

# European defence: strong fundamentals behind a soft market

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## Points clés

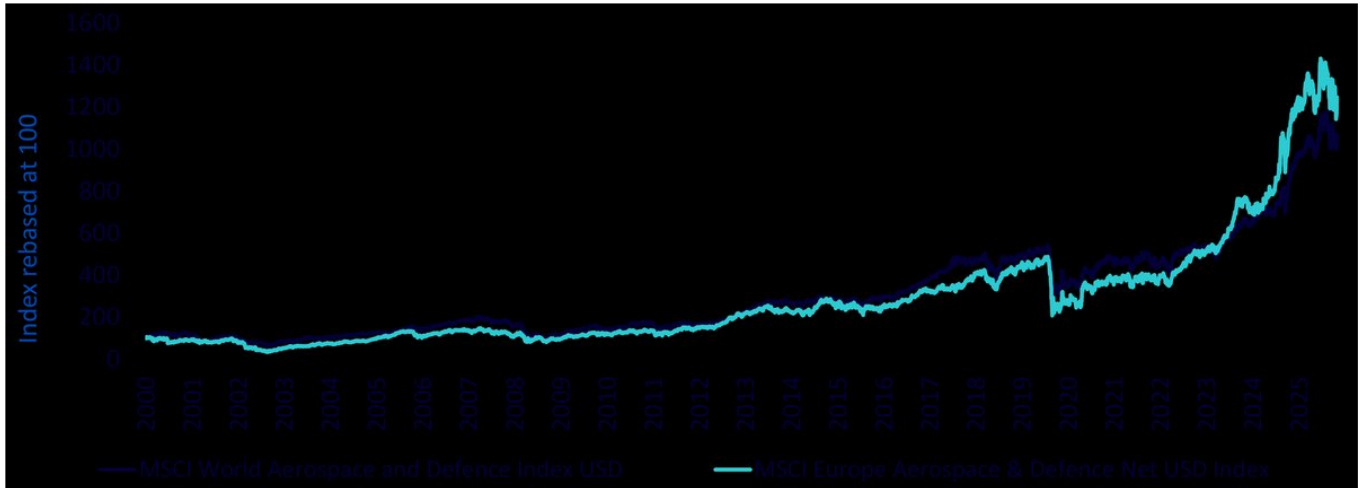
- Recent European defence sector price weakness is sentiment-driven, not fundamental.
- Book-to-bill ratios across European defence constituents average 1.49x, offering signals of accelerating demand.
- European defence trades at a meaningful discount to US peers (28.6x vs 48.8x P/E) while offering higher forecast earnings growth (19.1% vs 16.8%).
- Related Products WisdomTree Europe Defence UCITS ETF - EUR Acc, WisdomTree STOXX Europe Aerospace & Defence 3x Daily Leveraged Find out more

## A sector rerating but not a fundamental story

European defence has been one of the defining investment themes of recent years. Russia's full-scale invasion of Ukraine forced a wholesale reassessment of European security. Since then, the continent's defence primes have been at the centre of a structural rearmament story. Order books have surged. Production capacity has expanded. Long-duration procurement contracts have multiplied. A policy architecture has taken shape that continues to deepen the demand underpinning the sector, with NATO's 5% GDP target, the EU's Readiness 2030 programme and Germany's multi-decade Bundeswehr modernisation.

Yet despite this backdrop, European defence equities have retreated meaningfully from their highs. For investors, this raises a natural question: if the fundamentals are intact, why are prices falling? The answer lies not in the fundamentals but in a convergence of sentiment-driven forces. The pattern is a familiar one: markets tend to rally defence stocks in anticipation of conflict or spending acceleration, then sell off once the event arrives. It happened after Russia's invasion of Ukraine in 2022. It is happening now, following US–Israeli military action against Iran. Revenue recognition in defence is slow, companies book orders months or years before delivery and when conflict escalates, markets initially price in future earnings, then pull back when they realise those earnings may be years away.

## Figure 1: Historical performance of global aerospace and defence indices



Source: Bloomberg Finance L.P., WisdomTree as of 27 May 2026. **Historical performance is not an indication of future performance and any investments may go down in value.**

#### Four specific near-term drivers compound this structural dynamic:

1. **Hedge fund de-grossing** defence has been a popular long in leveraged books, and when volatility rises, positions are cut regardless of underlying merit.
2. **Increased global competition for defence capital** has emerged as the US FY272 defence budget request reached approximately US\$1.5tn (+50% year-on-year (yoy)), drawing attention and flows toward American primes.
3. **Debate around conventional versus next-generation systems**, re-ignited by the Middle East conflict, has introduced uncertainty about which technologies will dominate future procurement, though for Europe, which faces a primarily land-based threat and decades of underinvestment across all dimensions, the answer is clearly both.
4. **German procurement bottlenecks**, an administrative consequence of the speed of spending acceleration rather than any reduction in intent, have introduced order timing uncertainty that markets have interpreted more negatively than the facts warrant. Berlin is planning €144.9bn in defence spend for 2027 alone.

