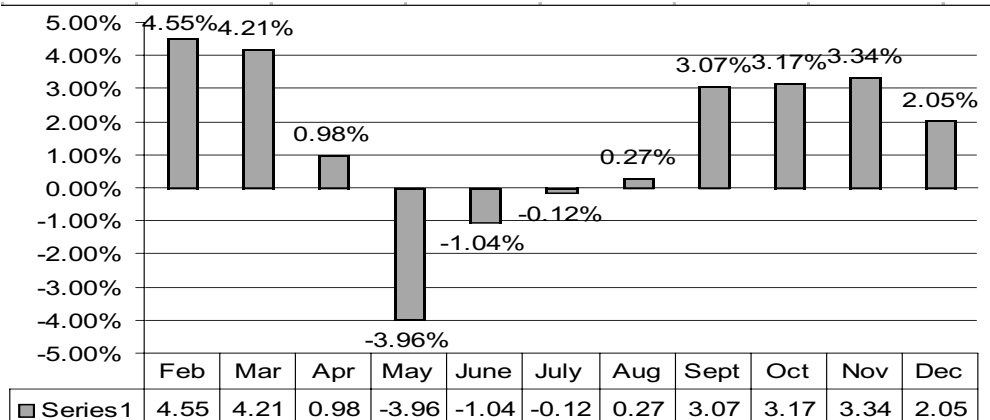
technology and biometrics/homeland security firms which were both out-of-favor in 2006. With large cap stocks doing so well in 2006, a return to mid and small-cap firms may be what's in store for 2007. It is also likely that the ETF that tracks our Index will see steady inflows as professional money managers use it to preserve 2006 gains from investments in individual companies as well as for the diversification it provides with smaller companies.

Specifically, some reasons why the run may still has some strength left in it.

1. A supplemental budget request of nearly \$100 billion on top of a \$21 billion increase for the DoD as part of the FY-2007 budget.
2. The politics of the 2008 Presidential election dictate that the Democratic leadership in Congress will support defense and homeland security initiatives
3. Defense and government service companies are flush with cash (\$7B and \$40B in borrowing capacity) and buying power and one can expect acquisitions to position their companies and meet Wall Street expectations.
4. With regards to national security, the world has become different and in the years following 9-11, those in western nations and the United States would be hard to argue against the increased visibility that defense and homeland security receive.
5. In the past, the cycle of defense build-ups can last 10-15 years as new technologies and systems were developed to meet emerging or evolving threats.

(continued on page 3)

**2006 Month-by-Month Performance of the SPADE Defense Index**



Year	SPADE	S&P500
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
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%

### Supplemental Budget Expectations...

Don't be surprised if the previously quoted supplemental approvals come in slightly below what has previously been quoted. The 17-page outline of the Pentagon's request for supplemental funds totalled \$99.7 billion. This is in addition to the \$70 billion Congress added to the 2007 defense budget for fighting the wars in Iraq and Afghanistan. This figure also contains a number of requests for RDT&E and training funds that some in Congress think may be out-of-place in a supplemental wartime spending bill. The only constant is that while the original \$110 billion estimate could officially end up \$100 billion (current proposal) or slightly less, it will still add significant revenues to the sector.

### 2007 (continued)

6. The conclusion of efforts in Iraq will not usher in an era of peace with the accompanying dividend experienced after prior conflicts. The likelihood of continued Congressional spending on defense and to secure our borders is likely to remain high through the beginning of the next decade.

Overall, it is widely believed that while short-term dips will appear from time-to-time as investors adjust to economic and financial issues but long-term, the sector appears to be stable and sound.

### 2007 Forecast - Aerospace Industry Sales

	2003	2004	2005	2006P	2007E
Civil Aircraft	\$32.4	\$32.5	\$39.2	\$47.5	\$54.6
Related Products	\$24.4	\$26.0	\$28.3	\$30.7	\$32.2
Space	\$35.9	\$35.9	\$37.3	\$38.6	\$39.4
Military Aircraft	\$40.4	\$46.6	\$50.0	\$52.8	\$53.5
Missiles	\$13.5	\$14.7	\$15.3	\$14.9	\$15.8
TOTAL	\$144.5	\$155.7	\$170.1	\$184.4	\$195.4

Source: Aerospace Industries Association  
Then-year dollars, not adjusted for inflation  
(AIA definition of market)

### Homeland Security Market

	2006
U.S. Federal	\$18.2B
U.S. State and Local	\$3.5B
U.S. Private Sector	\$9.3B
Total U.S.	\$31.0B
Total Rest of World	\$24.6B

The homeland security market has grown by 29% to \$55 billion in the last two years.

