Global defense outlook: A compelling opportunity to participate in a generational defense build up

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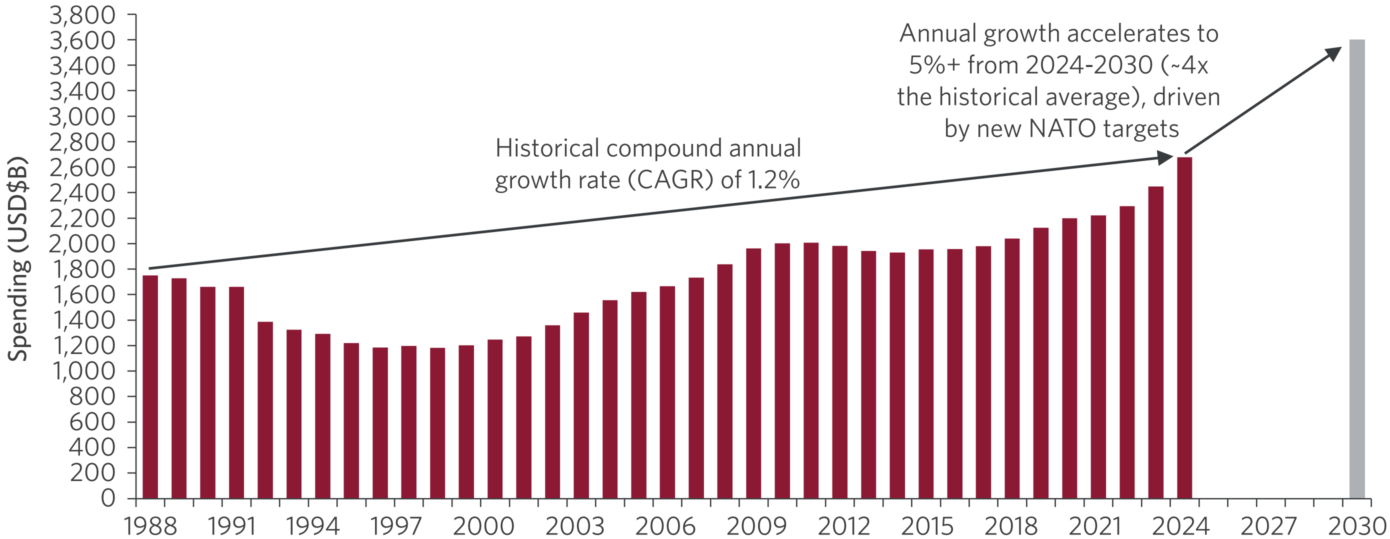
Key takeaways:

- The world is entering one of the most significant periods in modern history for defense spending
- Canada, Europe, the US, and Japan all represent varying degrees of opportunity
- Near-term potential for peace between Russia/Ukraine will not slow down the pace of spending
- Space is likely to be a key investment theme as militaries look to modernize and defend from new threats

Following nearly 4 years of heightened geopolitical tensions (with no clear end in sight), the recent commitment from North Atlantic Treaty Organization (NATO) countries to increase defense spending (with projected incremental spend of USD$300B+, which is purely defense-related and not driven by infrastructure) is the key factor underpinning our view that global defense represents one of the most compelling investment themes for 2026 and beyond.

Global defense spending outlook



For illustrative purpose only.
Source: Stockholm International Peace Research Institute (SIPRI), Our World in Data. As of year-end 2025.

Key global markets:

Canada – A domestic defense revitalization: Mark Carney's commitment to spend 5% of GDP on defense (and related infrastructure) by 2035 will likely represent one of the most substantial defense build-ups in Canada's modern history. Additionally, the *pace* of spending will be accelerated materially. In 2024, the Trudeau government released the "Our North, Strong and Free" defense mandate, calling for ~$81B of total spending over a 20-year period. This compares to $81B over just 5 *years* in the 2025 budget.

The data points below help put the changes in defense spending into context:

- The 5% spending level would compare to just 1.4% in 2024 (and a low point of 1% in 2015)
- The last time the Canadian government spent 5% of GDP on defense was in the late 1950s
- Canada has not spent 2% of GDP on defense since 1990
- Planned defense funding in fiscal 2025 will represent the largest annual increase since 1952

Given the scale and pace of defense-related spending increases, we view Canada as an environment with a handful of high-quality opportunities for investors to take advantage of. The fact that 82% of all aerospace and defense activity is exported globally (the highest rate in the world) is a key source of potential growth, as a portion of manufacturing, research, and development activity can be re-domiciled. We also see potential for technology transfer agreements between Canada and other countries (especially the US given upcoming United States-Mexico-Canada Agreement (USMCA) negotiations), much like the rumoured collaboration between Bombardier and Saab for the manufacturing/development of Gripen fighter jets. Agreements of this nature would allow Canada to participate in and receive economic benefit from projects that the country does not currently have the capacity to take on independently. We also believe that for any purchase agreements from foreign companies, Mark Carney will focus on securing a minimum level of investment in Canada to ensure job creation and an accelerated build-up of Canada's defense industry. We also note Canada's fiscal position (with a deficit that is ~4% of GDP) is at the lower-end of all economies mentioned in this report, leading to more accommodative fiscal capacity.

