

Defence-Themed ETFs and Mutual Funds: Hype or Real Investment Opportunity?

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In this shared research report Detlef Glow analyses the asset allocation, assets under management, fund flows, and Total Expense Ratios of defence-themed ETFs and mutual funds (available for investors in Europe) based on the investment theme of higher defence spending in the NATO member states and other countries of the world in an attempt to identify the differences in the products as well as underlying trends and developments.

In addition, Tajinder Dhillon puts a spotlight on the development of the valuations of defence stocks by using LSEG StarMine model scores and analyst forecasts. While Robin Marshall, analyses the already visible impacts of increased spending on German Government bonds.



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Defence-Themed ETFs and Mutual Funds – The New Kids on the Block?

Since the end of the Second World War, Western European countries have no longer been confronted with military conflicts on their soil and have enjoyed increasing economic growth and general prosperity. This so-called peace dividend is based on trusting cooperation between states on a political and economic level. In addition to the political and economic solidarity, the countries of Western Europe also built their defence community, NATO (North Atlantic Treaty Organization), to maintain peace. This long period of peace prompted the heads of state and government of these countries to reduce their defence spending even though the NATO agreement requires them to spend at least 2% of their GDP on defence. The lack of investment in their defence made European countries vulnerable for any armed conflict on their home ground and therefore increasingly dependent on the U.S. over time.

With the outbreak of war in Ukraine in February 2022, many European countries realized that there was a real possibility of war in Europe. In the context of the promised military aid for Ukraine, it became clear that although many countries were prepared to support Ukraine, they were unable to keep their promises due to a lack of the necessary equipment.

This situation led some European countries to increase their defence budgets in order to provide the promised military aid and at the same time maintain their ability to defend themselves. As a result of this increased defence spending, investors began to buy shares in defence companies which led to corresponding price increases. With this emerging trend, the investment industry began to develop initial products and place them on the market over time.

Since the European ETF industry has always been very innovative with the launch of new products, it was no surprise to see that the first defence-themed products launched in this environment were ETFs. That said, the oldest available defence-themed product available is a mutual fund, **APUS Capital Defence Fonds R**, which was launched on October 16, 2017. While the first spree of defence-themed ETFs launched between July 3, 2023, and October 29, 2024, were investing in stocks which may profit from the increase in defence spending globally, the next round of product launches were defence-themed ETFs with a focus on stocks which may profit from the increase in defence spending in Europe. Conversely, all mutual funds, with exception of the APUS Capital Defence Fonds R, were launched in 2025.

With the new spending goal of 5.0% of the GDP, which includes defence-related infrastructure spending, NATO members set the stage for new investment products during the NATO meeting on June 25, 2025. The revised spending target is anticipated to drive substantial changes in the financial performance of defence contractors and firms involved in military infrastructure and equipment production.

When it comes to this, defence-themed investment products now have an even more solid investment case than ever before. Despite this, even as NATO members have agreed to more than double their annual defence spending by the year 2035 it needs to be seen if the respective actions are really taken. The past proved that defence spending is one of the positions that get slashed in annual budgets if a government needs the money to fulfil the promises they made during their election campaigns.

With regard to the unknown defence spending pattern and the high valuations of some defence stocks, it is not surprising that investors are somewhat nervous and react negatively to any political news about a possible ceasefire or peace negotiations around the war between Russia and Ukraine, since such an agreement would lower the demand for weapons and ammunition.

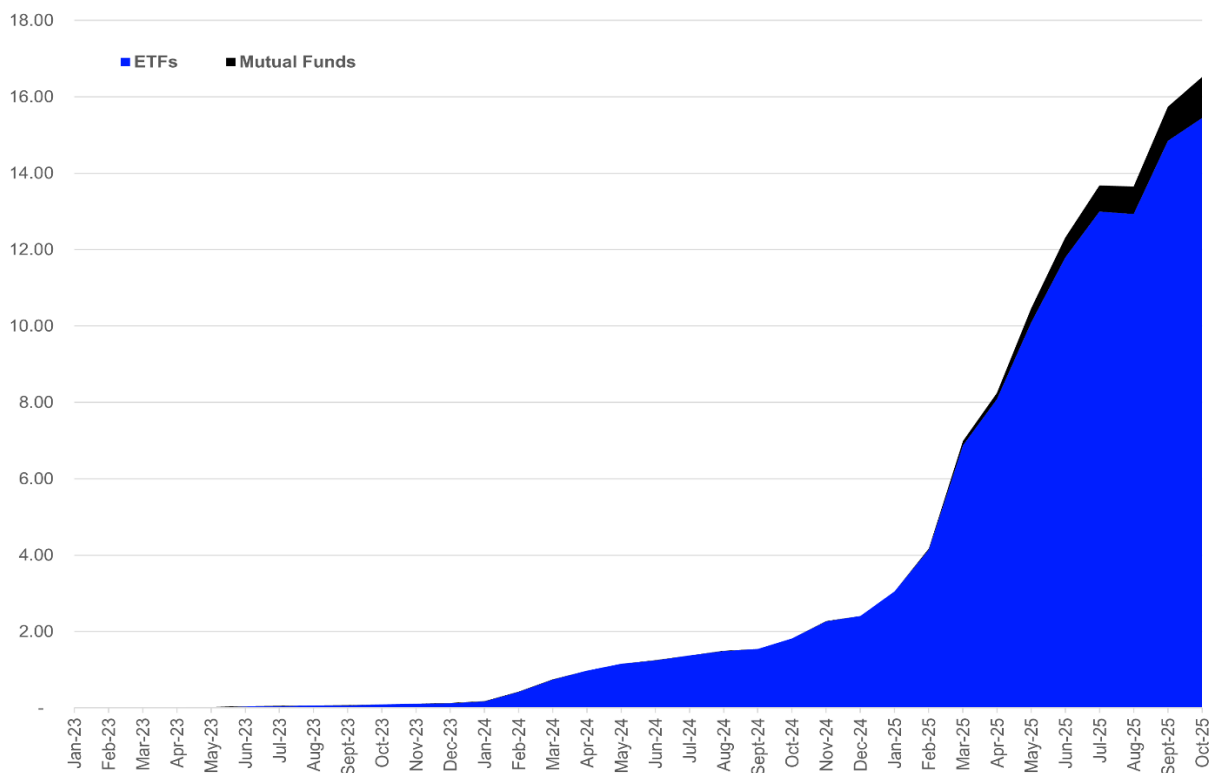
This means that the general defence spending might be much lower than expected, which in turn will negatively impact the earnings of defence-related companies and, therefore, also the investment case for defence-themed mutual funds and ETFs, since this will impact the expected returns negatively.

Assets Under Management in Defence-Themed Products

As chart 1 shows, the investment theme of defence has gathered some interest from investors in Europe. This seems to be especially true since the beginning of the year 2025, since U.S. President Donald Trump made clear that any future engagement of the U.S. in NATO would be dependent on increased defence spending by all NATO members, as most members did not reach the defence spending target of 2% of GDP. Roughly at the same time, the newly elected German government launched an initiative for increased military spending which should not fall under the measures of the German debt break.

In more detail, the assets under management of defence-themed mutual funds and ETFs did not significantly increase after the outbreak of the war in Ukraine, but started to increase when it became clear that the governments in Europe need to increase their defence spending to keep up with their commitments made to the Ukraine, as well as to increase their own defence capabilities. That said, the largest driver for the popularity of defence-themed products was the inauguration of Donald Trump as new president of the United States of America, as he increased the pressure on NATO members to hit and even overfulfil the agreed spending target of 2% of GDP. As a result, the increased spending agreements led investors towards defence-themed ETFs—the assets under management in the respective products skyrocketed from €1.8 billion on December 31, 2024, to €16.5 billion on October 31, 2025.