source: Civitas

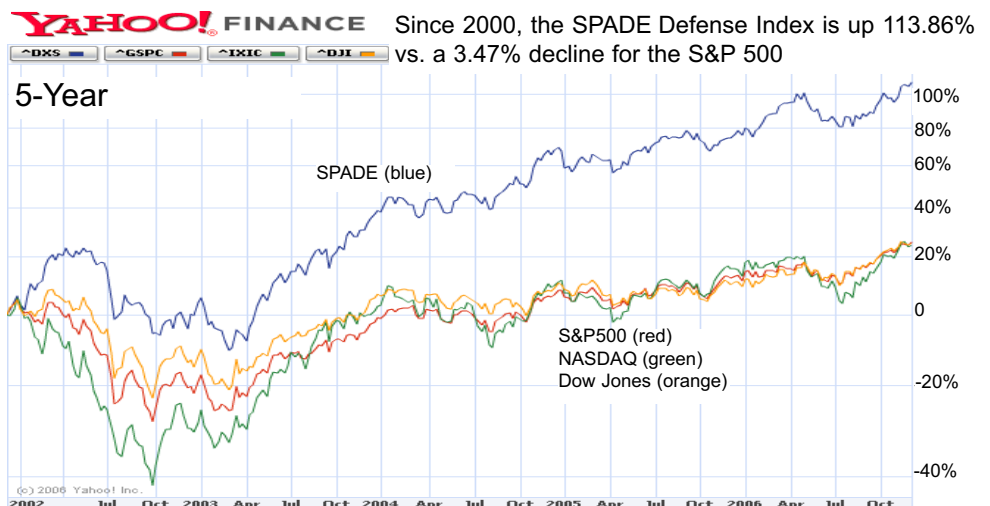
### Supplemental Funding is Not Something New

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Budget	273.2	295.5	315.7	344.8	382.7	400.5	420.0	441.5	442.8	464.0
Supplemental	19.1	8.6	19.8	17.3	72.6	65.3	75.9	65.8	60+	110+
Total	292.3	304.1	335.1	362.1	455.3	465.8	520.9	557.3	572.8+	

Source: OMB / Defense News (Dec 06)

### About the Chart to the Right

Five-year returns by the Dow 30, S&P500 and NASDAQ have all converged to a return of slightly more than 20%...whereas the SPADE Defense Index was up in excess of 100%!



If you didn't receive an email alert that the latest newsletter is available and want to get on our list. Email us at: info@spadeindex.com

**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**

ETF options are traded by the American Stock Exchange using the underlying symbol.

**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](http://www.spadeindex.com)

- \* Market Cap: Minimum \$100M
- \* Share Price: Minimum \$5.00
- \* Liquidity: 50,000 avg daily trading

**Contact Information**

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

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**Analyst Corner**

*What the analysts and the financial media are saying...*

**CNBC**

**Defense - One of their "Seven Investments for '07"**



**(Scott Sacknoff, Manger, SPADE Defense Index is on the upper left)**

**NY Times (26 Dec 06)**

**"Defense Stocks Likely to Outperform in 2007"**

"...these are very good times for military contractors. Few in the military industry are worried by the recent Democratic Congress victory: The Pentagon's 2007 budget is expected to exceed \$560b, and in the spring, President Bush has indicated that he will ask for another \$100b for Iraq and Afghanistan. No one expects the Democrats to make major changes in the last two years of the Bush Administration, especially with the war continuing: Democrats are sensitive to being seen as "soft" on defense, and are more likely to use the term to establish their military qualifications in advance of the 2008 presidential elections"

*...Exactly what we told SPADE Investor readers in November nearly two months ago*

**Department of Homeland Security 2007 - Top Six Priorities**

1. Control of U.S. borders (includes initiatives such as Secure Border Initiative, US-VISIT, biometric technology, and improving internal enforcement of immigration laws.
2. Defending the country against weapons of mass destruction and new detection technologies
3. Strengthen screening of travelers and workers
4. Securing critical infrastructure systems (including rail and chemicals)
5. Build a nimble, efficient, and effective emergency response system
6. Encourage national culture of preparedness

**Merrill Lynch**

**"10 Themes Appropriate for the Next 10 months"**

A global arms buildup appears to be under way as defense spending continues to rise around the world, fueled by economic and political tensions and the increased threat of terrorism. As we see it, those tensions and the related buildup in military spending aren't going to fade any time soon.

At the same time, many developed nations, including the U.S., are rebuilding their traditional defensive capabilities in order to respond to a variety of emerging threats. Solid economic growth and the surge in global commodity prices not only have exacerbated those tensions but also have provided the liquidity necessary for a number of countries to fund arms buildups of their own. In the past five years alone, global military spending has surged by 25%, led by US and its efforts in Iraq & Afghanistan. While the pace may not accelerate meaningfully during the next ten years, all indications suggest that spending will continue to grow.

