



The case for European defence: Innovation and investment in an era of geopolitical change

The case for European defence: Innovation and investment in an era of geopolitical change

Rising demand for defence investments

The race is on in Europe. Since the invasion of Ukraine, many European leaders have called for substantial increases in defence spending. For decades, the US has been the dominant military power in Europe, contributing more than two-thirds of the overall defence spending within the North Atlantic Treaty Organisation (NATO). Defence investment has long been a deeply political issue, with burden-sharing between the United States and European NATO countries serving as a core issue in the management of the alliance. The re-election of President Trump in 2024 has intensified pressure on European allies to significantly increase defence spending, exceeding the 2% of Gross Domestic Product (GDP) target, or face the prospect of maintaining security without the traditional guarantees provided by NATO.

NATO members first agreed on the 2% target in 2006 and formally renewed it in 2014¹ to ensure a fair contribution to maintaining the alliance's military readiness. Ten years later, European NATO members are expected to exceed the 2% target of their combined GDP for the first time. Until now the largest increases in defence expenditures have occurred on NATO's eastern flank after Russia's invasion of Ukraine. This heightened pressure from the US, coupled with the ongoing war in Ukraine, has driven a notable need to raise defence spending across Europe.

¹ North Atlantic Treaty Organisation as of October 2024

Key drivers of increased defence spending include:



NATO commitments: Member states are enhancing military capabilities to meet alliance obligations.



Geopolitical tensions: Potential US disengagement from European security has prompted Europe to assume greater responsibility for its defence.



Technological advancements: Investments in emerging technologies such as cyber defence and advanced weaponry are critical to maintaining technological superiority.



Defence industry consolidation: Efforts are underway to strengthen Europe's defence industry through consolidation and increased investment, ensuring competitiveness and strategic autonomy.

Unyielding global conflicts, rising geopolitical tensions and rapid defence modernisation support a secular shift upwards in defence spending.

Closing the gap in Europe's defence market

Europe's push to meet NATO defence spending targets

For years, European defence spending fell short of NATO's recommended target of 2% of GDP, highlighting significant gaps in collective military readiness. Since 2022, momentum toward meeting this benchmark has accelerated. NATO estimates that 23 out of 32 members are expected to meet the 2% target in 2024 in comparison to seven in 2022 and just three in 2014, reflecting a commitment to bolster defence capabilities.

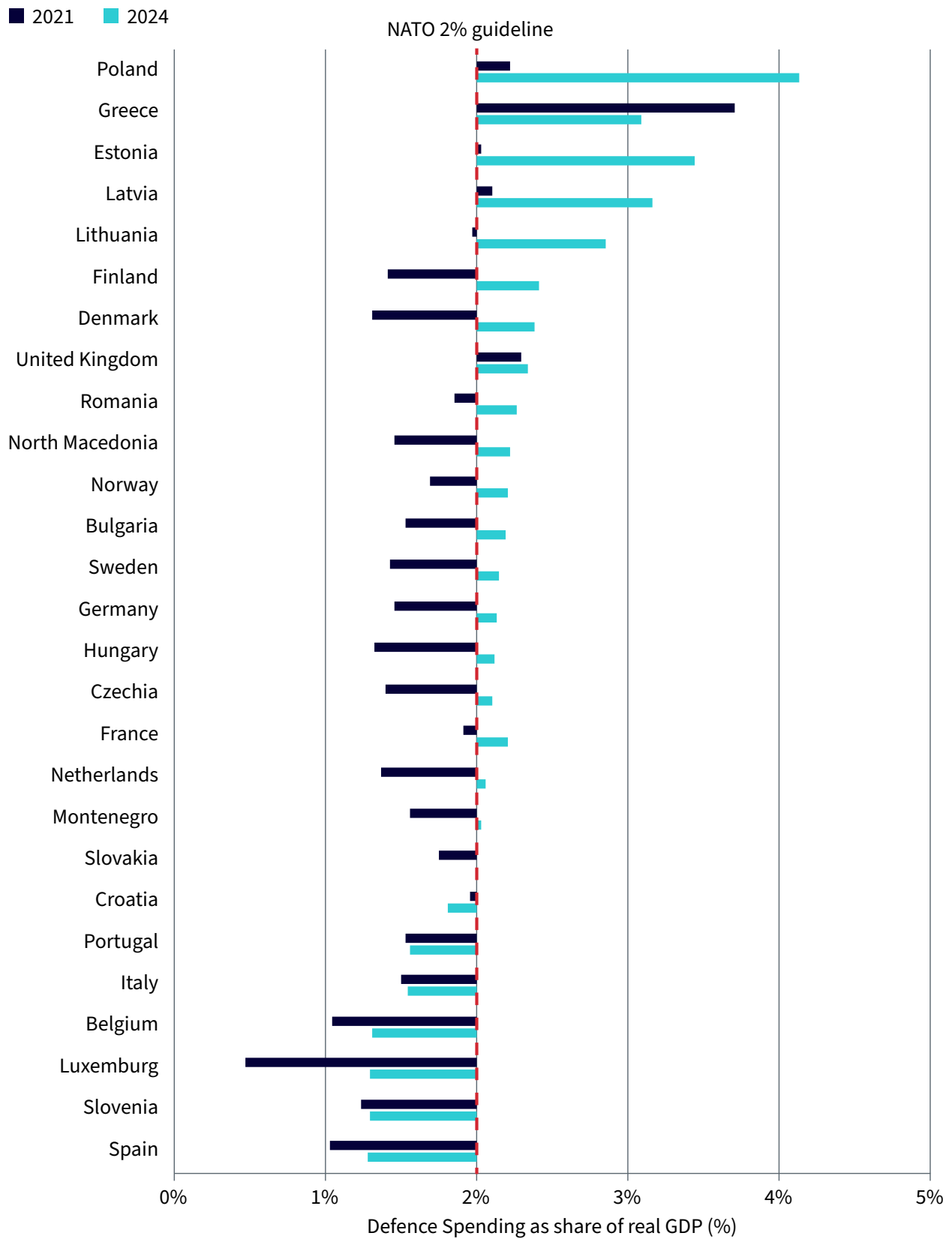
Total EU defence spending in 2024 is estimated to reach €326 billion, reflecting an 11% increase in total NATO spending compared to 2023, with a 19% rise among European NATO members². However, many European nations may require even higher investments to address existing shortfalls and enhance military readiness amidst evolving security challenges.

