Invest in Europe's defence renaissance

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Key Takeaways

- The European defence industry is undergoing a paradigm shift.
- The European Defence Industrial Strategy aims to unify and strengthen Europe's defence sector, positioning European defence stocks for long-term growth.
- Governments are being pushed to shift their defence spending away from external actors (like the US) and toward European manufacturers.
- The WisdomTree Europe Defence UCITS ETF (WDEF) was created to capture the upside of Europe's multi-year defence expansion.

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Many said it could not be done and would never happen. But the European defence industry is undergoing a paradigm shift. The geopolitical landscape has shifted dramatically, and delayed action is no longer an option. With rising global instability and the return of President Trump to the White House, European leaders must act decisively to ensure security, strategic autonomy, and industrial resilience in defence. This is not just a short-term response—it marks the beginning of a multi-year investment cycle poised to benefit European defence industries over their US counterparts.

A game-changer: The European Defence Industrial Strategy

For decades, Europe has relied too heavily on US defence capabilities, leaving its defence industry fragmented and dependent on non-EU (European Union) suppliers. However, with uncertainty surrounding US military commitments, European nations are fast-tracking plans to build a stronger, more self-reliant defence industry that can meet the security challenges of today and the future.

The European Defence Industrial Strategy (EDIS) is Europe's most ambitious attempt yet to transform its defence capabilities1. The strategy aims to unify and strengthen Europe's defence sector by prioritising joint procurement, innovation, and collaboration among member states.

The urgent measures driving this transformation include:

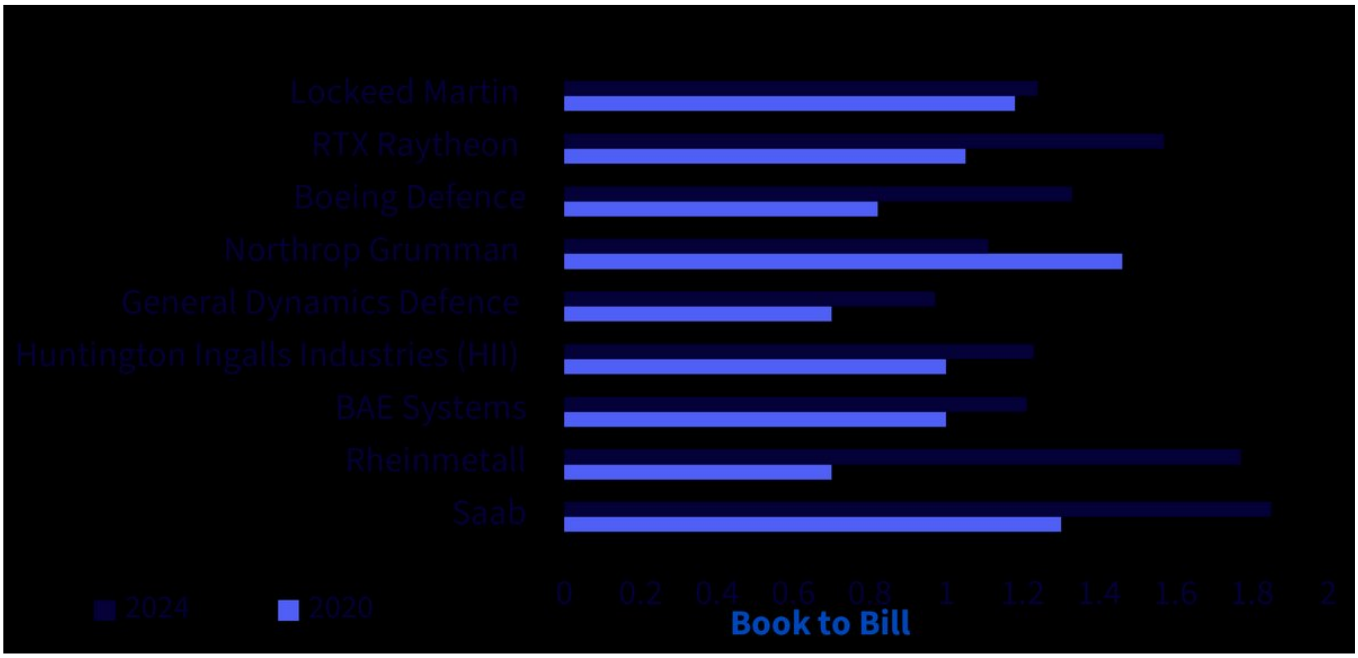
- **Rebuilding European defence manufacturing:** by 2030, at least 50% of EU defence procurement must come from European manufacturers, rising to 60% by 2035. This is essential to reduce reliance on non-EU suppliers, particularly the US.
- **Enhancing intra-European defence trade:** the EU is aiming to boost defence trade within the bloc to 35% of the total defence market value, fostering a stronger, more integrated industrial base.
- **Collaborative procurement surge:** currently, only 18% of EU defence equipment is procured jointly. By 2030, this must rise to 40%, ensuring lower costs, better interoperability, and a more resilient supply chain.
- **Redirecting defence budgets toward Europe:** governments are being pushed to shift their defence spending away from external actors (like the US) and toward European manufacturers, mitigating risks associated with foreign dependency.
- **Incentives to accelerate investment:** the EU is exploring joint procurement tax incentives and VAT waivers to encourage faster and larger-scale European defence collaborations.