**Investor's Business Daily**

"...with global tensions high...where else would you want to be?" (7 Dec 06)

**Homeland Security Market**

U.S. Homeland Security Missions and Market Opportunities, 2006-10	
Intelligence	21%
Law Enforcement & Counterterrorism	17%
Aviation Security	7%
Port Security	6%
Ground Transportation Security	2%
Border Security	6%
Physical Security	8%
Cyber Security	8%
Emergency Preparedness & Response	10%
Bioterrorism & Chemical Agent Prevention	12%
Nuclear, Radiological Prevention	2%

*source: Civitas*

December 2006 Close		SPADEFENSE Index						Market		Forward		Price/		Price/			
Company	Ticker	Float %	Price	Price	Price	% Ch	% Ch	Cap	P/E	Sales	Book			Div Yld			
		approx.	31-Dec-05	30-Nov06 CL	29Dec CL	YTD	MTD	intraday	(ttm, intraday)	ttm	mrq			forward %			
United Technologies	UTX	6.77%	55.91	64.53	62.52	11.82%	-3.11%	62.75	15.03	1.36	3.25			1.70%			
Boeing Co	BA	6.59%	70.24	88.53	88.84	26.48%	0.35%	70.25	18.74	1.19	6.39			1.60%			
Lockheed Martin	LMT	6.56%	63.63	90.45	92.07	44.70%	1.79%	39.03	15.71	1.00	4.82			1.50%			
Honeywell Intl	HON	5.98%	37.25	42.98	45.24	21.45%	5.26%	36.94	15.44	1.22	3.28			2.00%			
Genl Dynamics	GD*	5.21%	114.05	74.84	74.35	30.38%	-0.65%	30.09	15.65	1.28	3.20			1.20%			
Directv Group	DTV	4.76%	14.12	22.75	24.94	76.63%	9.63%	30.52	18.61	2.15	4.89						
Northrop Grumman	NOC	4.49%	60.11	66.93	67.70	12.63%	1.15%	23.38	13.99	0.78	1.36			1.80%			
Raytheon Co	RTN	4.25%	40.15	51.04	52.80	31.51%	3.45%	23.48	17.78	1.04	2.08			1.80%			
Echostar Communications'a'	DISH	4.14%	27.18	36.01	38.03	39.92%	5.61%	16.92	19.70	1.80							
Rockwell Collins	COL	4.11%	46.47	60.33	63.29	36.20%	4.91%	10.58	17.88	2.76	8.85			1.00%			
Itt Indus	ITT*	4.10%	102.82	53.95	56.82	10.52%	5.32%	10.49	16.81	1.31	3.32			0.80%			
Precision Castparts	PCP	4.01%	51.81	75.46	78.28	51.09%	3.74%	10.62	16.24	2.54	4.39			0.20%			
L-3 Communications Hldgs	LLL	3.97%	74.35	82.25	81.78	9.99%	-0.57%	10.22	14.60	0.85	2.02			0.90%			
Garmin Ltd	GRMN*	3.72%	66.35	50.89	55.66	67.78%	9.37%	12.01	23.49	8.19	9.01			0.90%			
Computer Sciences	CSC	3.48%	50.64	52.20	53.37	5.39%	2.24%	9.18	12.65	0.63	1.52						
Harris Corp	HRS	2.71%	43.01	42.11	45.86	6.63%	8.91%	6.15	14.89	1.71	3.57			1.00%			
Goodrich Corp	GR	2.30%	41.10	45.00	45.55	10.83%	1.22%	5.68	14.89	0.99	2.72			1.80%			
Sirius Satellite Radio	SIRI	2.28%	6.70	4.26	3.54	-47.16%	-16.90%	4.98		9.53							
Ball Corp	BLL	1.87%	39.72	42.76	43.60	9.77%	1.96%	4.54	13.33	0.72	4.06			0.90%			
Xm Satellite Radio Holdings'a'	XMSR	1.82%	27.28	14.44	14.45	-47.03%	0.07%	3.88		4.57							
Oshkosh Truck	OSK	1.45%	44.59	48.01	48.42	8.59%	0.85%	3.57	10.60	1.04	3.35			0.80%			
Trimble Navigation Ltd	TRMB	1.21%	35.49	47.97	50.73	42.94%	5.75%	2.82	22.15	3.24	4.07						
Alliant Techsystems	ATK	1.05%	76.17	77.31	78.19	2.65%	1.14%	2.57	13.37	0.77	5.10						
Drs Technologies	DRS	0.88%	51.42	49.69	52.68	2.45%	6.02%	2.12	15.96	0.89	1.50			0.20%			