At the 2023 Vilnius Summit, NATO leaders agreed a new Defence Investment Pledge, making an enduring commitment to investing at least 2% of GDP annually on defence³. They acknowledged that in many cases, expenditure beyond 2% of GDP would be needed to remedy shortfalls and meet new requirements across all domains arising from a more contested security order.

² European Defence Agency

³ NATO 2023 Vilnius Summit Declaration

Figure 1: Nato allies defence spending following Russia’s invasion of Ukraine



Source: Atlantic Council, WisdomTree. 2024 numbers are estimates. Iceland excluded as it does not have a standing army.

European Defence Industrial Strategy objectives to 2030

The European Defence Industrial Strategy (EDIS) objectives to 2030 present transformative opportunities for Europe's defence sector, driving innovation, collaboration, and growth while addressing strategic security needs.



Increased Investments and revenue growth: The EDIS objectives are aimed at boosting defence spending across EU member states. This increased spending unlocks significant revenue opportunities for European defence manufacturers, estimated to exceed €500 billion annually by the late 2020s⁴.



Focus on strategic autonomy: EDIS aims to reduce reliance on non-European suppliers by fostering an independent European Defence Technological and Industrial Base (EDTIB).



Innovation and Research & Development (R&D) expansion: By 2030, European defence R&D spending is expected to grow by 5–10% annually, offering a competitive edge to European firms in global markets⁵.



Enhanced collaboration across member states: The strategy promotes joint projects and pooled resources, reducing inefficiencies caused by fragmented procurement and development processes.



Export Market Expansion: Europe's focus on advanced and autonomous defence systems positions it as a major global arms exporter, potentially increasing exports by 30–40% by 2030.

Opportunities in European defence

The European defence sector is undergoing a transformation as countries ramp up their military spending to meet NATO's defence spending guidelines. European NATO procurement budgets – the part of the defence spending budget that affects contractors most – are expected to grow by 4.5% a year on average for the rest of this decade. The beneficiaries of this increased defence spending include munitions manufacturers like Rheinmetall AG, alongside BAE Systems Plc, driven by growth in F-35 deliveries and the AUKUS submarine program. Other key players include Leonardo SpA, with expertise in defence electronics and cybersecurity, and SAAB, particularly in missile systems.

Budget allocation is a national, sovereign decision, but NATO allies have agreed that at least 20% of defence expenditures should be devoted to major equipment spending, including the associated R&D, perceived as a crucial indicator for the scale and pace of modernisation.

European defence companies' face substantial backlogs that have been growing at record pace over the past two years, indicating future demand. Many defence companies are gearing up for

