Europe's Defense Build-Up: The Equity Price Downdraft That Isn't the Story

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Key Takeaways

- Despite the recent sell-off in key European defense stocks like Rheinmetall and Saab, the underlying driver, Europe's Readiness 2030 defense surge, remains a powerful, long-term structural trend for investors.
- The shift toward rearmament is not temporary policy noise but a durable reallocation of capital into Europe's industrial base, with implications for AI, robotics and dual-use technologies.
- The WisdomTree Europe Defense Fund (WDEF) offers targeted exposure to this once-in-a-generation investment thesis, turning market volatility into a potential entry point.

Markets love clean narratives, and the one around European defense companies looked straightforward in early 2025: war on Europe's doorstep, decades of underinvestment being reversed, a once-in-a-generation surge in defense budgets and stocks delivering eye-catching returns. Then came August, nearly eight months later. The very companies that had led the charge, Rheinmetall in Germany, Saab in Sweden, Leonardo in Italy, gave back a meaningful chunk of their gains.1

For many investors in the U.S., the instinct was to chalk this up to Europe overpromising and underdelivering. Defense is volatile. Europe is politically messy. Maybe the rally was a mirage.

That interpretation misses the bigger picture. The pullback is not the story. The structural commitment is.

The Bias Problem: Palantir vs. Rheinmetall

U.S. investors believe they know Palantir. They've seen the headlines about contracts with the Pentagon, the CIA and most recently the Department of Defense's big bet on AI-driven battlefield intelligence.2 Palantir is part of the narrative, so it gets the benefit of the doubt.

Rheinmetall, by contrast, is less familiar. It doesn't have the same brand recognition in Silicon Valley or on CNBC. Yet, Rheinmetall is arguably Europe's equivalent of Palantir, a defense industrial backbone company that is critical to Ukraine's war effort, a supplier of ammunition, armored vehicles and air defense systems, and a key node in the European Unions (EU's) rearmament plans.

The difference in perception is not about fundamentals. It's about familiarity bias. Investors over-weight to what they know and under-weight to what they don't. That works until it doesn't, until the overlooked assets are backed by structural commitments too large to ignore.

Europe's Readiness 2030: A Once-in-a-Generation Shift3

The Joint White Paper for European Defence Readiness 2030 is blunt: "The moment has come for Europe to re-arm." The policy direction is not ambiguous. It calls for a "once-in-a-generation surge" in defense investment, aimed at rebuilding deterrence, supporting Ukraine and constructing a resilient European defense industrial base.

Consider the trajectory:

- **Defense spending up 31% since 2021**, reaching €326 billion in 2024. Defense investment (procurement and research and development) nearly doubled over the same period.
- The new Security & Action for Europe (**SAFE) instrument** provides up to €150 billion in EU-backed loans to member states for common procurements that range from ammunition to AI systems.
- Europe is building not just more military kit, but a **pan-European market for defense equipment** designed to eliminate fragmentation, increase scale and guarantee predictable demand for prime contractors.

This isn't the politics of the moment. It's a structural reallocation of resources. For investors, that distinction matters.

Why Ukraine Doesn't End the Story

Skeptics often point to Ukraine. If a ceasefire materializes, won't Europe's urgency fade? History suggests otherwise.

The EU is explicit: Ukraine is not just a beneficiary of support but is being integrated into Europe's defense industrial base. The white paper describes Ukraine as "the world's leading defense and technology innovation laboratory," a place where drone tactics, AI-driven targeting and electronic warfare are stress-tested daily.

Even if the shooting stops, the logic of deterrence remains. A Europe that has lived through the largest land war since 1945 will not quickly revert to underinvestment. The plan is to build credible force by 2030, regardless of whether the battlefield goes quiet in 2026 or 2027.

For U.S. investors, this is key. Unlike discretionary stimulus programs, defense commitments built around deterrence are sticky. The credibility of NATO, the EU and European democracies depends on them.

The Industrial and Technological Dimension

Investors should also see this for what it is: industrial policy as much as military policy.