Graph 1: Assets Under Management in Defence-Themed Mutual Funds and ETFs Registered for Sales in Europe, January 1, 2023 – October 31, 2025 (in bn EUR)

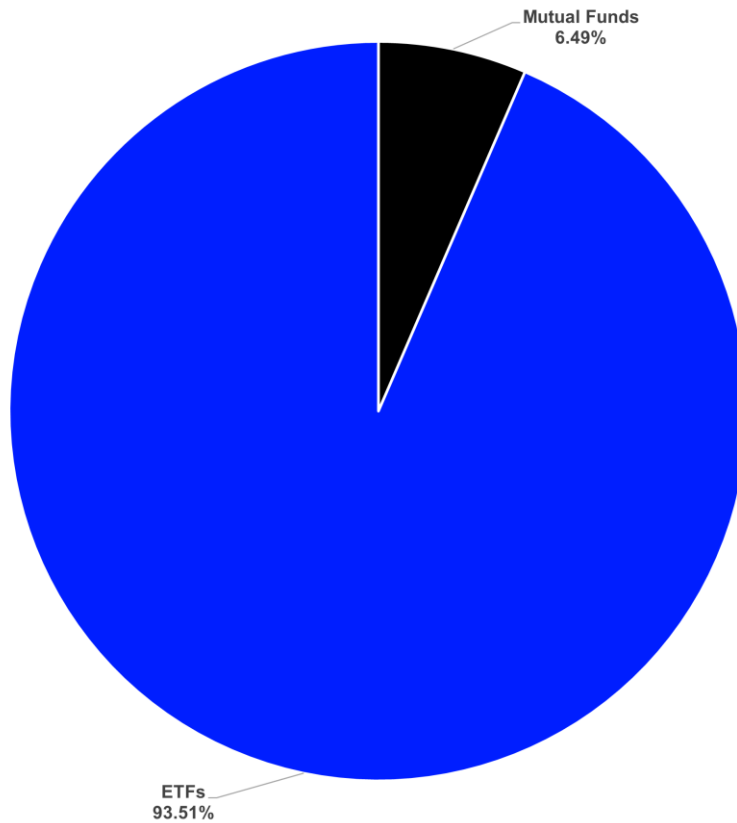


Source: LSEG Lipper

The stunning increase in assets under management was led by exchange traded funds (ETFs). In fact, ETFs dominated the assets under management for defence-themed products. They held €15.4 billion, or 93.51%, of the

overall assets under management on October 31, 2025, while defence-themed mutual funds held only €1.1 billion, or 6.49%, of the overall assets under management on October 31, 2025.

Graph 2: Market Share of Assets Under Management of Defence-Themed Mutual Funds and ETFs, October 31, 2025



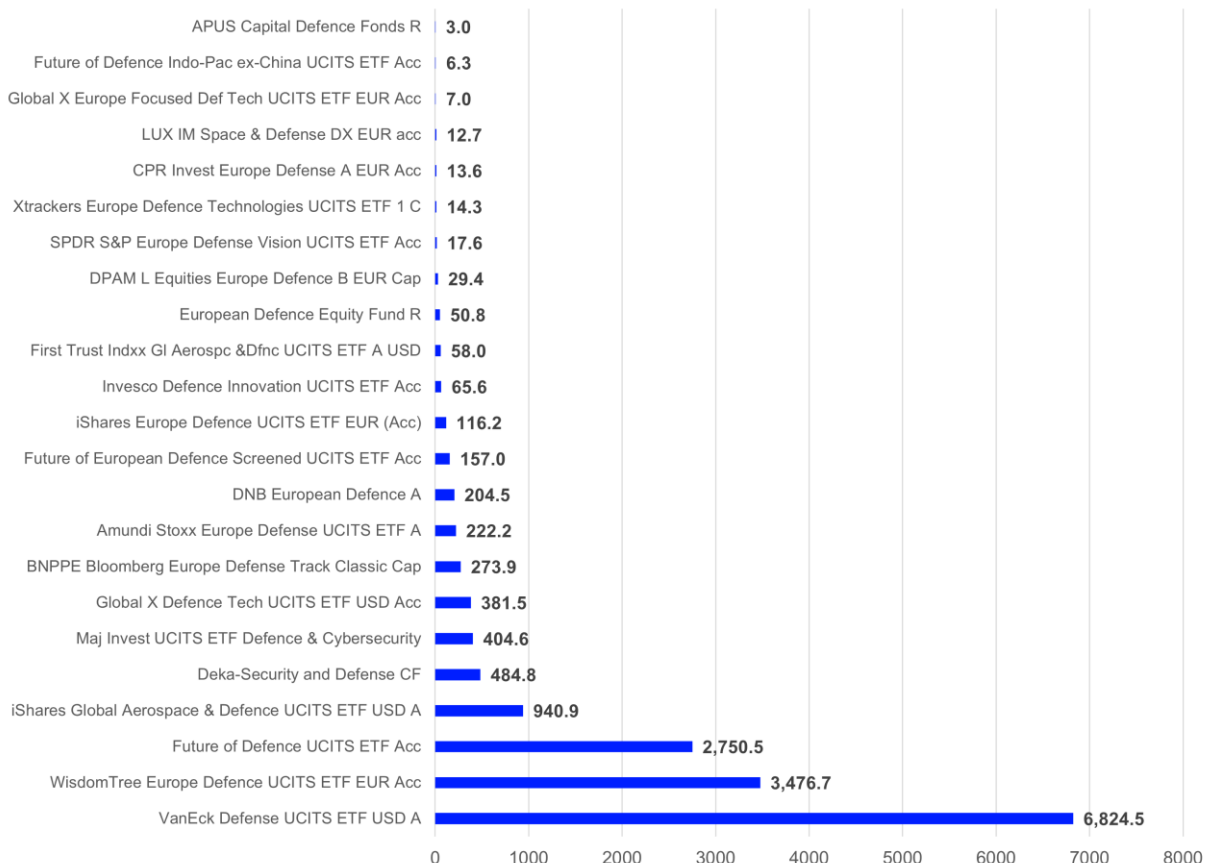
Source: LSEG Lipper

These numbers show that European investors prefer ETFs over mutual funds when it comes to defence-themed products. One of the reasons for this might be seen in the number of available products in each category, as there are only eight defence-themed mutual funds available to investors in Europe, while they can choose from 15 ETFs.

As graph 5 shows, the growth in assets under management was driven by strong inflows in defence ETFs. That said, these flows were mainly concentrated in the largest defence ETFs registered for sale in Europe.

With regard to this, graph 3 shows the dominance of ETFs in the segment of defence-themed products. Only three of the 10 largest defence-themed products are mutual funds, while the other seven are ETFs. As a side note, one may find it interesting that the oldest available defence-themed product (**APUS Capital Defence Fonds R**) is the smallest available product (AUM €2.98 m), which means that the APUS Capital Defence Fonds R could not capitalize on the so-called first mover advantage.

Graph 3: Assets Under Management by Product, October 31, 2025 (in million EURO)