### The earnings season dispels the myth

The most effective antidote to sentiment-driven narratives is reported data. The Q1 2026 European defence earnings season has been remarkably consistent in one respect: the top European defence primes confirmed or upgraded full-year guidance. Operational delivery has not faltered. What has moved is the market's willingness to pay for it.

**Rheinmetall** reported Q1 2026 revenues of €1,938m against the consensus of €2,270m, marking a 15% miss that generated significant investor attention. The context matters. A €140m pull-forward effect in Q1 2025 artificially inflated the comparable period and was never going to repeat. The company's earnings before interest and taxes (EBIT) margin came in at 11.6%, in line with expectations. Full-year guidance was confirmed at 40–45% revenue growth and an approximate 19% EBIT margin. Management guided Q2 2026 sales growth of 60–65% yoy. This is a timing effect, not a demand problem.

**Hensoldt** provided perhaps the most striking single data point of the reporting season. Q1 2026 total order intake came in at €1.36bn, up 94% yoy, with a group book-to-bill of 2.8x. The Optronics division registered a book-to-bill of 7.0x, driven by the Shakal programme and a Puma award. Revenue grew 24% organically. With approximately 60% of revenues derived from Germany, Hensoldt is directly exposed to the domestic spending acceleration.

**Thales** reported group order intake of €4.7bn (+27% organically) for Q1 2026. Within that, Defence orders surged 75% organically to €2.2bn, including seven contracts above €100m, three of them for air defence systems (Denmark SAMP/T, Qatar Ground Master, command posts to a European country). Group revenues of €5.3bn were 2% ahead of consensus. Full-year guidance was confirmed.

**BAE Systems** delivered an AGM trading update consistent with its reputation for execution<sup>3</sup>: in line with full-year guidance, with year-to-date order awards of approximately £4.5bn, materially ahead of the ~£1.9bn disclosed in June 2025. Geographic diversification across the US, UK, Australia and the Middle East insulates BAE from any single budget cycle, while the Australia–United Kingdom–United States (AUKUS) security partnership and the Global Combat Air Programme (GCAP) provide decade-long revenue visibility.

**Safran** delivered revenues of €8.6bn for Q1 2026 (+23% organic, 4% ahead of consensus), with LEAP engine deliveries rising 63% and M88 military engine deliveries increasing materially. Management guided to the top end of the full-year range. This is notable given Safran's well-established conservatism on guidance.

**Leonardo** has navigated sector de-rating alongside a CEO transition. Q1 2027 order intake is forecast at €7.9bn (+15% yoy) and could deliver an upside surprise to consensus.

Kongsberg, Saab, Airbus Defence & Space, and Rolls-Royce each confirmed guidance and reported growing backlogs.

## Seizing the investment opportunity in Europe's defence sector

In response to the accelerated push for European defence autonomy, WisdomTree launched the [WisdomTree Europe Defence UCITS ETF \(Ticker: WDEF\)](#), the first dedicated European defence ETF, on 11 March 2025. It tracks the WisdomTree Europe Defence Index (WTEUDEFN), a rules-based index designed to capture the performance of European companies with meaningful and measurable exposure to defence spending. Year-to-date the exchange-traded fund (ETF) has garnered US\$1.4bn of net inflows, lifting



## Valuations have moderated

Valuation multiples have moderated despite continued growth in order backlogs and earnings expectations. The WisdomTree Europe Defence UCITS ETF's trailing P/E has fallen from 39.5x to 30.9x. The earnings growth trajectory for the portfolio continues to run materially ahead of both MSCI Europe and MSCI Europe Industrials. Current market valuations imply lower multiples despite improved multi-year backlog visibility compared to twelve months ago.

The WisdomTree Europe Defence UCITS Index is positioned for strong earnings growth, with earnings per share expected to rise by 15.1% in 2026 and 21.5% in 2027. This reflects expanding market share, multi-year procurement cycles, and increasing defence budgets across Europe. Dividends per share are also expected to grow over the next two years.