These measures collectively aim to build a more self-reliant and resilient European defence industry while reducing dependency on non-EU suppliers.

Policy-driven capital allocation towards European defence companies

While the US defence industry has been a strong performer in the past, European defence stocks are now positioned for superior long-term growth due to this sustained investment cycle and structural policy shift. The US defence budget is already near record highs, limiting future upside for stocks. Not to mention, DOGE2 is looking to cut costs with defence spending increasingly targeted. In contrast, Europe is at the start of a multi-year rearmament cycle, with significant upside for European contractors. European defence firms are experiencing record-high order books, ensuring stable, long-term revenue growth. Rheinmetall posted a 1.8x book-to-bill3, on top of its 1.7x ratio in 2023, reflecting robust demand for its portfolio of munitions and combat vehicles4. Saab's order intake totalled 79.2 bn krona, or a book-to-bill of 1.8x, with international customers accounting for 80%2. In comparison, order activity for US defence contractors is less heated but still healthy, averaging 1.2x5.

Figure 1: US vs European defence stocks—book to bill trends



Source: Company Filings, WisdomTree, Bloomberg as of 31 December 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

Seizing the investment opportunity in Europe’s defence sector

Given Europe's historic underinvestment in defence, the WisdomTree Europe Defence UCITS ETF (WDEF) was created to capture the upside of Europe’s multi-year defence expansion.

The exchange-traded fund (ETF) invests in European listed companies only that are involved in the European defence industry (which includes manufacturers of civil defence equipment, parts or products, defence electronics and space defence equipment). Each selected company is assigned an exposure score from 1 to 3 based on the revenue exposure to defence activities.

- **Exposure score 3:** companies with **> 50%** exposure to defence activities
- **Exposure score 2:** companies with **25% to 50%** exposure to defence activities
- **Exposure score 1:** companies with **10% to 25%** exposure to defence activities

The ETF is weighted by free-float market capitalisation, adjusted by the exposure score. This means that companies with higher defence revenues are assigned greater weights, making it a better investment vehicle for the European defence trend than market cap weighted indices. Companies with more than 50% exposure to defence activities are capped at 12.5% while all other securities are capped at 7.5%. These caps represent the highest weighting each index constituent can have when the index rebalances.

The UCITS “20/35” diversification rule, which means one component can go up to 35% and the rest should be capped at 20%, allows us to create a very focused defence strategy in a UCITS ETF tracking a UCITS compliant Index.

In comparison, VanEck defence UCITS ETF (DFNS) provides exposure to global companies, that is, mostly US companies, involved in military or defence industries, making the WisdomTree Europe Defence UCITS ETF (WDEF) a more focused, undiluted play on European defence stocks.

At a time when investors are actively seeking exposure to Europe's decade long rearmament cycle, WisdomTree is offering a unique and differentiated way to invest in this historic defence resurgence. The WisdomTree Europe Defence UCITS Index has a 50% median exposure to European firms and a lower median exposure to the US, thereby positioning the portfolio to benefit from increased defence spending in Europe.