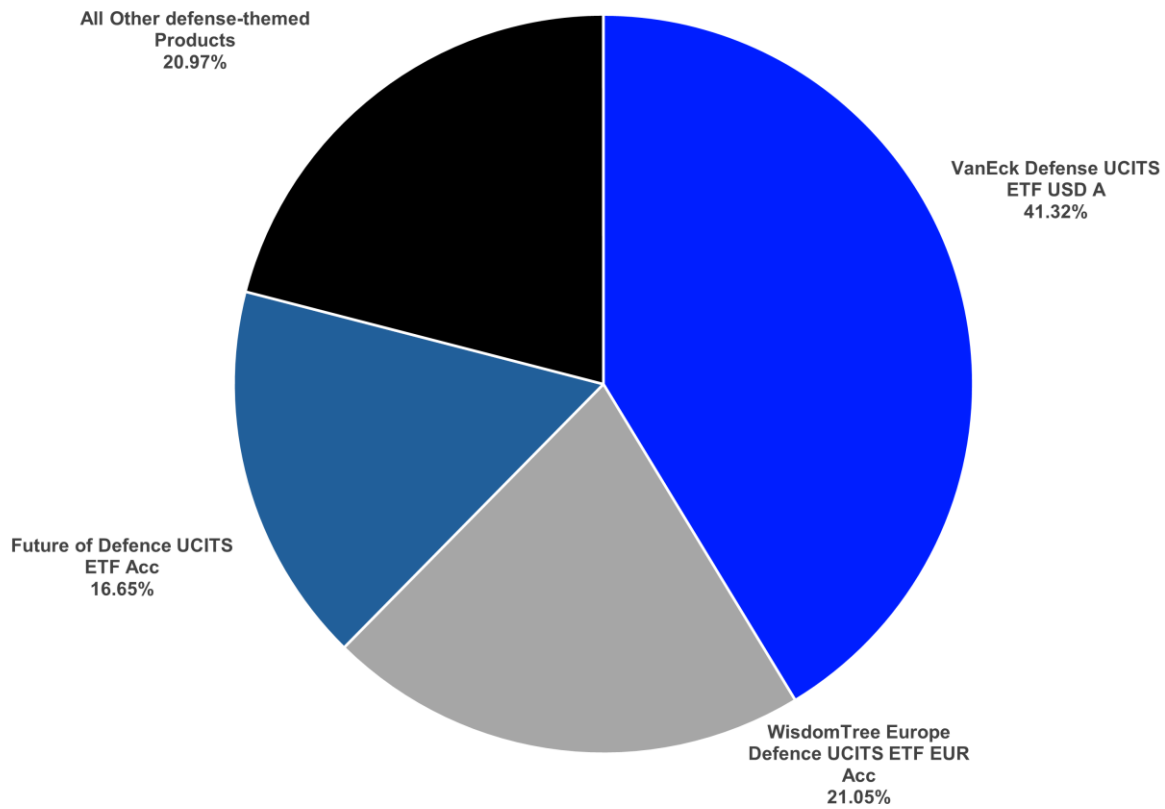
Source: LSEG Lipper

The chart above also shows that the segment of defence-themed products is dominated by three products. The largest defence-themed product in Europe at the end of October 2025 was the **VanEck Defense UCITS ETF USD A** (AUM €6.8 bn), which was actually the first defence-themed ETF in Europe, launched on March 31, 2023. This ETF was followed by the **WisdomTree Europe Defence UCITS ETF EUR Acc** (AUM €3.5 bn) and **Future of Defence UCITS ETF Acc** (AUM €2.8 m). In addition to this, it is noteworthy to bear in mind that the VanEck Defense UCITS ETF USD A and the **Future of Defence UCITS ETF Acc** are investing globally in defence stocks, while the **WisdomTree Europe Defence UCITS ETF EUR Acc** is focusing on Europe.

Additionally, it is noteworthy that the Wisdom Tree Europe Defence UCITS ETF EUR acc has been launched on March 4, 2025, which means it took only six months to become the second largest defence-themed product in Europe.

These three ETFs held combined assets under management of €13.1 bn, or 79.03%, of the overall assets under management in defence-themed products. This underpins the assumption that European investors prefer ETFs when it comes to investments in defence-themed products.

Graph 4: Market Share of Assets Under Management of the Three Largest Defence-Themed Products, October 31, 2025



Source: LSEG Lipper

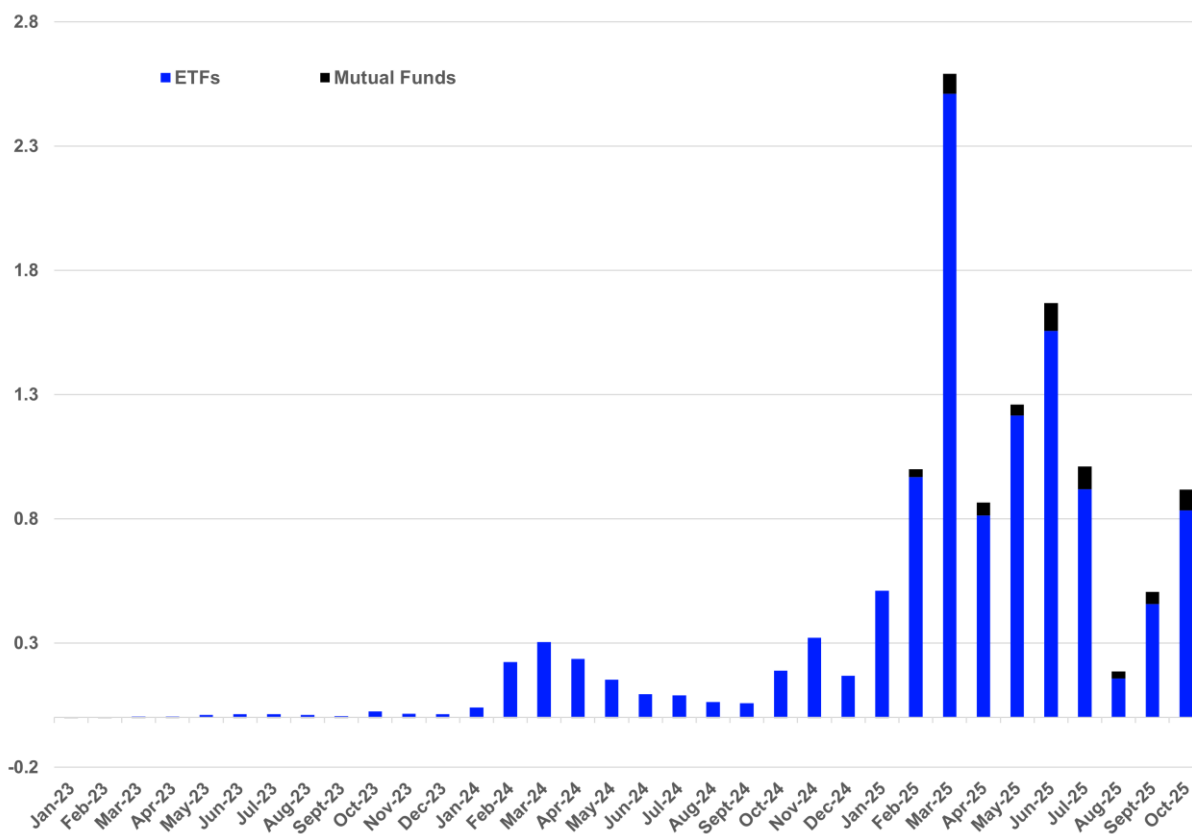
Estimated Net Flows in Defence-Themed Products in Europe

As the topic of defence became part of broader discussions between political decisionmakers, as well as the public, the interest in defence-themed products increased after the breakout of war in Ukraine.

Chart 5 shows that defence-themed products enjoyed estimated overall net inflows in all months, with the exception of January (-€0.01 million) and February (-€0.14 million) 2023 between January 1, 2023, and October 31, 2025.

March 2025 was the month with the highest estimated net inflows (+€2.5 bn) on record since the first defence-themed product was launched on October 16, 2017.

Graph 5: Monthly Estimated Net Sales of Defence-Themed Products in Europe, January 1, 2023 – October 31, 2025 (in Euro billions)



Source: LSEG Lipper

Since European investors have the choice between mutual funds (which were in some cases even long established) and ETFs, it makes sense to analyse the estimated net flows in defence-themed products by product type. As graph 5 shows, ETFs are the preferred products when it comes defence-themed investments.

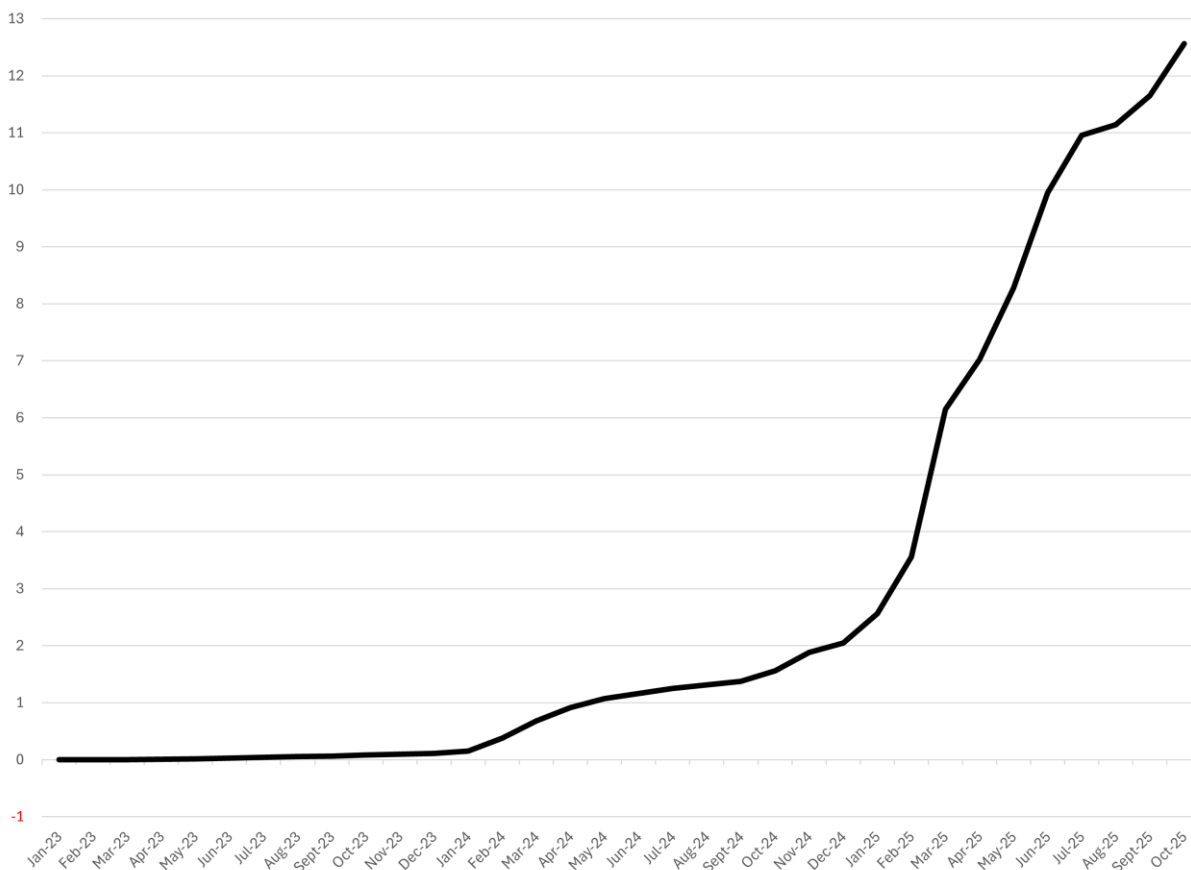
In more detail, defence-themed mutual funds faced slight estimated outflows in 24 of the first 25 months of the observation period, while defence-themed ETFs enjoyed estimated net inflows in each of 34 months of the observation period.