North American Aerospace Defense Command (NORAD) modernization, Arctic surveillance, submarines, shipbuilding, flight simulation and pilot training, defense aircraft, satellite manufacturing, and space-related activity are key areas of opportunity for investors to take advantage. Companies we consider well positioned include CAE Inc., Bombardier, and MDA Space.

United States – Trump giveth, Trump taketh: While the US represents a considerable growth opportunity, we view its defense landscape as among the most complex and unpredictable. Relative to the other markets examined, we believe the US is the most late stage of all, with the most limited fiscal capacity (deficit expected to remain near 8% of GDP). Recent announcements by President Trump have had a sort of whipsaw effect on US defense primes, with potential restrictions on capital allocation driving stocks lower, only for a proposed USD$1.5T budget in fiscal 2027 (implying ~5% of GDP and a 50% increase from current levels) to drive a sharp recovery. Given the scale and capacity of the US defense industry, we believe domestic firms will benefit from capacity constraints in Canada and Japan, and to a lesser extent, Europe. Lastly, the strategic importance of Greenland (and President Trump's hyperfocus on the territory) will likely lead to additional defense and infrastructure investment. Greenland's location provides critical tracking and interception capabilities for submarines, missiles, and other threats that would potentially emanate from Russia. As a result, we believe submarine ports, missile defense systems, enhanced surveillance/imaging technology, and personnel facilities will be required.

Despite this, we view any executive order restricting capital allocation decisions as a source of further uncertainty for US defense stocks (not limited to legacy primes). The push for mandatory investment in production capacity is likely to limit growth in free cash flow, and limitations on buybacks would hurt earnings growth potential. Trump's generally unpredictable nature, willingness to target specific companies, and existing relationships with private defense players gives us pause on the potential for successful stock picking in the US defense market. We also believe that next generation defense platforms such as Anduril, SpaceX, and Palantir (two of three being private) are likely viewed as more technologically advanced, able to do more with less, and better positioned for speed of delivery. For these reasons we think a share of incremental contract awards will likely go to privately held firms, potentially limiting upside for legacy primes like Lockheed Martin, RTX Corporation, and Northrop Grumman.

Europe – Less a choice, more a requirement: The Russia/Ukraine conflict has fundamentally reset threat perception in Europe. Geographic proximity to Russia, and more importantly to Ukraine, has effectively re-framed defense spending in numerous major European economies as mandatory national resilience versus discretionary foreign policy. Increased preparation is now considered a structural, non-cyclical requirement in order to minimize the likelihood of future conflict and deter potential aggressors.

While Eastern Europe and the Baltic states are the most at risk, we view Germany and France as sizeable Western European economies that will represent a significant share of total spend.

Germany: Europe's largest spender on defense, accounting for 25%+ of total outlay. €649B of total spend is planned over the next 5 years, more than double the country's prior rate. Recently announced €350B of planned *additional* funding, supporting a 3.5% core military spending target by 2029. In March 2025, Germany amended its constitutional "debt brake", allowing the government to create an off-budget fund solely to support increased defense spending. Rheinmetall, Hensoldt, and RENK Group are highlighted as key participants.

France: Recently accelerated the planned annual defense budget of €64B up to 2027, vs. the previous 2030 timeline. While questions remain on how France will fund spending increases, the country possesses a particularly strong aerospace environment, with Airbus, Dassault, and Thales all positioned well.

Given recent trade-related tensions between the Trump administration and the EU, we believe the percentage of defense activity allocated to US contractors will decline over time, benefiting domestic European platforms.

While a potential Russia/Ukraine peace deal will likely result in near-term headline risk, we believe the long-term outlook for European defense spending remains strong and stable. A potential restriction on NATO membership, a cap on the size of Ukraine's military, and the possibility of Ukrainian land concessions removes a significant buffer between Russia (and its ally Belarus) and the rest of Europe. We also believe the presence of NATO troops in Ukraine will be a significant point of contention for Russia in negotiations. Lastly, multiple instances of airspace violations (such as into Poland, Sweden, Romania, and Latvia) by Russia has demonstrated Putin's willingness to repeatedly push the boundaries with other European countries, underpinning the need for military strengthening and preparedness.