Figure 2: Revenue exposure Europe vs US

Figure 2a: Revenue exposure to Europe

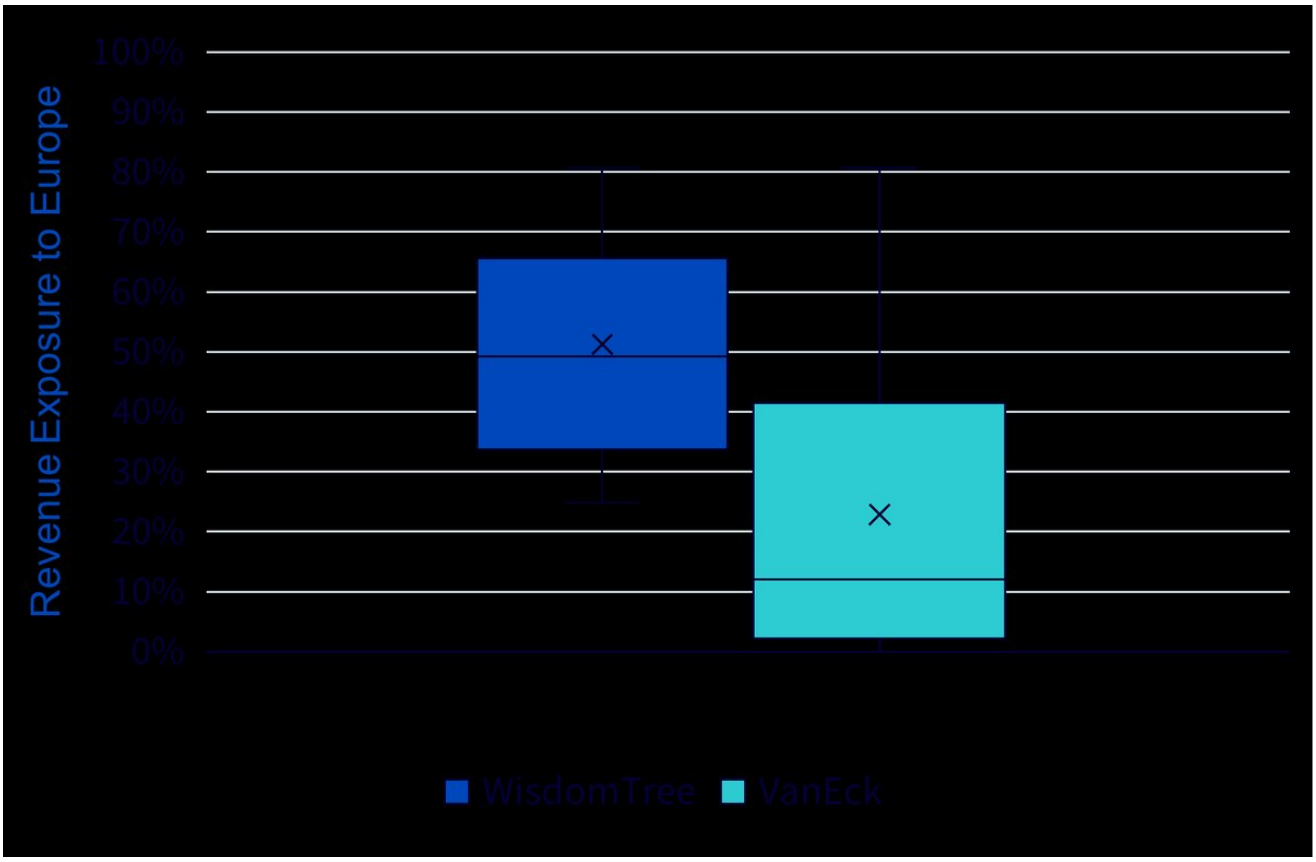
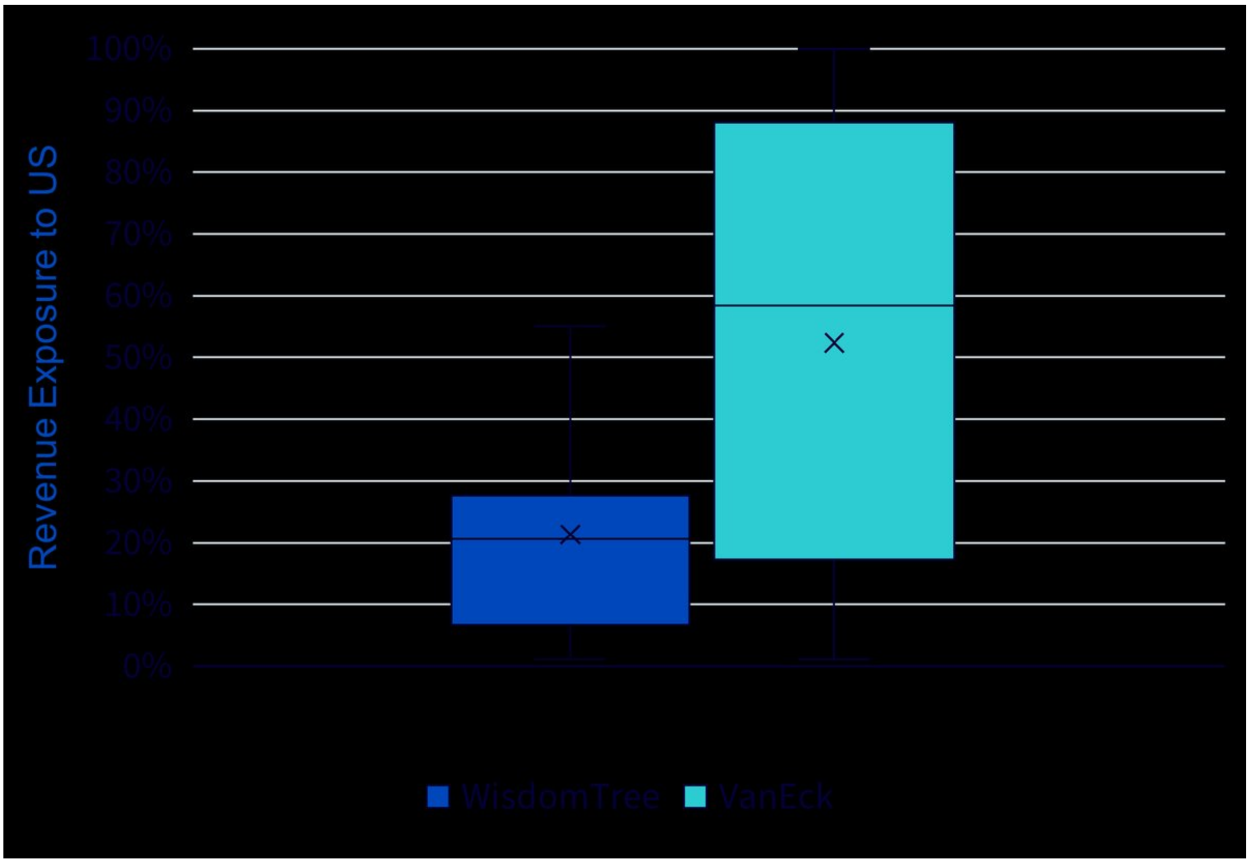