The overall estimated net flows over the observation period add up to €12.6 bn. As graph 6 shows, the majority of these flows were gathered over the course of the first 10 months of 2025. This leads to the assumption that investors were buying into the defence theme after President Trump increased the pressure on NATO member states to reach their defence spending goals of at least 2% of their respective GDPs.

The inflows got fuelled even further when the discussion to increase the defence spending goal for NATO members to 5% reached its peak, as some countries in Europe agreed to this goal to make Europe more independent from the U.S.

The inflows into defence-themed products were further driven by the escalation around the Gaza conflict and other geopolitical discussions.

Graph 6: Cumulative Estimated Net Sales of Defence-Themed Products in Europe, January 1, 2023 – October 31, 2025 (in Euro millions)

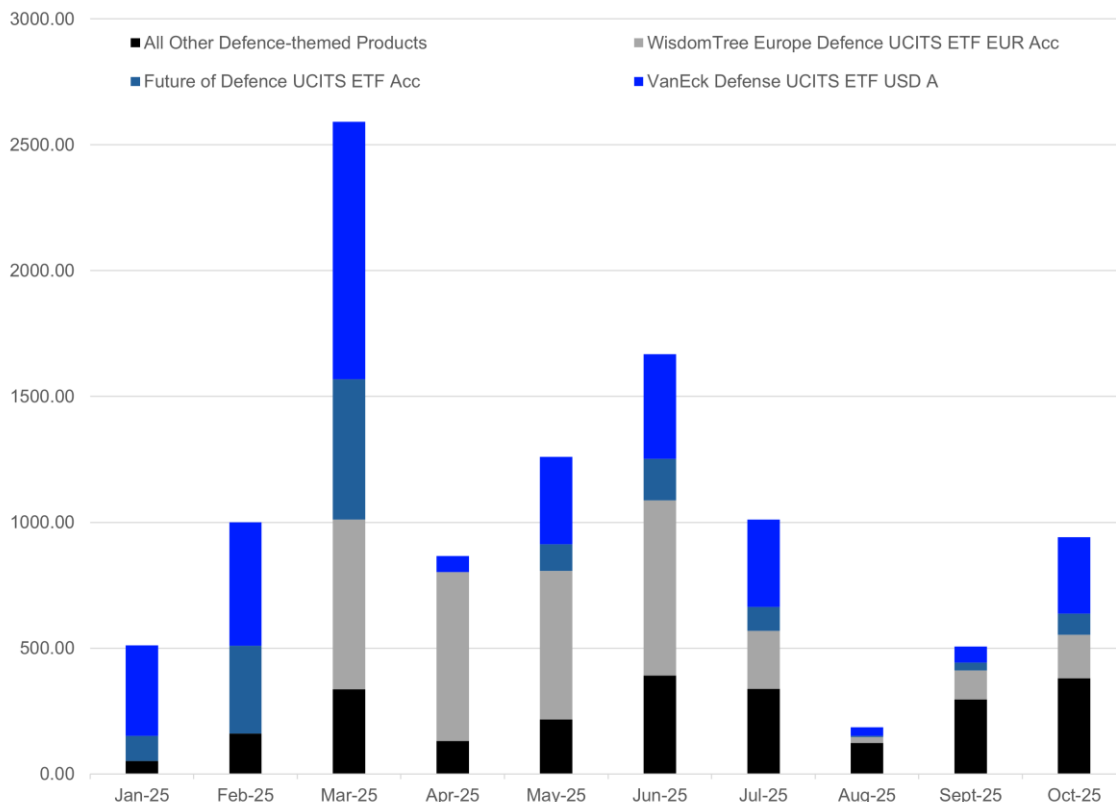


Source: LSEG Lipper

Nevertheless, the inflows into defence ETFs are highly concentrated since only three products were so far able to gather assets under management of more than €1.0 bn.

Chart 7 shows how the newly launched **WisdomTree Europe Defence UCITS ETF EUR Acc** gathered €3.2 bn over the course of seven months. This chart also shows the dominance of the three largest products compared to all other defence-themed products (black) available in Europe.

Graph 7: Monthly Estimated Net Sales of the 3 Top-Selling Defence-Themed Products vs. All Other Defence-Themed Products January 1, 2025 – October 31, 2025 (in Euro millions)



Source: LSEG Lipper

While the **VanEck Defense UCITS ETF USD A** and the **Future of Defence UCITS ETF Acc** may take profit from the so-called first mover advantage since these two ETFs are the oldest defence-themed ETFs available in Europe. The **WisdomTree Europe Defence UCITS ETF EUR Acc**, however, may profit from its comparably low TER (0.40%)—which was the lowest TER of all defence-themed products when the ETF was launched—since European investors seem to be cost conscious. That said, the TER should only be considered as second or third criteria in a proper ETF/fund selection process since it is more important that the respective investment vehicle suits the needs and expectations of the investor rather than just be the cheapest available product. If there are like-for-like products, an investor might prefer the product with the lower TER.

Total Expense Ratios of Defence-Themed Products

The Total Expense Ratio (TER) represents the costs an investor has to bear for the management of a mutual fund or ETF. The TER should not be mixed up with the total cost of ownership because this also takes trading and cost related to the ownership of an ETF or mutual fund into account.

Generally speaking, it is normal that the average TER of defence-themed mutual funds is higher than the TER of defence-themed ETFs, since an ETF does not carry any costs for research or distribution. It is also normal that the TER of a defence-themed ETF is above the average TER of a plain vanilla equity ETF. This is because the providers of the underlying indices often charge the ETF promoters a higher licence fee for thematic indices compared to plain vanilla indices. This is due to the higher costs for research and index development since the index provider needs to build an investment universe based on the respective investment theme. This requires in-depth analysis of balance sheets and revenue streams to identify companies which might be eligible to be included in the respective themed index.

