



Defense Stocks: A Smart Bet in an Uncertain World

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U.S. Strategic Shift Away from NATO

Trump's return to the White House has intensified European concerns. His pivot toward Russia in the Ukraine war, the U.S. territorial threats toward NATO members Canada and Denmark, have raised questions about the intent of the U.S. and its approach to international relationships.

At the 2025 Munich Security Conference, U.S. Vice President JD Vance made it clear that Europe must take greater responsibility for its own defense, raising concerns about NATO's long-term viability¹. This change in stance underscores the growing uncertainty surrounding the alliance's future and whether the United States remains committed to defending its European allies.

Article 5: The Backbone of NATO Under Strain

Article 5 of the NATO treaty is the foundation of the alliance, which states that an attack on one member is considered an attack on all, obligating allies to take necessary measures, including military force, to defend the affected nation². However, President Donald Trump's rhetoric and actions have cast doubt on America's unwavering commitment to this principle.

For nearly 80 years, NATO has been the pillar of Western security, but Trump's actions have significantly weakened the confidence of allies, leaving many to wonder whether the U.S. remains truly committed to Article 5. While NATO still exists on paper, its fundamental principle, which is collective defense, may no longer be as solid as it once was.

The Urgent Push for European Defense Autonomy

Following the Cold War, European defense spending has been insufficient and the beginning of the war in Ukraine, have exposed severe deficiencies in military infrastructure and ammunition stockpiles.

European leaders increasingly recognize that relying on Washington for security is no longer a viable long-

term strategy. Calls for Europe to achieve independence from U.S. military support have grown louder, with efforts focused on increasing defense spending, strengthening military readiness, and continuing support for Ukraine. A major topic of discussion is the development of a European nuclear deterrent, one that would exist outside of U.S. control to ensure Europe's security regardless of Washington's stance.

Growing Investment and Strategic Commitment to European Defense

The European Union is making an unprecedented commitment to defense spending, with up to €800 billion set to be invested over the next four years under Ursula von der Leyen's ReArm Europe proposal³. This investment aims to strengthen Europe's defense industrial base, improve military capabilities, and ensure strategic autonomy. A major concern has been Europe's fragmented defense industry, which struggles to produce equipment at the necessary scale and speed. By centralizing procurement through a European Military Sales Mechanism and securing multi-year orders, European defense companies will gain stability and the ability to ramp up production. This move will also keep high-value jobs, research, and innovation within Europe, rather than outsourcing defense needs to non-EU countries.

European leaders emphasize the need to act swiftly, and the EU's investment plan prioritizes essential capabilities such as air and missile defense, artillery, ammunition, drones, and cybersecurity. With political backing from EU leaders, these initiatives align with the broader goal of achieving a strong European defense posture by 2030.

German Defense Stocks Poised for Growth Amid Historic Military Spending

Germany's historic decision to exempt defense spending from its strict debt rules and create a €500bn infrastructure fund marks a seismic move that could significantly benefit German defense stocks⁴. With defense expenditure no longer constrained by borrowing limits, companies in the sector stand to gain from increased military modernization and procurement programs. This policy change, driven by geopolitical uncertainties and a reevaluation of security priorities, is expected to revitalize Germany's defense industry, boosting demand for military equipment, technology, and infrastructure. Investors may view this move as a long-term growth catalyst, as Germany commits to strengthening its armed forces and contributing to a more robust European defense framework.

The Unstoppable Surge in European Defense Stocks

EU's massive defense investment plan is a game changer. The European defense sector is witnessing unprecedented growth and has become one of the most lucrative investment opportunities in recent times, with European defense stocks soaring to record highs.

Additionally, political leaders and industry figures are increasingly pressuring investors to support the

defense sector, framing it as essential for European security. British politicians have urged investors to back military-related industries⁵, while France has suggested removing ESG-related restrictions on the defense sector. Many investors see a lucrative opportunity, with Europe’s rearmament drive expected to provide strong long-term returns.