Figure 2b: Revenue exposure to US



Source: WisdomTree, FactSet, as of 28 February 2025. "X" sign denotes the arithmetic average of the revenue exposure of the holdings. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

The WisdomTree Europe Defence UCITS Index has a low overlap compared to the VanEck MarketVector Global Defence Industry Index and the benchmark index MSCI World Aerospace and Defence Index, providing a differentiated approach to accessing the European defence sector.

Figure 3: Low overlap weight vs VanEck MarketVector Global Defence Industry Index

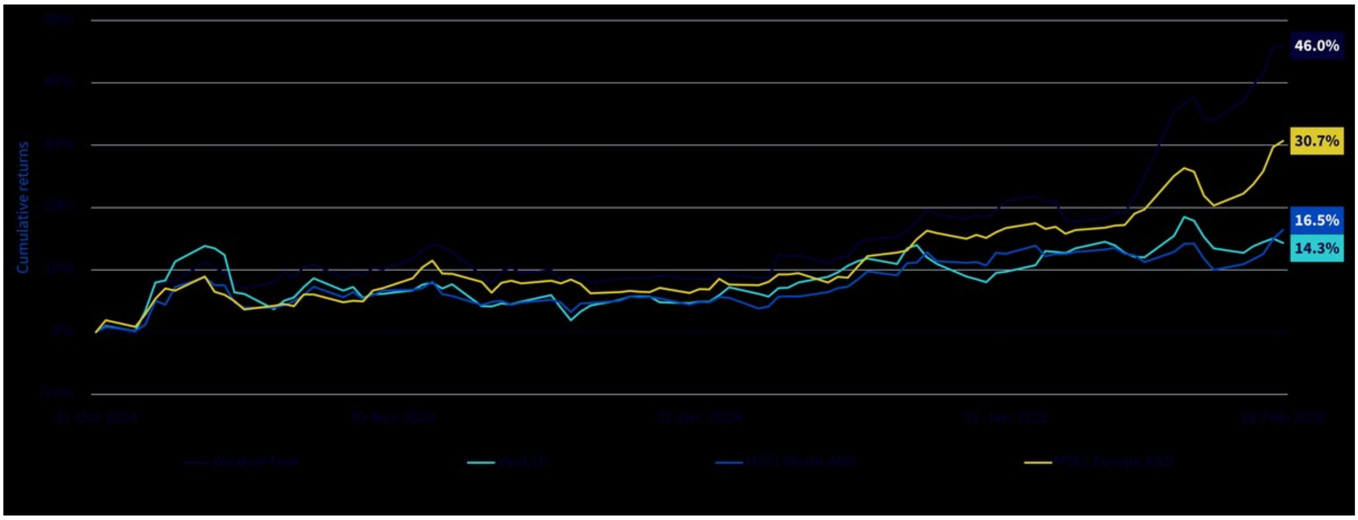
Overlap weight

Overlap WisdomTree vs VanEck Top 10 Positions

Source: WisdomTree, Bloomberg. Holdings data as of 28 February 2025. You cannot invest directly in an index. Historical performance is not an indication of future results and any investments may go down in value.

The simulated performance since the earliest common history highlights the WisdomTree Europe Defence UCITS Index's outperformance versus the VanEck MarketVector Global Defence Industry Index, alongside the MSCI World and Europe Aerospace and Defence Indices.

Figure 4: Simulated backtested performance since earliest common history



Source: WisdomTree, Bloomberg, from 31 October 2024 to 28 February 2025. Return figures for time periods longer than 1 year are annualised. WisdomTree Europe Defence UCITS Index (WTEUDEFN) calculations include back tested data and are computed in EUR. Historical returns of other indices are also calculated in EUR. Calculations are based on returns in EUR. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

Positioning for the future of European defence

Taking into consideration the fundamental ratios, the WisdomTree Europe Defence UCITS Index offers amongst the highest long-term estimated growth estimates versus the VanEck MarketVector Global Defence Industry Index6. At the same time, while investors are cautious of the recent rally among European defence stocks, the Price to Earnings to Growth (PEG) estimates shed some light on the comparatively low valuation of the WisdomTree Europe Defence UCITS Index relative to its peers.