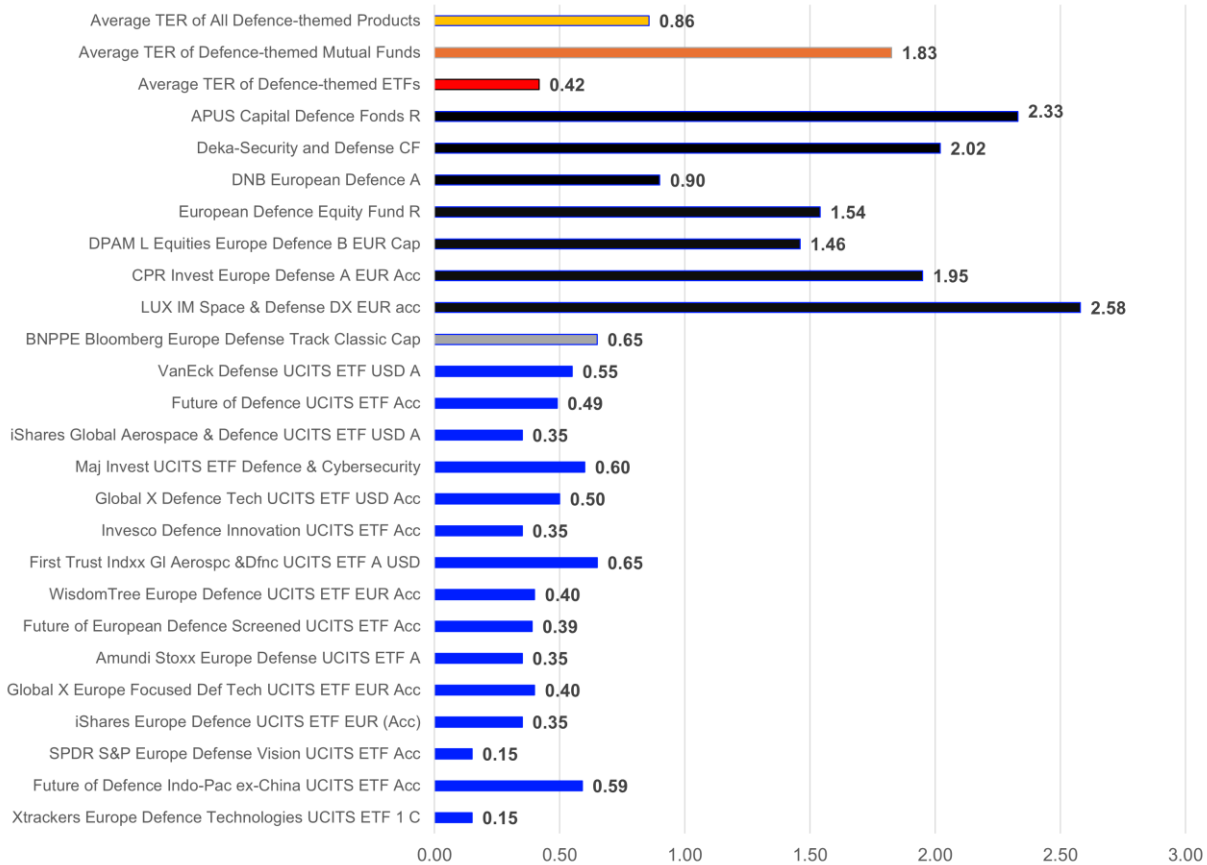
It is considered as normal that the first mover in the segment of defence ETFs charges an above average TER since there is no reference price point in the market and the promoter wants to generate an income stream from the management fees that compensates for the management, marketing, and sales efforts of a new product. After the first product has been established, promoters who follow with further products have a price point and can offer their product with a lower TER since the TER can be a competitive edge for the distribution of like-for-like products. When it comes to this, it is not surprising that the TERs of younger defence-themed ETFs are lower than for older ones. This might be subject to change since the older ETFs might be able to lower their prices too, which could lead to a price war.

It is also considered normal that the TERs for mutual funds are independent from the launch date, since the respective asset manager is pricing a product based on its costs and expected profit margin. Since some managers have lower base costs than others, they might be able to charge lower management fees while maintaining an attractive profit margin.

The same is somewhat true for index tracking mutual funds. The price tag for these products is driven by the internal costs of the respective asset manager. Nevertheless, an index tracking mutual fund can't become "too expensive" since these products compete with ETFs and need, therefore, attractive pricing to be able to gather assets. This is reflected in graph 8, as the index tracking mutual fund has the same TER as the most expensive ETF. At the same time this TER is way below the total expense ratio of the cheapest actively managed mutual fund.

To visualize this, graph 8 below is sorted by product type (mutual funds – black, index tracker – grey, ETFs – blue) and the launch date of the respective products (the oldest on top and newest at the bottom).

Graph 8: Total Expense Ratios of Defence-Themed Products registered for sales in Europe – December 31, 2025 (in %)



Source: LSEG Lipper

Looking at graph 8 one may argue that the TERs for newer ETFs are not always lower than those of the first movers. This argument is true, but a more detailed view shows that a lot of the ETFs which charge the same or higher TERs as the first movers try to differentiate themselves by adding a specific topic or focus such as cybersecurity, or a more complex methodology to determine the constituents of their index, to their product to justify the higher costs. The **Future of Defence Indo-Pacific ex China UCITS ETF Acc** is a good example to showcase the evolution of defence-themed ETFs in Europe since it is the only product which focuses on the Indo-Pacific region and not on Europe or globally. Hence, this product is a first mover in a sub-theme of defence-themed ETFs. This justifies the relatively high TER compared to the other defence-themed ETFs.

A View on the Asset Allocations of Defence-Themed Products

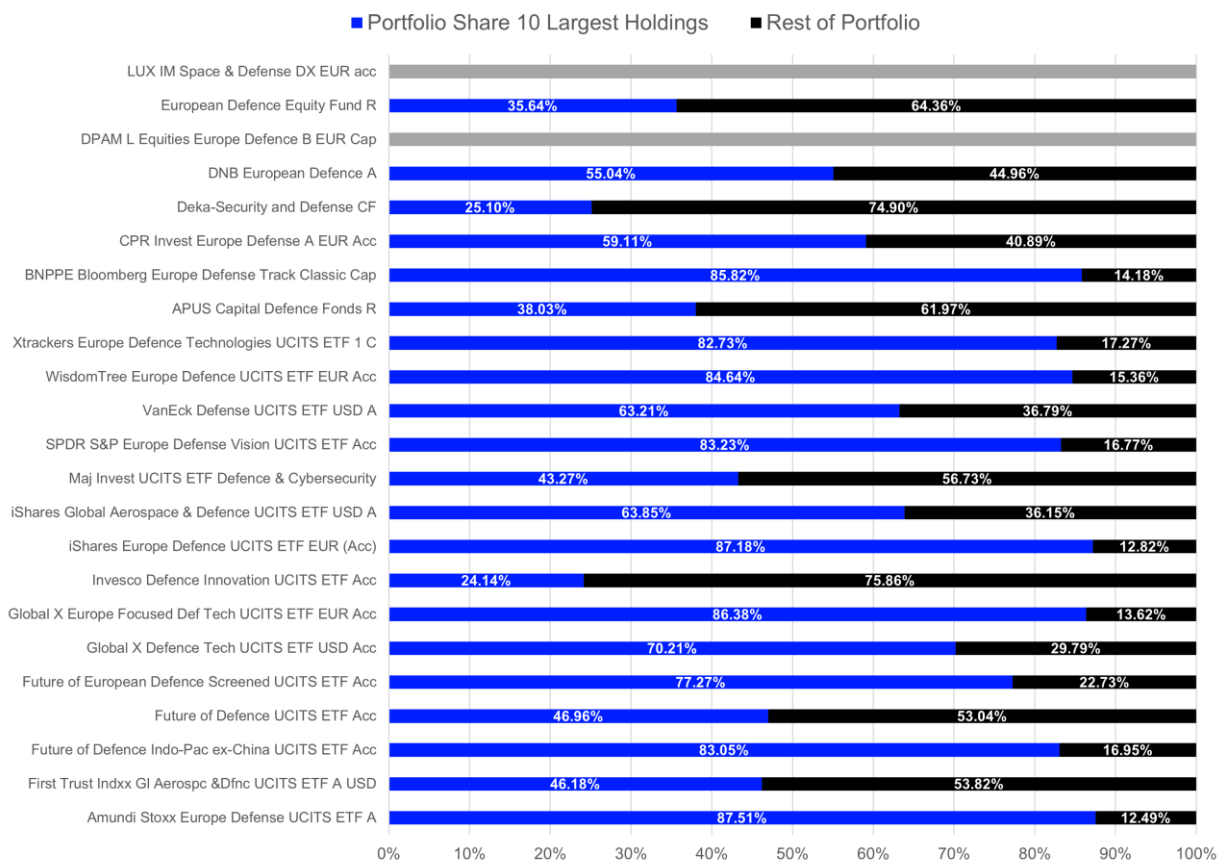
In order to examine the structure of the defence-themed mutual funds and ETFs registered for sales in Europe from a portfolio point of view, it makes sense to shed light on the concentration of single stocks within portfolios.

With regard to this, the share of 10 largest holdings within a portfolio is a good indicator to evaluate the concentration risk of each strategy.

Graph 9 shows that the concentration of the 10 largest holdings in the portfolios of defence-themed mutual funds and ETFs varies by a wide margin. The highest concentration of the 10 largest holdings (87.51%) can be found in the portfolio of the **Amundi Stoxx Europe Defense UCITS ETF A**, while the lowest concentration (25.10%) is shown in the portfolio of the **Deka-Security and Defense CF**.

Graph 9 also shows the disadvantage of mutual funds compared to ETFs when it comes to transparency, since there were two mutual funds (**LUX IM Space & Defense DX EUR acc** and **DPAM L Equities Europe Defence B EUR Cap**) which did not publish any information about their portfolios at the date the data for this study were collected. Conversely, the ETFs in this study published all portfolio holdings and their respective weightings on a daily basis.

