The New Defensive Playbook: Defense Spending as a Long-Term Reality

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Key Takeaways

- Defense spending is transitioning from a cyclical theme to a structural supercycle. Multi-year backlogs, inventory replenishment and modernization efforts in Europe and Asia point to durable revenue visibility for defense companies.
- Modern warfare is accelerating innovation in drones, radar, AI and electronic systems. Much of this technological edge is being developed outside the U.S., particularly in Europe, Japan and South Korea.
- European and Asian defense equities offer differentiated exposure. They have low overlap with broad international indexes and have historically shown lower correlation to U.S. equities, enhancing portfolio diversification.

From Headline Risk to Structural Reality

Geopolitical risk has moved from a background concern to a central portfolio variable. Institutional surveys increasingly rank it as one of the most difficult risks to model, surpassing even inflation in some cases.

Yet today's environment is not simply about short-term conflict headlines. It reflects a deeper transformation: a sustained global rearmament cycle, driven by modernization, technological competition and shifting alliances.

For investors, the key question is not whether tensions will fluctuate. It is whether defense spending, particularly in Europe and Asia, has entered a durable growth phase. We believe it has.

A Multi-Decade Rearmament Cycle Is Underway

Recent events have highlighted the effectiveness of modern Western defense systems, particularly interceptors, radar, drones and electronic detection. At the same time, they have exposed the rapid depletion of existing inventories.

That combination matters.

Defense contractors are not just working through existing backlogs. They are moving into what could be described as “far logs”, orders extending well into the next decade. Replenishment alone can stretch delivery timelines from three to five years out to 2030 and beyond.

This dynamic is not dependent on perpetual conflict. Even in a calmer geopolitical environment, countries are rebuilding inventories, upgrading systems and hardening domestic defense capabilities. In many cases, the modernization push is structural and bipartisan.

Defense is increasingly resembling a subscription model for governments, steady, recurring and essential.

The Pivot to Modern Warfare

One of the most important shifts investors may be underappreciating is the nature of modern defense.

This is no longer just about aircraft carriers or traditional heavy hardware. Increasingly, it is about:

- Drone systems and counter-drone technology
- Radar and early detection systems
- Small-munition interception
- AI-driven battlefield analytics
- Advanced communications and electronic components

In Europe, where large-cap technology ecosystems are limited, defense companies are often at the forefront of advanced engineering and R&D. In Asia, particularly Japan and South Korea, electronic components and precision interception technologies are global leaders.

Defense innovation has historically spilled into civilian technology. The Cold War catalyzed many of the foundational technologies that underpin today’s digital economy. It would be premature to assume the current cycle will not generate similar second-order innovations.

For investors, this means the “industrial” label often attached to these companies understates their technological depth.

Valuations and the “Overbought” Question

After strong performance, investors naturally ask: Has the opportunity already played out?

It is important to distinguish between price momentum and structural earnings visibility.

Defense firms in Europe and Asia are benefiting from:

- Expanding order books
- Government commitments to multi-year spending increases
- Inventory replenishment cycles
- Technological upgrading

These factors provide forward revenue clarity that is uncommon in many equity sectors.

Even if geopolitical tensions ease in the near term, spending trajectories are unlikely to reverse. Defense budgets, once increased, rarely retreat meaningfully, especially amid rising global fragmentation and great-power competition.

Why Broad International Exposure May Miss the Theme

Many investors assume they already own this opportunity through broad international or emerging markets ETFs. In reality, that exposure is minimal.

Traditional international indexes are often dominated by financials and value-oriented sectors. Defense allocations are typically small, and overlap with dedicated defense strategies is limited.

This creates two important portfolio benefits:

1. Low overlap and differentiation from traditional international holdings.
2. Lower correlation relative to U.S. growth-heavy benchmarks.

Portfolio Application: Targeted Access to Europe, Asia and Global Defense

WisdomTree provides targeted exposure through:

- The WisdomTree Europe Defense Fund (WDEF)

These strategies offer access to companies that are often difficult to purchase directly on U.S. exchanges and may lack liquid American Depositary Receipts.

These funds focus on firms positioned to benefit from modernization, technological advancement and expanding global defense budgets. Sector exposure skews toward industrials, but with meaningful embedded technology components.

For investors looking to diversify U.S. equity exposure, particularly concentrated positions in mega-cap growth, these strategies can serve as complementary allocations with differentiated drivers.

Conclusion: A Structural Shift, not a Tactical Trade

Europe and key Asian allies are building independent and technologically advanced defense capabilities. This buildout appears durable, bipartisan and multi-year.

For investors, the takeaway is clear: defense spending in Europe, Asia and globally has moved beyond a headline-driven trade. It is a structural allocation story, supported by modernization, replenishment and innovation.

In a world where geopolitical risk is harder to model than inflation, targeted exposure to global defense may serve not only as an opportunity, but as a portfolio stabilizer.

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