Figure 5: Fundamental comparison

Figure 5a: Est. long-term growth

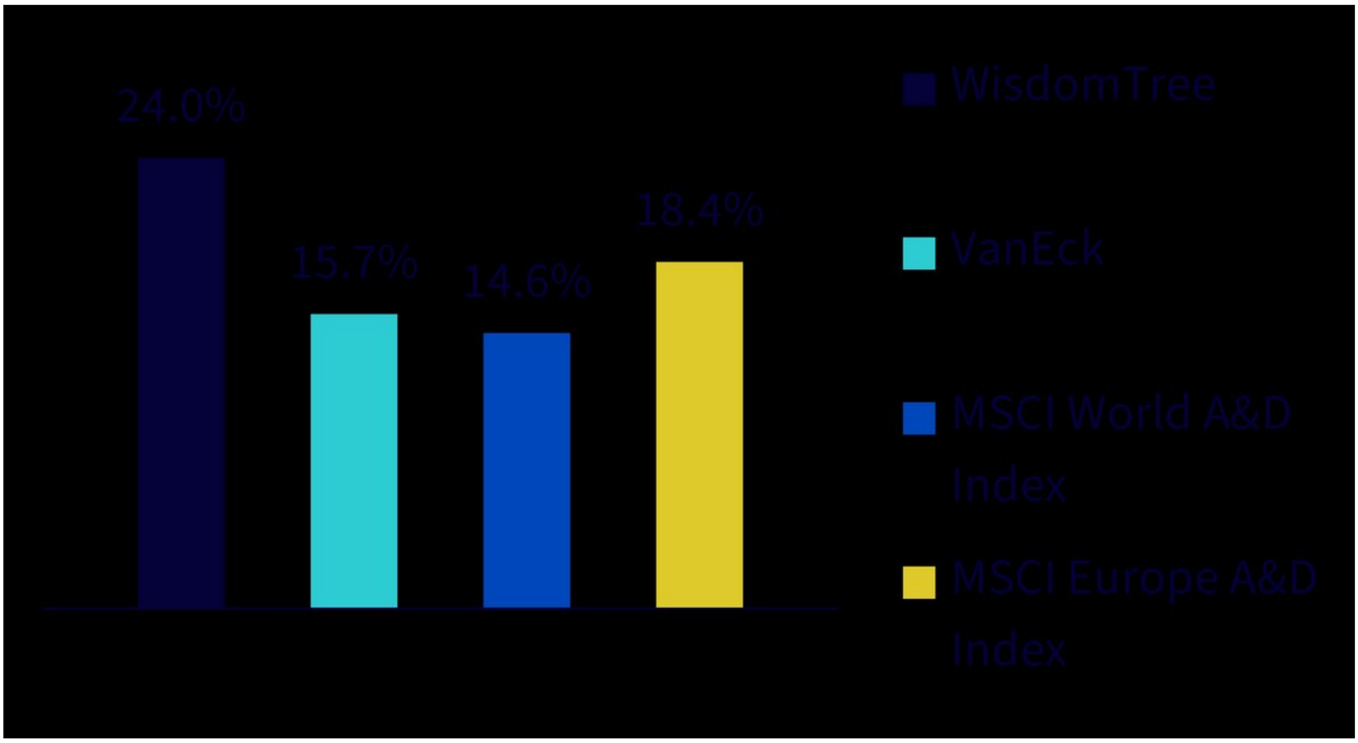


Figure 5b: Price-to-earnings (fwd 12m)

