

Global Equity Pulse: Conflict and opportunity

"We have started a surge in defense spending up to €800 billion till 2030. Member states are stepping up their investment at record levels. And this has helped to triple the market value of European defense companies since January 2022."

-Ursula von der Leyen, President of the European Commission, January 21, 2026.

Increased European defense spending and greater strategic autonomy are growth drivers for the European aerospace and defense industry. However, they also make it more challenging to identify the most compelling investment opportunities—particularly with constant "headline noise."

We believe an active approach grounded in deep fundamental research can help target undervalued opportunities as a wave of rearmament progresses at a rapid pace, and not only in Europe but also across the globe (see sidebar). In such an environment, we believe a focus on bottom-up stock selection and price discipline is key.

Despite a strong 2025 for equities, we believe markets have been overly fixated on near term geopolitical events rather than the longer term structural forces reshaping the European defense industry. Any de-escalation of geopolitical tensions can drive swings in sentiment and short-term volatility—US President Trump's U-turn on Greenland is one recent case. When seeking long-term opportunities, we keep an eye on these short-term events to see if they impact multiples on stocks with long-term visible earnings drivers.

Rearmament: A global phenomenon

United States: The Trump administration has proposed a historic US\$1.5 trillion defense budget for fiscal year 2027, representing a roughly 42% increase over current funding levels.

Europe: As of May 2026, the European Commission is implementing a €150 billion loan scheme via the Security Action for Europe (SAFE) instrument to support member-state defense procurement. Concurrently, Germany has finalized its 2027 budget, raising defense spending to 3.1% of gross domestic product (GDP).

Japan: Japan's Cabinet approved a record ¥9 trillion (US\$58 billion) defense budget for the fiscal year beginning April 2026, marking a 9.4% increase from 2025.

Cumulative Index Performance: Price Returns (US Dollars)

March 2011–March 2026



Source MSCI. As of March 2026. The MSCI Europe Aerospace and Defense Index is composed of large- and mid-cap stocks across 15 developed markets countries in Europe. All securities in the index are classified in the Aerospace and Defense industry group (within the Industrials sector). The MSCI Europe Index represents large- and mid- cap companies across 15 developed markets in Europe, covering approximately 85% of the free float-adjusted market capitalization. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or guarantee of future results.**

Industry fundamentals strong but stock selection still key

The conducive policy backdrop and healthy growth prospects affirm our conviction in European aerospace and defense companies. However, we remain prudent in our investment approach, maintaining valuation discipline amid ongoing sector strength. As shown in Exhibit 1 on the previous page, the MSCI Europe Aerospace and Defense Index has been on an extended run versus the broader European market, with a 26% five-year price return versus the MSCI Europe Index's 6.0% (as of March 31, 2026).

A shift back to Europe?

Much of the increase in defense budgets is driven by equipment-related spending, which is the component directly feeding into the revenue of aerospace and defense companies, as compared to personnel or infrastructure-related spending. So far, major US suppliers have been the key beneficiaries of this demand growth, but we think the recent cracks in the trans-Atlantic security partnership may lead to a partial or even significant pivot back to European suppliers.

From our bottom-up perspective, we look for companies with strong government backlogs, conservative balance sheets, consistent free cash flow and attractive valuation multiples. We believe these firms are best positioned to benefit as rising defense budgets flow through to order growth and long-term earnings potential. Multi-year government contracts are important as they provide stable, predictable revenue regardless of economic cycles.

We also look at the health of margins and sustainability of earnings power, among other factors. Some key considerations are:

- **Technological edge and the ability to adapt to new trends:** The nature of warfare is changing, and military customers and adversaries are increasingly using offensive and defensive cyber and electronic warfare capabilities. One of our European favorites, a large UK-based aerospace and defense company, is already diverse, but it plans to continue to shape its portfolio toward these higher growth, technology-focused, and strategically important domains such as space, drones, counter-drones and electronic warfare.
- **Exposure to increased defense spend:** This company in our research universe is a strategic partner to the French military, deriving >40% of defense sales from the French state, which is also a 26% shareholder in the company. Its electronics and sensors are on all France's major defense platforms—fighter jets, frigates and air defense systems—and it has a ~25% share of France's national defense budget.

Investors should also keep in mind that some European defense majors have diverse sales exposure to not just Europe, but also the United States and Asia-Pacific countries. Ultimately, defense as an investment theme is not exclusive to Europe. At a time when a multi-polar world order is slowly but surely taking shape, nations spending more to build their own defense will likely be a permanent feature of the global security landscape, and a potentially lasting opportunity that investors can harness for long-term returns.

Market review

Global equities rebounded strongly in April, with the MSCI All Country World Index (ACWI) rising 10.03% in US dollar terms, as markets recovered a substantial share of the March selloff. Performance was driven primarily by the partial unwinding of the energy shock that had dominated sentiment at the end of the first quarter. The announcement of a temporary US-Iran ceasefire, intermittent progress in talks, and periods in which the Strait of Hormuz appeared effectively open helped trigger sharp declines in oil prices and a broad relief rally across risk assets.

Outlook

In the United States, health care remains of particular interest given historically low valuations, stabilizing/improving fundamentals, and resolution of various macro-overhangs. European equities face a near-term energy headwind as Middle East tensions lift crude oil, liquefied natural gas (LNG) and refined product prices, weighing on growth and inflation. Yet medium-term prospects are improving, supported by competitiveness reforms, German fiscal stimulus and defense spending. In Asia Pacific, the bellwether semiconductor names in Taiwan and South Korea have reported record-high first-quarter earnings. Driven by the technology sector, regional earnings growth at the index level continues to look robust. We maintain our high conviction but will be selective in our allocations, focusing on the more resilient parts of the artificial intelligence (AI) value chain.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Commodity-related investments are subject to additional risks such as commodity index volatility, investor speculation, interest rates, weather, tax and regulatory developments.

Equity securities are subject to price fluctuation and possible loss of principal.

The **investment style** may become out of favor, which may have a negative impact on performance.

To the extent the portfolio invests in a **concentration of certain securities**, regions or industries, it is subject to increased volatility.

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