Graph 9: Share of the 10 largest Holdings in the Portfolio vs the Rest of the Portfolio



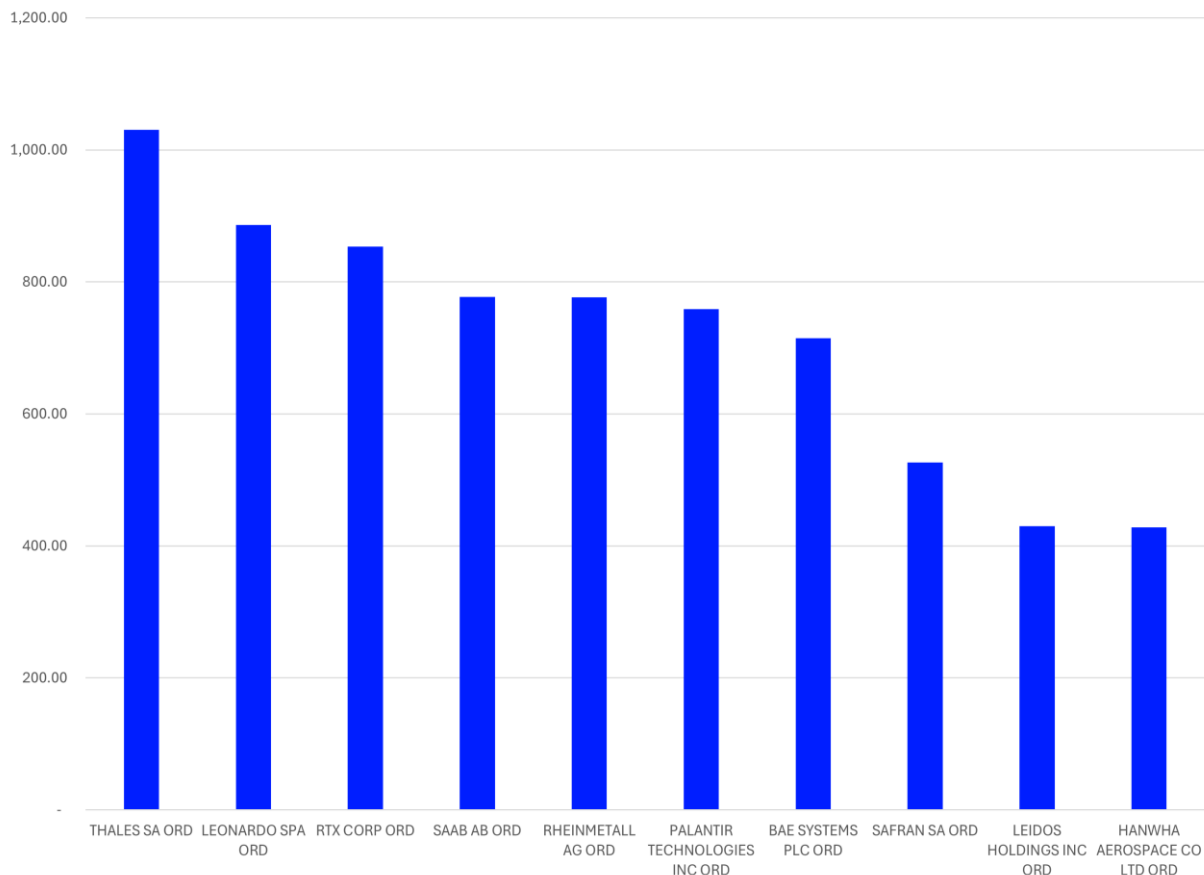
Source: LSEG Lipper

This means investors need to think twice if they want to own a product with a high concentration risk, or if they prefer wider diversification. That said, wider diversification may lead to more portfolio holdings which are related to the defence theme, but do not produce weapons, ammunition, or the underlying technologies. As a result, portfolios with wider diversification may not profit in full from the expected increase in defence spending.

However, some of largest holdings in defence-themed products are big industrial companies which have a defence business beside their main business. This means there might other drivers for the in- or decrease of their share price.

The 10 companies shown in graph 10 are the companies which gathered the highest investment from all defence-related products. Hence, these are the combined most popular stocks from all defence-themed products.

Graph 10: The 10 Companies with the Highest Combined Investment Amount (in million EUR)



Source: LSEG Lipper

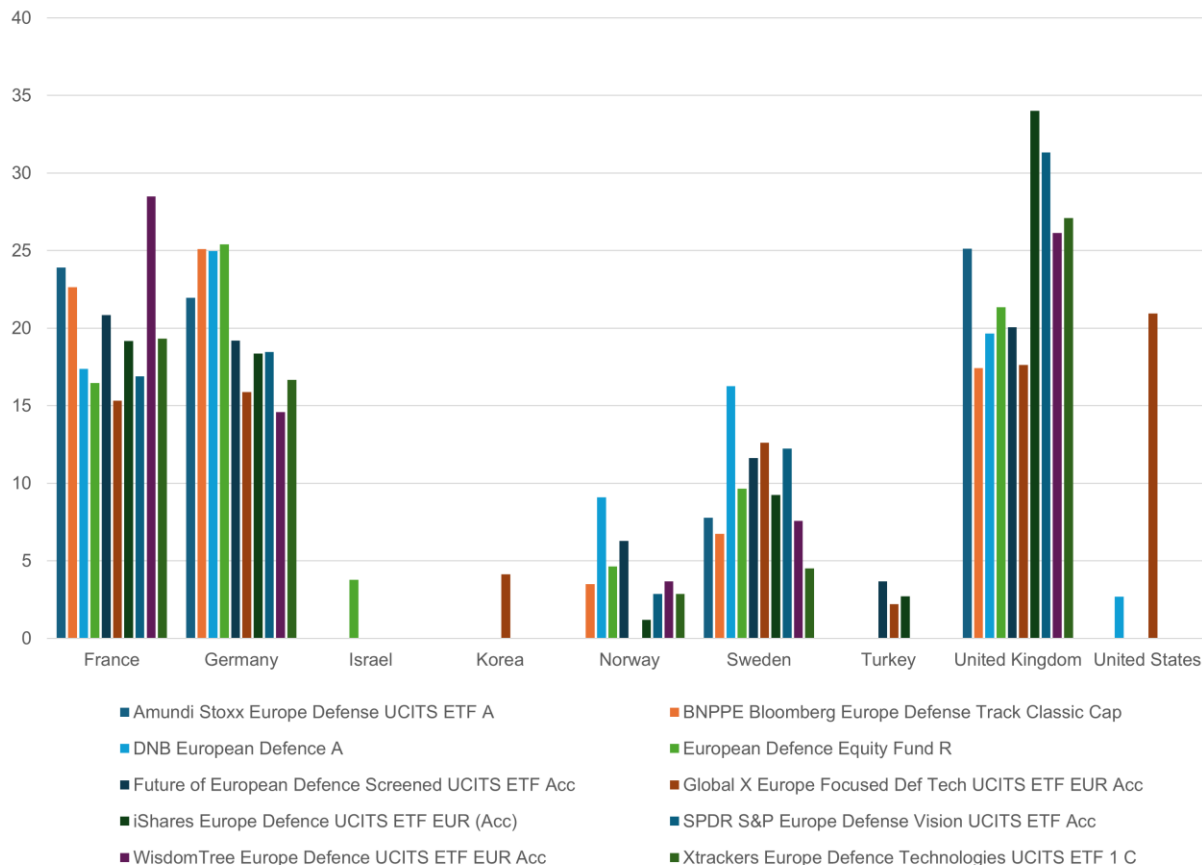
In more detail, defence-themed products invested €7.2 bn in these 10 stocks. This means 43.54% of the overall assets under management in defence-themed products were invested in these 10 stocks.

In addition to the concentration risk at the company level, one needs also to bear in mind that some portfolios may have a concentration risk at the country level. Hence these products might also be impacted by other factors like general changes in local policies or movements in currency.

When it comes to this, it is clear that global defence-themed products will have a lower exposure to Europe or Asia than their peers with a regional approach. Nevertheless, the relatively high exposure to the U.S. dollar may impact the performance of a euro investor. Obviously, this impact can be positive when the value of the U.S. dollar increases compared to the euro, but also negative when the U.S. dollar decreases.

But even products with the same geographical focus have quite different asset allocations at the country level, as graph 11 shows. Despite the fact that all of the products covered in graph 11 have a focus on Europe, some of the products have significant holdings outside of Europe. This means investors need to analyse also the country allocations of defence-themed mutual funds and ETFs to find the product which suits their needs.

Graph 11: Country Weighting (in %) – Defence-Themed Products with a Geographical Focus on Europe



Source: LSEG Lipper

Generally speaking, one would expect that asset allocation at the country level will vary from one ETF to another since there are only a few very large players in the defence industry. This means the different country weightings reflect the allocation to the stocks with the highest weighting within the ETF portfolio. Hence, the different weightings are a result of the different investment strategies of the different mutual funds and ETFs. This also means that the results of a single defence ETF may vary widely over time, even if the respective ETFs are investing in the same theme and region.