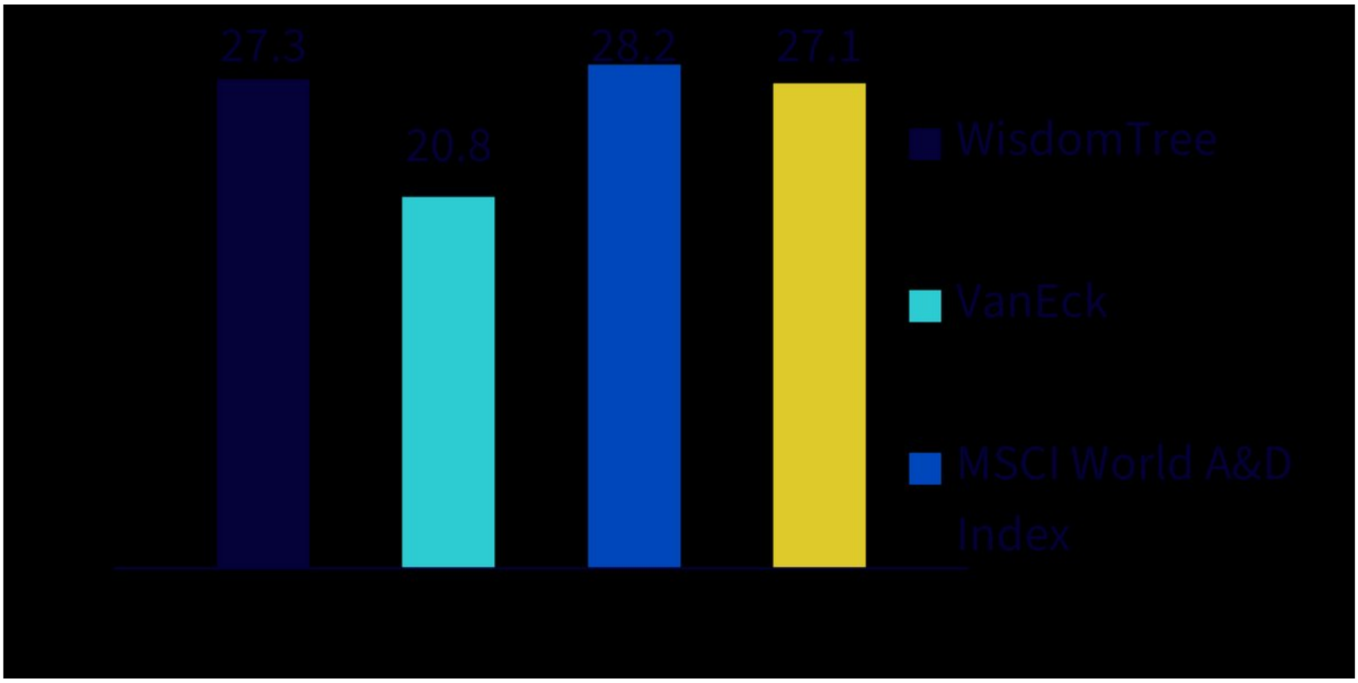
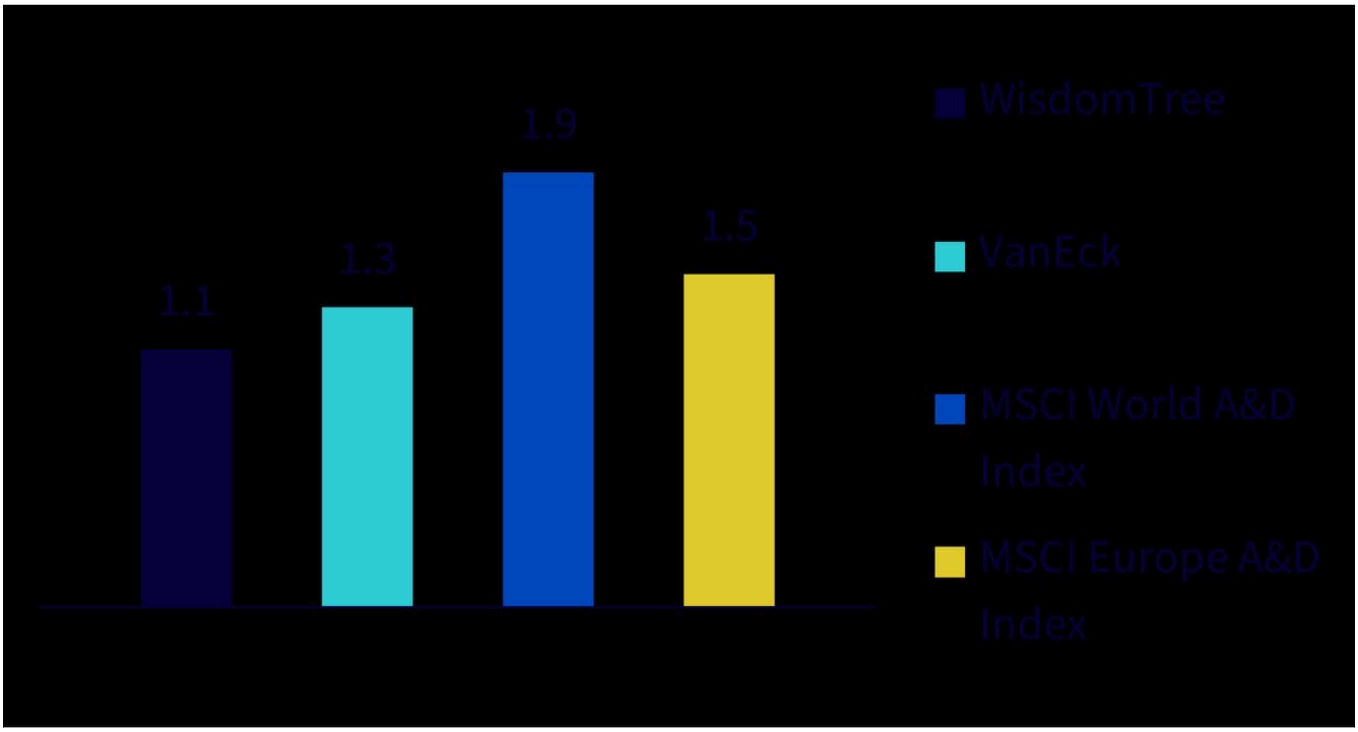