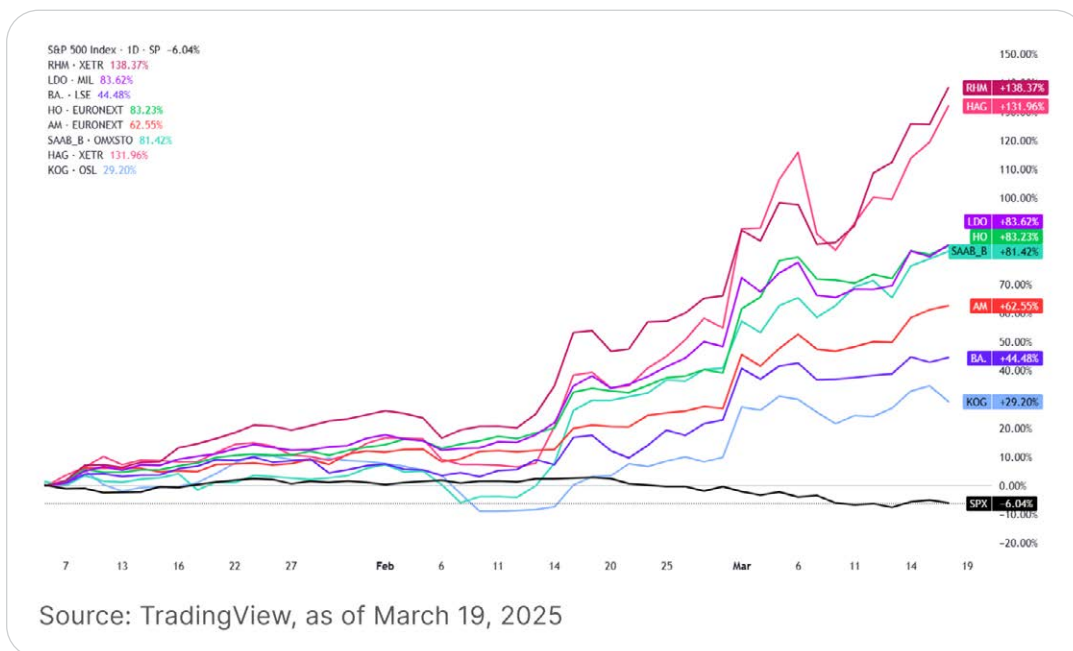
The change in sentiment toward defense stocks signals a significant transformation in the European investment environment. By investing in European defense stocks, investors can benefit from a long-term growth opportunity, driven by urgent security demands, increased government spending, and a commitment to European sovereignty.

European Defense Stocks Outperform U.S. Peers

Since the onset of the war in Ukraine in 2022, European defense stocks have been surging, significantly outperforming their U.S. peers. This outperformance is even more evident in 2025 as investors anticipate a wave of European military spending that is expected to benefit local contractors more than American firms.

Despite an increase in NATO spending targets, which should provide long-term growth for the industry, U.S. defense stocks have faced a notable de-rating since November 2024 amid President Trump’s plans to end the war in Ukraine and a decision to pause military aid to Ukraine.

While the S&P 500 Aerospace and Defense Index has risen over 5% this year, concerns over budget cuts have prevented US defense stocks from reaching their late 2024 highs, even as European stocks surge. Defense Secretary Pete Hegseth’s plan to cut projected military spending by 8% over five years⁶ has added to market caution. However, whether the U.S. continues as the dominant superpower or operates in a multi-polar world, will sustain high defense spending. The upcoming passage of the 2025 and 2026 fiscal budgets and expected defense contract awards will likely serve as catalysts for stock growth.



European Defense Stocks – The New Magnificent Seven

Following the recent geopolitical developments, European defense stocks have experienced phenomenal growth: with Rheinmetall up 118% YTD, Leonardo up 81% YTD, BAE Systems up 42% YTD, and Rolls-Royce up 40% YTD. These gains highlight investors' growing confidence in the sector, which continues to outperform broader markets and U.S. defense stocks, presenting a golden opportunity for investors.

Defense Stocks are Back in Vogue

The defense sector has emerged as one of the best-performing industries and given the plans for increased defense spending over the next four years, this momentum is likely to continue. For investors looking to hedge against global instability while tapping into strong growth potential, defense stocks present an attractive opportunity.

Rather than focusing solely on U.S. or European defense companies, a more balanced approach that includes exposure to both markets offers greater diversification and resilience. With Europe ramping up defense spending and the U.S. maintaining its leadership in the sector, a globally diversified defense ETF could be a prudent long-term investment strategy.

History has shown that overlooking transformative trends can be costly, and with geopolitical tensions driving sustained demand for defense capabilities, investors should not ignore this critical sector.

Footnotes:

¹Munich Security Conference, Westlessness Reloaded?, as of February 2025

²NATO, Collective defence and Article 5, as of July 4, 2025

³Euro News, European Commission to propose EU-wide mechanism to pool member states' defence orders, as of March 18, 2025

⁴BBC, Germany votes for historic boost to defence spending, as of March 18, 2025

⁵BBC, Labour MPs urge investors to support defence firms, as of March 6, 2025

⁶U.S. Department of Defense, Hegseth Addresses Strengthening Military by Cutting Excess, Refocusing DOD Budget, as of February 20, 2025

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