- **Industrial revitalization**: Legacy sectors like steel, chemicals and automotive are being pulled into defense supply chains. For cyclical industries struggling with global competition, defense provides durable demand.

For example, Rheinmetall has indicated that Volkswagen's Osnabrück plant in Germany would be "very suitable" for conversion to defense production, given its existing heavy-duty infrastructure. CEO Armin Papperger explained that discussions with VW are ongoing, but emphasized that large, sustained orders, such as a production run of Lynx infantry fighting vehicles, would be necessary before any repurposing could proceed. The proposal reflects Rheinmetall's broader push to expand output rapidly in response to Europe's rearmament drive and the continent's structural need for greater defense industrial capacity.4

- **Dual-use spillovers**: Defense investment feeds directly into AI, quantum, robotics, space and advanced electronics. Europe is positioning to ensure these technologies are not entirely ceded to the U.S. or China.
- **Capital deepening**: Long-term procurement contracts create predictability for companies to expand production lines, invest in R&D and scale output, which is exactly what Europe's fragmented defense sector has lacked for decades.

This is not simply about bullets and tanks. It's about rebuilding Europe's capacity to compete in frontier technologies with both economic and military applications.

Why theShare Price PullbackCould Be an Opportunity

Markets move faster than policy. By the time the EU announces a new defense initiative, investors have often already priced in its impact. That explains part of the strong start to 2025.

But markets also overshoot. When stocks like Rheinmetall or Saab run double in a matter of months,5 corrections are inevitable. The mistake is assuming the correction signals a reversal in the structural story. In fact, it's the opposite:

- **Cyclicality in price, durability in policy**: Defense equities will continue to be volatile, but the budgets underpinning them are locked in by treaty obligations, geopolitical necessity and industrial strategy.
- **Parallel with U.S. defense cycles**: American defense names have often corrected after surges tied to conflicts or budget announcements. Long-term, the trajectory remained up because the policy commitments didn't evaporate.
- **Europe's timeline is just beginning**: Readiness 2030 is about building capacity through the end of the decade. That's a five-year runway of budget growth and industrial ramp-up. August's pullback is turbulence on the runway, not the plane turning around.

The Bigger Picture: Deterrence as Investment Logic

In the end, this isn't about Europe catching up on military budgets or U.S. investors adding a few foreign tickers to their watchlist. It's about a world where deterrence has returned as the organizing principle of strategy.

Europe cannot muddle through the next decade relying on nostalgia for the post-Cold War order. The Readiness 2030 plan reflects that reality. The U.S. pivot to Asia only reinforces it. Whether investors think in terms of geopolitics or balance sheets, the conclusion is the same: Europe's defense build-up is not optional. It's existential.

The August sell-off doesn't invalidate that logic. It reinforces it, by offering investors a reminder that markets are noisy, but policy is enduring.

The WisdomTree Europe Defense Fund (WDEF), built to track the total return performance, before fees, of the WisdomTree Europe Defense Index, creates a specific exposure to companies central to the European defense narrative. Rheinmetall and Saab, companies mentioned in this piece, have been relatively large exposures.6

1 Source: "EuropeanDefence Stocks Send False Peace Signal," **Reuters**, 8/19/25.

2 Source: "Palantir Gets $10 Billion Contract from U.S. Army," **The Washington Post**, 7/31/25.

3 In what follows, unless otherwise stated, the source is: "Joint White Paper for European Defence Readiness 2030," European Commission, 2025.

4 Source: "VW's Osnabrück Plant Would Be ‘Very Suitable' for Defence Production, Rheinmetall CEO Says," **Reuters**, 3/12/25.

5 Sources: "Defence Group Saab Exceeds Earnings, Raises 2025 Outlook; Shares More than Double This Year," **Reuters**, 7/18/25; "Rheinmetall Joins EURO STOXX 50 amid Surge in Europe's Defense Stocks (up 181% this year)," **STOXX Blog**, 6/23/25.

6 As of 8/19/25, WDEF had 11.81% in Rheinmetall and 5.16% in Saab. **Holdings subject to change.**

Important Risks Related to this Article

For current holdings of WDEF, please click here. Holdings are subject to risk and change.

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