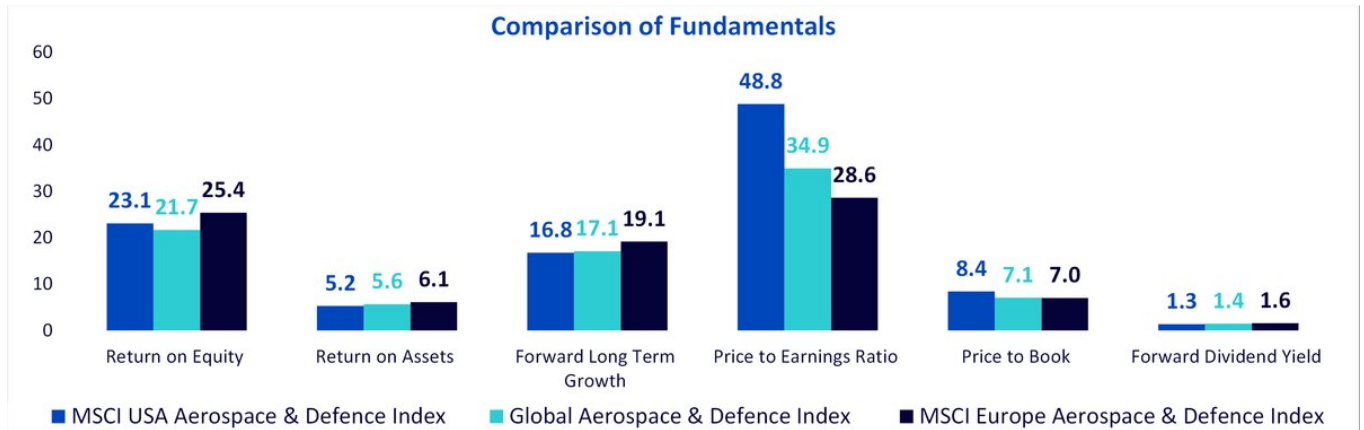
### Figure 3: Fundamental earnings estimate – WisdomTree Europe Defence UCITS Index

Measure	Current	2026		2027		2028	
		F12 Est	Growth	Y+1 Est	Growth	Y+2 Est	Growth
Earnings Per Share	12.56	14.46	15.14%	17.56	21.45%	21.08	20.03%
Cash Flow Per Share	20.54	25.51	24.19%	28.29	10.90%	34.94	23.50%
Dividends Per Share	4.96	5.89	18.57%	7.12	20.94%	8.6	20.88%
Book Value Per Share	67.44	74.55	10.55%	84.55	13.41%	97.97	15.88%
Sales Per Share	157.36	172.5	9.62%	193.66	12.27%	217.76	12.44%
EBITDA Per Share	21.7	26.88	23.88%	31.17	15.95%	36.24	16.29%
Net Debt Per Share	0.93	-4.82		-10.84	-124.86%	-20.77	-91.56%
Enterprise Value Per Share	365.09	368.04	0.81%	364.56	-0.95%	359.33	-1.43%

Source: Bloomberg, WisdomTree as of 19 May 2026. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

Compared with global defence benchmarks, European defence trades at a lower historical P/E ratio (28.6x versus 48.8x for the US Aerospace & Defence Index) while offering higher forward long-term growth estimates (19.1% versus 16.8%). The European Aerospace & Defence Index also exhibits stronger quality characteristics, with higher return on assets and return on equity than the US Aerospace & Defence Index, as illustrated below.

### Figure 4: Comparison of fundamentals – US vs Europe Defence



Source: Bloomberg Finance L.P., WisdomTree, MSCI, as of 18 May 2026. **Historical performance is not an indication of future performance and any investments may go down in value.**

## Conclusion

The current period of share-price weakness is uncomfortable. It has been driven by sentiment, timing effects and a macro rotation, none of which alter the underlying reality that European governments are engaged in the most significant rearmament programme since the Cold War, and the companies represented in the portfolio are expected to play an important role in supporting European defence procurement programmes. For investors with a medium to long-term horizon, the combination of improving fundamentals and compressed valuations represents a strong entry point.

While the sector benefits from long-term defence spending commitments, investment in defence equities remains subject to risks. Government procurement programmes can experience delays, budget priorities may change, and contract awards may not materialise as expected. Defence companies may also face execution, supply-chain and geopolitical risks, while share prices can remain volatile and may diverge from underlying business fundamentals over shorter periods. Valuation multiples and earnings expectations may change, and there is no guarantee that anticipated growth in defence spending will translate into future investment returns.

1 Source: Financial Times, “Defence stocks: the geopolitical trade dividing investors”, 2 April 2026.

2 Source: US Department of War FY 27 budget.

3 Source: BAE Systems, as of 7 May 2026.

4 Source: Bloomberg Finance L.P. as of 21 May 2026.

5 Source: Bloomberg Finance L.P. as of 18 May 2026.

6 Source: Bloomberg Finance L.P. as of 19 May 2026.

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