As a consequence, investors who want to participate in possible gains from higher defence spending of the NATO members need to research the products very carefully to ensure they will invest in an ETF that really suits their needs and invests in line with their expectations to avoid any disappointment. This also means that the overall performance of the products might not be a relevant measure in the first stage of ETF selection.

Spotlight on the Valuations of Defence Stocks

By Tajinder Dhillon, CFA, LSEG StarMine

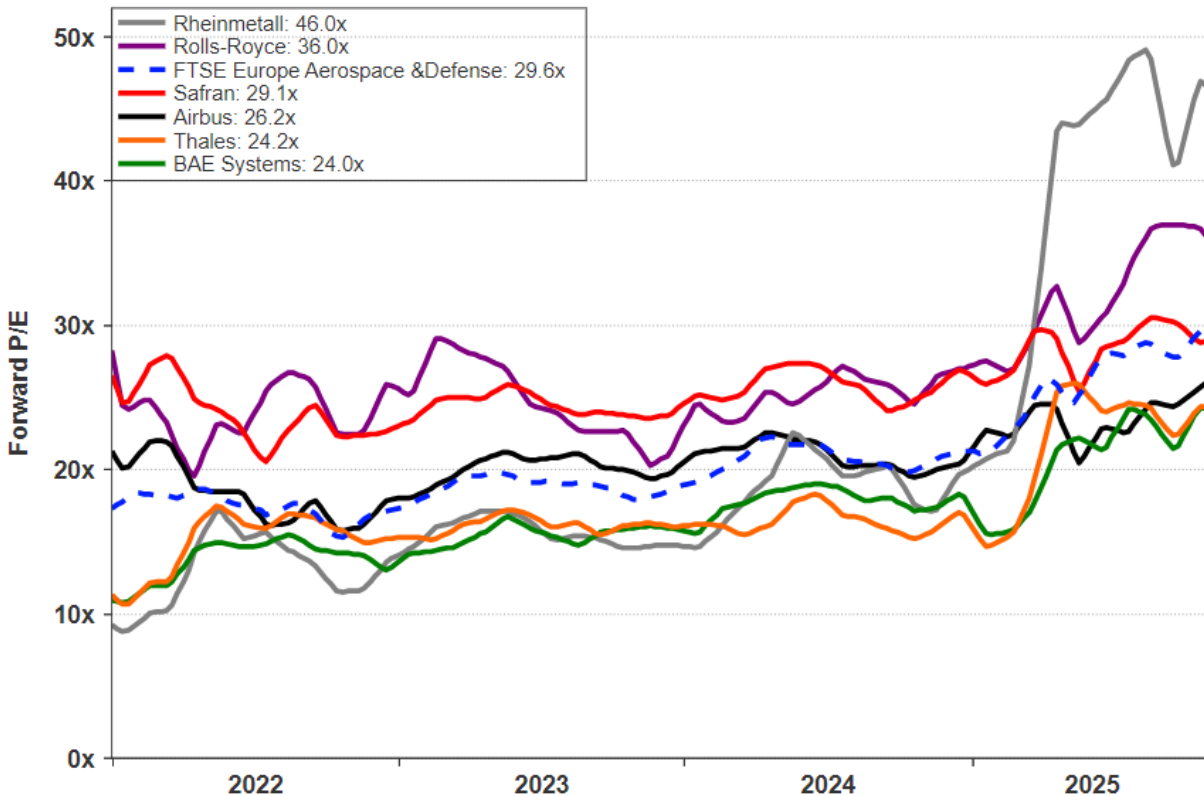
The FTSE World Europe Aerospace and Defence Index has delivered an exceptional performance year to date through October, ranking as the second best-performing industry group in Europe with a gain of 85.5%. This marks the strongest start to the year since the index’s inception. A breakdown of returns shows that the rally has been highly concentrated, with Rolls-Royce Holdings, Airbus, Rheinmetall, Safran, BAE Systems, and Thales driving the bulk of the gains. Together, these six companies account for roughly four-fifths of the index’s overall return.

Valuations across the defence sector have surged, approaching multiples typically associated with high-growth technology companies. The group now trades at an aggregate price-to-earnings ratio of 29.6x—an all-time high and a 42% premium to its five-year average of 20.8x. This makes defence the second most expensive industry group in Europe, trailing only Technology Hardware & Equipment at 31.5x, a figure heavily skewed by semiconductor giant ASML. Within the sector, companies with concentrated exposure to military defence—such as Rheinmetall, Thales, and BAE Systems—have experienced the sharpest expansion in valuation multiples, while diversified aerospace players such as Airbus and Boeing have seen more moderate increases.

Graph 12: European Defence Valuations

European Defense Valuations

Forward P/E Ratio

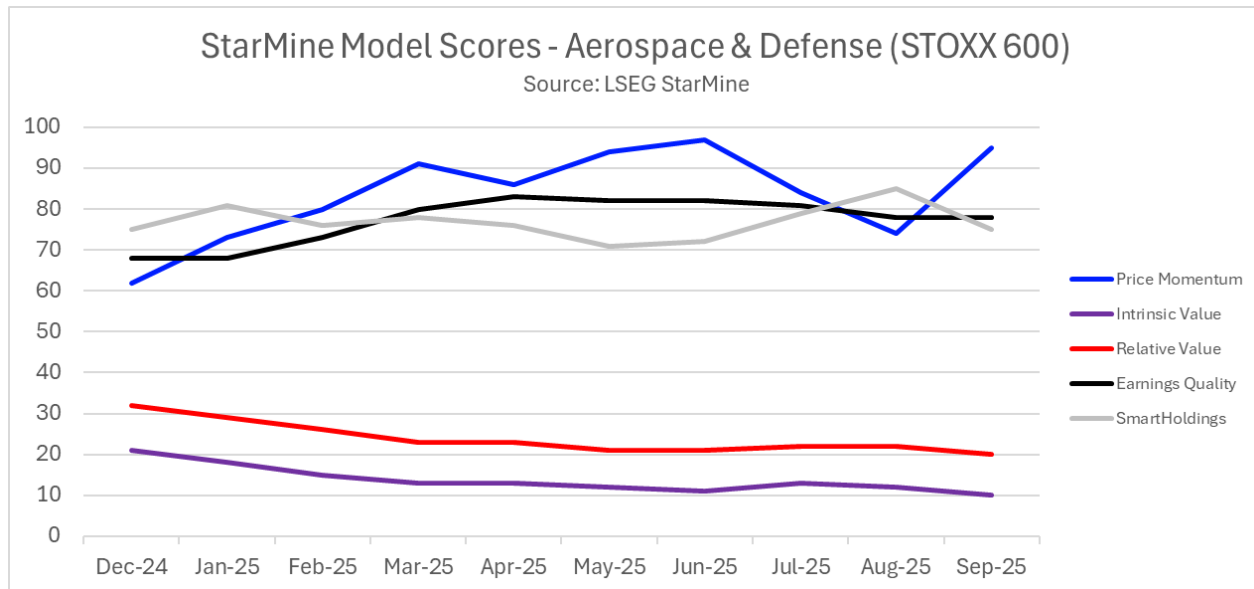


Source: LSEG Datastream / Tajinder Dhillon, CFA

Source: LSEG Datastream

When viewed through a quantitative lens, the sector ranks in the bottom quintile for both the Intrinsic Value (IV) and Relative Value (RV) models—clear indicators of how expensive the group has become. In contrast, quality remains a key strength, with an Earnings Quality score of 78 as of September, reflecting the sustainability and reliability of future earnings. Additionally, buy-side institutional sentiment continues to lean bullish as measured by the Smart Holdings model. StarMine model scores are ranked on a percentile basis from 1 to 100, where higher values signal a more favourable outlook (1 = bearish, 100 = bullish).

Graph 12: StarMine Model Scores – Aerospace & Defence (STOXX 600), December 2024 – September 2025



Source: LSEG StarMine

At the constituent level, both sell-side and buy-side sentiment toward the group appears strongly aligned. All of the selected companies in the table below have an ARM score—a measure of sell-side optimism—above 70, with most showing a positive 90-day change, signalling potential upward earnings revisions. Buy-side institutional sentiment as measured by Smart Holdings (SH) is similarly constructive, with four of the six companies posting SH scores above 70. Additionally, the Combined Alpha Model, which aggregates all StarMine alpha signals into a single score, is also scoring strong across much of the group.