URS Corporation	URS	0.85%	37.61	44.16	42.85	13.93%	-2.97%	2.22	16.80	0.53	1.52						
Armor Holdings	AH	0.85%	42.65	56.55	54.85	28.60%	-3.01%	1.95	10.82	0.97	2.40						
Flir Systems	FLIR	0.84%	22.33	32.21	31.83	42.54%	-1.18%	2.09	21.08	3.89	6.07						
Caci Intl	CAI	0.68%	57.38	59.84	56.50	-1.53%	-5.58%	1.73	16.77	0.97	2.26						
Moog Inc.	MOGA	0.63%	28.38	36.58	38.19	34.57%	4.40%	1.62	14.86	1.25	2.13						
Sra International'a'	SRX	0.62%	30.54	29.18	26.74	-12.44%	-8.36%	1.5	19.10	1.24	2.69						
SAIC (Added Dec 06)	SAI	0.61%			17.79			7.28	20.64	0.91	5.11						
Ceradyne Inc	CRDN	0.58%	43.8	52.77	56.50	29.00%	7.07%	1.53	11.82	2.60	4.35						
Teledyne Technologies	TDY	0.55%	29.1	40.20	40.13	37.90%	-0.17%	1.39	17.00	1.03	3.38						
Mantech International'a'	MANT	0.50%	27.86	36.28	36.83	32.20%	1.52%	1.24	20.24	1.14	2.92						
L-1 Identify Solutions	ID	0.46%	17.61	16.76	15.13	-14.08%	-9.73%	1.09	137.55	10.66	0.70						
Orbital Sciences Corp	ORB	0.43%	12.84	18.12	18.44	43.61%	1.77%	1.13	23.95	1.44	2.64						
Cogent Inc.	COGT	0.41%	22.68	11.33	11.01	-51.46%	-2.82%	1.04	22.47	10.00	2.21						
Esterline Technologies	ESL	0.40%	37.19	38.94	40.23	8.17%	3.31%	1.02	13.15	1.06	1.45						
DynCorp* (YTD from IPO 10July06)	DCP	0.37%	15	13.10	15.87	5.80%	21.15%	0.91	13.92	0.44	2.67						
Viasat Inc	VSAT	0.35%	26.73	26.63	29.81	11.52%	11.94%	0.85	19.87	1.75	2.86						
Gencorp	GY	0.31%	17.75	13.81	14.02	-21.01%	1.52%	0.78		1.19							
SafeNet Inc.	SFNT	0.27%	32.22	23.31	23.94	-25.70%	2.70%	0.51	18.14	1.80	0.96						
Cubic Corp	CUB	0.22%	19.96	22.20	21.70	8.72%	-2.25%	0.58	16.95	0.72	1.83			0.80%			
United Industrial	UIC	0.22%	41.37	48.89	50.75	22.67%	3.80%	0.57	16.53	0.97	11.67			0.80%			
American Science & Engineering	ASEI	0.21%	62.37	63.44	59.51	-4.59%	-6.19%	0.54	21.03	4.01	3.76						
Essex Corp.	KEYW	0.21%	17.05	23.81	23.91	40.23%	0.42%	0.52	33.68	2.22	3.38						
TASER International Inc.	TASR	0.20%	6.96	8.48	7.61	9.34%	-10.26%	0.47	29.27	7.92	5.00						
Ladish Co	LDSH	0.20%	22.35	33.74	37.08	65.91%	9.90%	0.53	15.07	1.49	3.57						
Edo Corp	EDO	0.20%	27.06	21.93	23.74	-12.27%	8.25%	0.5	14.56	0.76	1.91			0.50%			
Argon St	STST	0.19%	30.98	22.67	21.54	-30.47%	-4.98%	0.48	18.10	1.84	1.79						
Si International	SINT	0.17%	30.57	34.43	32.42	6.05%	-5.84%	0.42	17.62	0.92	1.82						
MTC Technologies Inc.	MTCT	0.14%	27.38	26.08	23.55	-13.99%	-9.70%	0.36	17.07	0.91	2.05						
Osi Systems	OSIS	0.14%	18.39	18.99	20.93	13.81%	10.22%	0.35	34.31	0.75	1.44						
Stanley (Added Dec 06)	SXE	0.13%			16.91			0.34	18.47	0.97	4.74						
Mercury Computer Sys	MRCY	0.11%	20.63	13.08	13.36	-35.24%	2.14%	0.29	16.49	1.35	1.53						
Herley Industries	HRLY	0.09%	16.51	16.14	16.19	-1.94%	0.31%	0.22	17.99	1.33	1.17						
Applied Signal Technology	APSG	0.07%	22.7	15.84	14.06	-38.06%	-11.24%	0.17	22.32	1.03	1.59			3.60%			
Kvh Industries	KVHI	0.06%	9.79	11.50	10.61	8.38%	-7.74%	0.16	21.65	2.03	2.09						