A key example of preparedness is ammunition inventory. The current NATO standard for ammunition inventory (minimum) is a 30-day supply. This compares to the existing inventory level in Europe of **2-3 days**. Even if the Ukraine war ended tomorrow (removing the largest source of consumption), it is estimated that it would take ***13 years*** (primarily due to input shortages) to reach the 30-day standard. There are also discussions to increase the standard to 60-90 days, further driving the need for additional investment and ultimately, independence from the US. We view Rheinmetall as well positioned for ammunition demand.

Finally, we flag the relaxation of environmental, social, and governance (ESG) restrictions throughout 2025 by the European Union (EU) which now allows defense companies to qualify for ESG benchmarks, potentially opening up significant capital flow into defense-focused stocks.

Japan – External threats force an independent approach to defense: Much like Europe, Japan is facing the most severe and complex national security environment since the end of WWII. Although Japan is not currently a member of NATO, the country's government has already approved numerous budget increases to support defense-related spending. While Japan's defense spend has historically been limited to 1% of GDP, the Defense Buildup Program (announced in 2022) called for doubling this figure to 2% by 2027 (implying ¥43T of total spend). This timeline has since been accelerated to fiscal 2026, primarily underpinned by the election of prime minister Sanae Takaichi, who is viewed as exceedingly supportive of defense budget expansion. Takaichi has also signaled willingness to bring the budget *beyond* 2% of GDP over time. Trump has also maintained his position that Japan should spend 3.0-3.5% of GDP on defense in order to reduce reliance on US military support. Japan has recently begun deploying missile batteries, radar towers, and other combat facilities on the Ryukyu island chain, located near Taiwan, which will likely put further tension on the country's relationship with China.

Despite the various threats Japan is exposed to (China's aggression towards Taiwan, Russia, North Korea), we note the fiscal environment has potential to limit growth. Japan's finances are heavily dependent on debt, and certain expenditures (i.e. social security given a rapidly aging population) are unlikely to moderate.

Potential barriers to growth

We must acknowledge that these planned increases in defense spending across Europe and allied countries may not fully materialize as expected, particularly given fiscal constraints. Many governments face high debt levels, rising interest burdens, aging populations and competing demands for social spending, all of which limit fiscal flexibility. Financing higher defense spending through additional borrowing could exacerbate debt sustainability concerns and expose countries to funding pressures, while funding them through higher taxes or spending cuts would likely prove politically difficult and is economically not palatable either.

The EU has taken steps to alleviate these challenges with a number of initiatives, such as the Security Action for Europe (SAFE), which allows EU countries to borrow at competitive rates, and loosening the EU fiscal rules with the national escape clause which allows member states to increase defense spending without breaking budget rules. Separately, countries like Germany have taken measures to provide mechanisms to increase defense spending without violating fiscal rules. While we believe there is a high level of commitment to ramp up defense spending towards the 5% target and the direction of travel is certainly for higher levels of spending, we take a balanced approach and acknowledge that there will be fiscal constraints that may affect the timing and ultimate level of spending.

Notable projects & areas of focus

Space: Given the significant shift towards the use of unmanned equipment (e.g. drones and missiles), space is now considered inseparable from future warfare and is expected to be a core investment theme. Beyond direct use in conflict, satellites also act as a critical piece of infrastructure for non-traditional communication networks. As many as 70,000 LEO (low-earth orbit) satellites are expected to be launched over the next five years, propelling the satellite market to an estimated value of USD$108B by 2035 (annualized growth of ~22%). Defense-oriented use cases for LEO satellites include surveillance (particularly in Arctic regions), advanced imagery, secure communication networks, and monitoring of borders and critical maritime/infrastructure assets.

Can the Golden Dome be a golden opportunity? The proposed Golden Dome project is a layered missile defense network integrating ground, air, maritime, and space-based elements. While the cost, scale, and ultimate feasibility of the project remain unclear, the initial cost estimate from President Trump comes in at USD$175B, with completion expected by the end of his term in 2029. Defense experts suggest both targets are unrealistic, with an independent estimate from the Congressional Budget Office pegging the total cost at north of USD$3.5T. While the project has the potential to be a long-term source of growth, ultimate visibility at this stage is very low. President Trump has also directly mentioned Canada's potential involvement, requesting a USD$61B investment. While it is far too early to determine Canada's ultimate contribution, we flag MDA Space as a beneficiary should a partnership be formed.