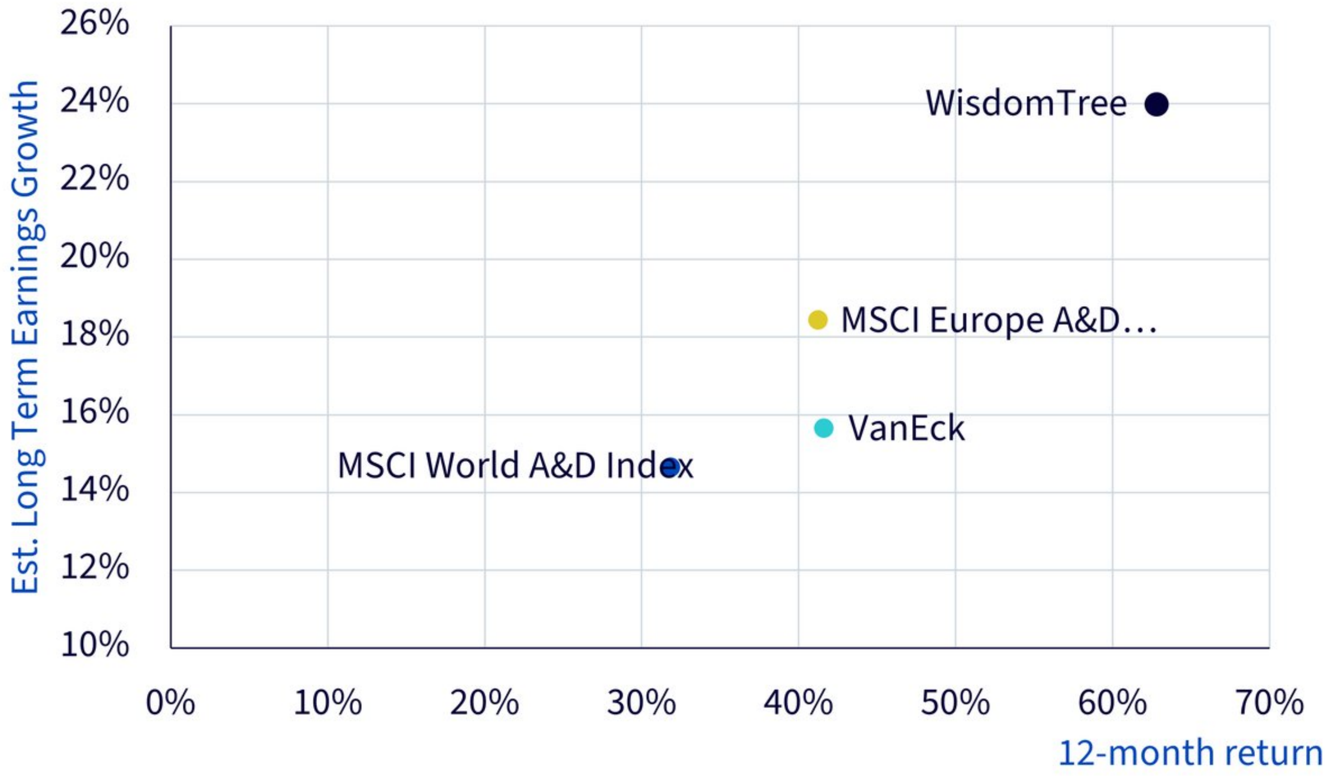
Figure 5c: Price/earnings-to-growth (PEG)



Source: WisdomTree, FactSet, Bloomberg, as of 28 February 2025. Holdings of the peers were sourced from Bloomberg. Fundamentals were sourced from FactSet. PEG ratios are based on forward P/E7 ratios and estimated long-term growth. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

On analysing the WisdomTree strategy's long-term earnings growth forecast among peers, compared to historical performance over the prior 12-months, we find the WisdomTree Europe Defence UCITS Index's strong growth potential, alongside performance, positions it ahead of its competitors.

Figure 6: Estimated long-term earnings growth vs 12-month return



Source: WisdomTree, Factset, Bloomberg, as of 31 January 2025. WisdomTree. Returns are based on 28 February 2024 – 28 February 2025. Europe Defence UCITS Index (WTEUDEFN) calculations include back tested data and are computed in USD. Historical returns of other indices are also calculated in USD. Backtest disclosure: WTEUDEFN uses the static datasets as of 31 October 2024, which are not redefined retrospectively in the backtest process. Such datasets including the initial universe of companies, and their revenue data, category classification, and companies' ESG assessment, as well as companies; market capitalisation and daily dollar volume requirements. Calculations are using Bloomberg PORT function on and on GTR (gross total return) basis. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

The shift in European defence spending is not temporary—it is structural. With Europe entering a multi-year defence upcycle, investors have a rare opportunity to participate in one of the most significant industrial transformations of our time, but the choice of investment vehicle will be critical for unlocking that potential.

1 European Commission: Joint communication to the European Parliament, the Council as of August 2024.
2 Department of Government Efficiency.
3 Book-to-bill is a key metric used in the defence and manufacturing industries to measure the strength of incoming orders relative to completed sales.
4&5 Company Filings, WisdomTree, Bloomberg as of 31 December 2024.
6 WisdomTree, FactSet as of 28 February 2025.
7 P/E = price-to-earnings.

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