⁴ McKinsey & Company

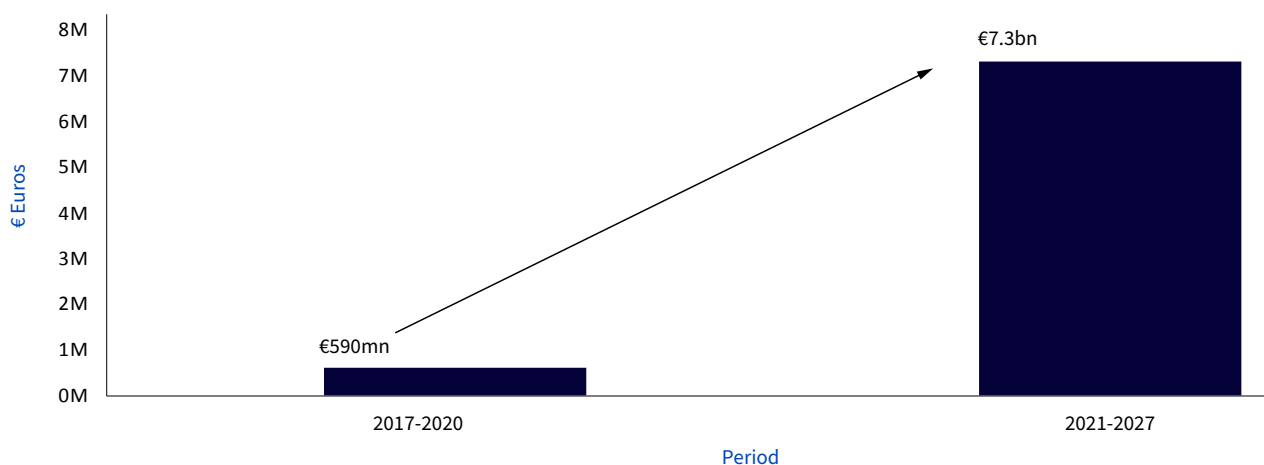
⁵ European Defence Agency

further capacity expansion to meet rising demand. Capital expenditure budgets are anticipated to expand over the next decade, supported by robust operating cash flows.

Role of technological advancements

Leveraging innovative technologies and adopting new operational approaches, Europe’s defence industry is enhancing its capabilities and competitiveness. The European Commission has significantly ramped up investment in weapons and defence technologies. €590 million was allocated to defence initiatives between 2017 and 2020, this has now surged to a €7.3 billion (\$7.9 billion) funding package for the 2021–2027 period. In 2024 alone, the European Defence Fund (EDF) committed €1.1 billion across 34 calls for proposals, targeting a wide range of military-related research and development projects.

Figure 2: Investment in weapons and defence technologies



Source: European Commission as of July 2024. Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

Europe has emerged as a leader in adopting technologies that improve military equipment. Significant investments are being made in advanced propulsion, biotechnology, nanotechnology, and new materials. These advancements are strengthening European military power, particularly in long-range precision weaponry and enhanced munitions.

At the same time, cybersecurity has become critically important. European nations are focusing on increasing resilience against cyber threats and combating cybercrime. These coordinated efforts demonstrate the EU’s 2019 commitment to protecting its digital infrastructure and addressing the growing challenges of a more connected yet contested cyberspace.

Lessons from the war in Ukraine

The war in Ukraine has significantly shaped the future of warfare, highlighting the critical importance of advanced technologies. The scale of ammunition usage and deployment of sophisticated weapons underscored the growing reliance on innovations such as unmanned aerial vehicles (UAVs or drones), the strategic value of cyber and space domains, the

transformative power of high-velocity intelligence fusion and dissemination, and the pivotal role of electronic warfare and its countermeasures.

Unmanned aerial vehicles (drones)

Growth and applications:

UAVs have become integral to military operations, providing surveillance, reconnaissance, and strike capabilities. Their ability to operate without risking human lives makes them valuable assets in various combat scenarios.

Data and images:

Numerous defence companies are investing heavily in drone technology. For instance, BAE Systems and Northrop Grumman are developing advanced UAVs equipped with AI capabilities for enhanced decision-making and operational efficiency.



Importance of cyber and space domains

Cyber warfare:

Cyber countermeasures are essential for defending against attacks that could compromise military systems, emphasizing the need for robust cybersecurity measures.

Space operations:

Space is becoming a vital arena for military operations with nations investing in satellite technologies for communication, navigation and reconnaissance.



High Velocity Intelligence Fusion and Dissemination

Intelligence fusion:

High-velocity intelligence fusion involves integrating vast amount of data from various sources to provide actionable insights quickly. This process supports decision-making at all levels of command.

Operational efficiency:

Modern military operations rely on synchronised Intelligence, Surveillance and Reconnaissance (ISR) capabilities that can operate across multiple domains simultaneously. This integration enhances situational awareness and operational effectiveness.



Electronic Warfare and Countermeasures

Electronic warfare (EW):

EW encompasses a range of tactics used to disrupt enemy electronic systems while protecting friendly forces. This includes jamming communications, deceiving radar systems and employing directed energy weapons.

Countermeasures:

Electronic countermeasures (ECMs) are designed to deny targeting information to enemies by tricking or deceiving their detection systems. These can be used offensively or defensively to enhance survivability in combat situations.

These technological advancements reflect a shift toward sophisticated military operations that leverage data, automation, and electronic capabilities, positioning Europe's defence industry as a global leader in innovation.

The European defence landscape is at a pivotal moment, driven by heightened security demands, technological progress, and strategic shifts. With robust investments and a commitment to innovation, the sector offers compelling opportunities for growth, making the WisdomTree Europe Defence strategy a timely and strategic investment avenue.

Important Information

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.



WisdomTree.eu
+44 (0) 207 448 4330