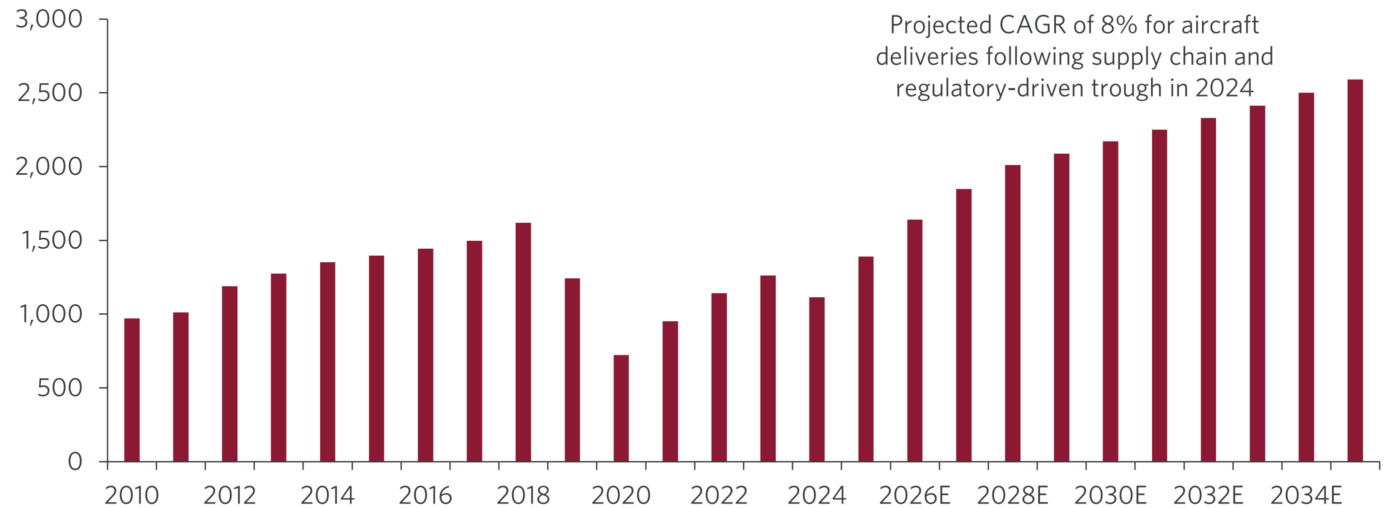
Force projection & fighter jets: European countries will need to expand force projection capabilities as the US shifts its focus toward the Indo-Pacific region. Platforms that support force projection such as bombers, transports and aerial tankers will become critical to strengthen and expand Europe's reach. Currently, Europe lags the US, Russia and China in force projection capabilities which should drive growing demand for these platforms. Similarly, Europe also has a gap in fighter jets with Russia and the US. Significant investments to modernize and expand the fleet will be required. Together, increased spending on force projection and fighter jets should become a strong growth driver across the supply chain, from engine and munitions production to pilot training.

Naval investment: Across all regions mentioned in this report, naval investment is one of the most structurally durable components of defense investment. While fleet expansion and modernization serve as key elements of spending, ISR (intelligence, surveillance, and reconnaissance), which support sea control, homeland missile defense, and critical maritime infrastructure protection will likely become a key growth driver.

Spotlight companies:

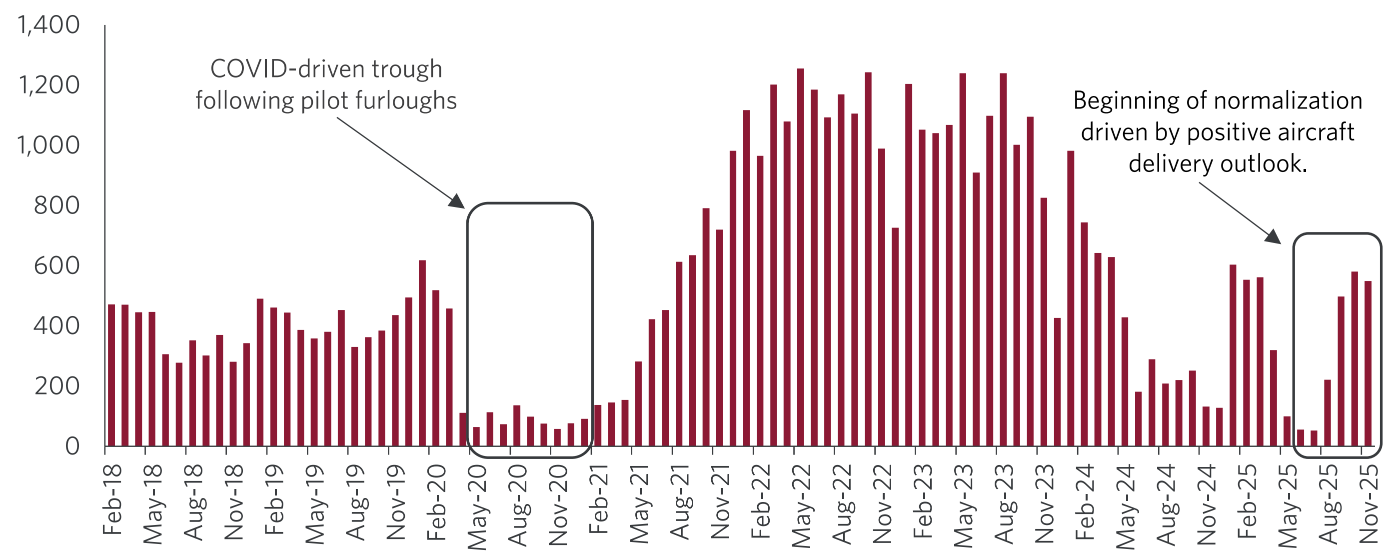
CAE Inc: Given CAE's position as a global leader in flight simulation/training services and the fact that ~46% of revenues are derived from the defense industry, we view the company as well positioned to benefit over the long term from defense spending tailwinds. Our research suggests that if CAE captures just 50-100 basis points (bps) of global incremental defense spend, it could lead to 40-50% growth in their defense business. We also believe a new management team with an enhanced focus on operational efficiency and asset optimization will drive utilization rates higher and improve both civil and defense operating margins over the long term. Growth in commercial aircraft deliveries and a resumption in pilot hiring should also support simulator sales and the demand for pilot training.

Commercial aircraft delivery outlook



For illustrative purpose only.
Source: Combination of sell-side estimates from Canadian and US brokers. As of December 2025.

Monthly pilot hiring trends



Source: Future & Active Pilots Alliance (FAPA). As of November 2025.

Bombardier: Since 2021, Bombardier has undergone a material transformation from a troubled, diversified transportation company to a pure-play aviation platform. As a result, adjusted EBITDA has grown at ~52% CAGR, margins have expanded by over 1,400bps, FCF generation has materially improved, and leverage has declined from a peak of ~42x to a healthy range of 2.0-2.5x. Expansion of the company's service segment and continued growth in the defense platform will continue to support higher margins over the long term. The company's leading position in defense-focused Early Warning Aircraft (EWA) and the interchangeability between business and defense jets gives Bombardier rare and highly valuable manufacturing flexibility.

MDA Space: As a key player in satellite manufacturing with a market-leading product, we believe MDA Space is well positioned to benefit from a long-term shift towards satellite usage and adoption from both corporate and defense clients. While idiosyncratic risks surrounding contract uncertainty remain as an overhang on the stock, we believe the level of demand for surveillance, monitoring, and communication networks will support MDA's business over the long term. In addition, healthy and stable margins, a strong balance sheet, and top-tier product quality/technological capabilities are underappreciated factors within MDA Space. We also note MDA's recent investment in Maritime Launch, providing the company with critical access to launch services and enhancing the ultimate value proposition for satellite customers.

Additional opportunities:

In addition to the companies listed above, we also view BRP Inc. and Canadian Engineering Consultancy (E&C) firms as potential beneficiaries of defense-related spending, albeit to a lesser degree. BRP has an underappreciated opportunity to deliver specialized and modified equipment to the Canadian military, specifically snowmobiles for Arctic operations. We also note BRP's capability to manufacture drone engines, which we consider a key area of growth as militaries continue to focus on unmanned operations. On the E&Cs, we believe increasing participation by Atkins-Realis, Stantec, and WSP Global will support incremental growth. Projects covering shipyard optimization, seaport and dry dock construction, and military base revitalization across various geographies are considered opportunities for these firms.

Conclusion:

The global defense sector stands at the forefront of a generational investment opportunity, driven by rising geopolitical tensions and a structural shift in the focus on national security across North America, Europe, and Asia. NATO's renewed targets and various multi-year commitments from some of the largest economies globally will drive a level of investment that far exceeds historical norms. Among the most important factors is the scope of the opportunity. As space continues to emerge as a critical domain, we expect investment to extend far beyond traditional military hardware. A focus on unmanned assets will also represent a core theme. To conclude, defense remains one of the most critical and resilient investment themes for 2026 and beyond. Structural tailwinds and multi-decade spending commitments create a compelling landscape for investors.

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