Table 1: LSEG StarMine Company Scores

RIC	Name	Combined Alpha Score	Smart Holdings Score	Analyst Revision Score (ARM)	ARM 90d Δ
RR.L	Rolls-Royce Holdings PLC	78	75	97	11
AIR.PA	Airbus SE	36	78	74	18
RHMG.DE	Rheinmetall AG	53	31	77	3
SAF.PA	Safran SA	77	64	94	9
BAES.L	BAE Systems PLC	71	88	74	-12
TCFP.PA	Thales SA	75	88	89	8

Source: LSEG Workspace, LSEG StarMine

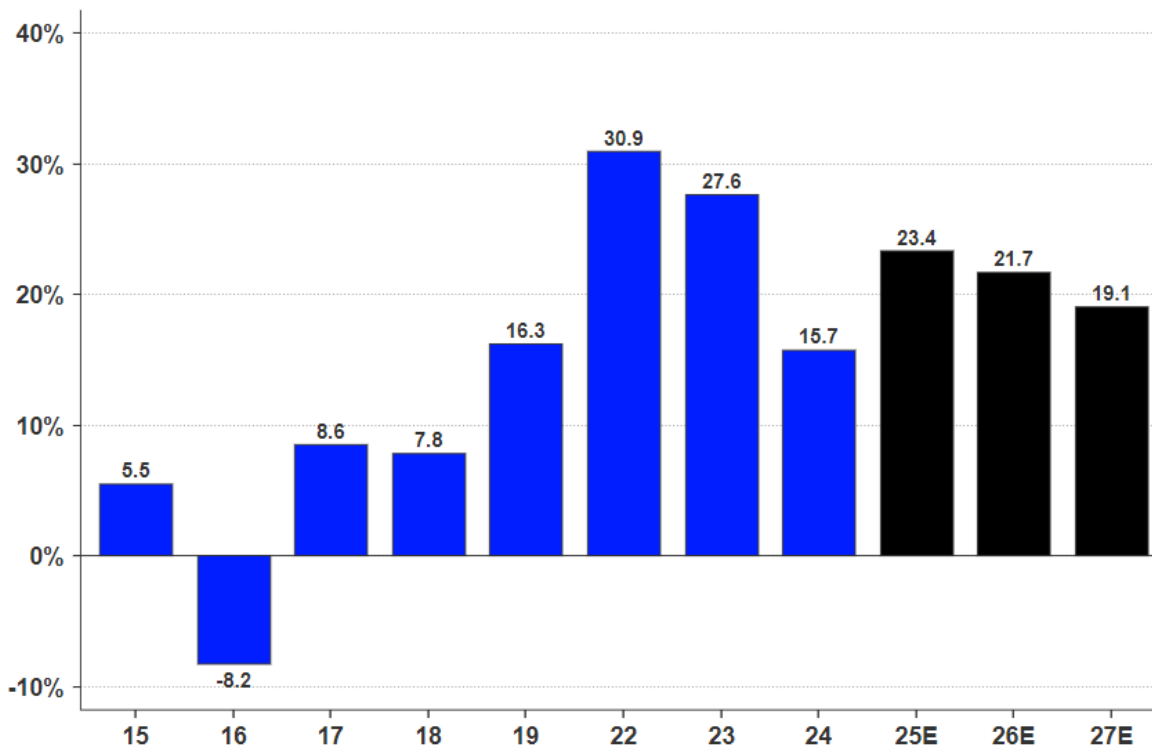
Source: LSEG StarMine

With valuations and sentiment running high, the final piece of the puzzle is the earnings outlook, which ultimately underpins the forward trajectory. According to LSEG Datastream, the group is projected to deliver robust earnings growth of 23.0% in FY2025, followed by 21.7% in FY2026 and 19.1% in FY2027. These growth rates are worth noting given that forward 12-month earnings are already at an all-time high of \$23.5 billion, making year-over-year comparisons more challenging. On the top line, revenues are expected to rise by 10.8% in FY2025, accelerating slightly to 11.9% in FY2026 and 11.7% in FY2027.

Graph 13: Annual EPS Growth Rate – FTSE World Europe Aerospace & Defence, December 2015 – 2027

FTSE World Europe Aerospace & Defence

Annual EPS Growth Rate using Current Constituents



Source: LSEG Datastream / Tajinder Dhillon, CFA. Note: Graph excludes 2020 and 2021 (extreme outliers)

Source: LSEG Datastream

German Defence Spending – Costs and Consequences

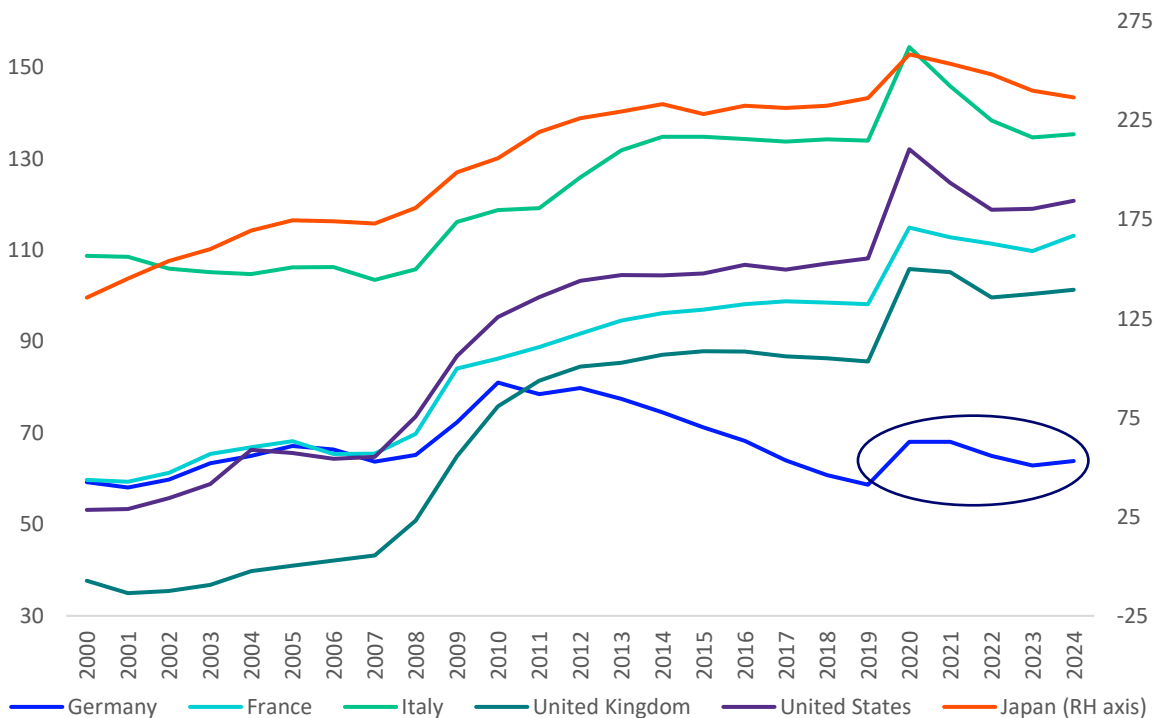
By Robin Marshall, M.A., M.Phil., FTSE Russell

The German coalition government is implementing a E500bn (12% of GDP) infrastructure and low carbon transition spending programme and also intends to increase defence spending from 2.4% of GDP in 2025 to 3.5% of GDP in 2029 (an average of about E160bn per annum). Germany also changed the constitution in March 2025 to allow unlimited debt financing for defence spending above 1% of GDP. Since the economy is currently in a phase of stagnation, and has significant spare capacity, with an output gap of about 2% of GDP¹, a counter-cyclical Keynesian fiscal stimulus would appear appropriate. This may also have significant multiplier effects, given the high proportion of investment spending.

But the scale of the stimulus programme is a radical change in German fiscal policy and a number of estimates of the projected debt/GDP ratio exceed the 60% Maastricht treaty guidelines, depending on the growth rate of nominal GDP, though the Commission rules do allow temporary overshoots of the 60% rule. Indeed, the EU Commission endorsed the programme in September 2025, based on a back-loaded fiscal tightening from 2027 onwards, which would pull the debt/GDP ratio back down to the 60% Maastricht Treaty guidelines by 2031. Tension with the EU Commission’s fiscal rules is resolved in this way, but the planned fiscal tightening from 2027 onwards should be borne in mind by investors. Reducing the debt/GDP ratio in this way also requires nominal GDP to grow at quite high assumed rates relative to recent experience (at an average above 3% per annum from 2025-30).

Germany at least starts this programme with a lower govt debt/GDP ratio than other G7 members, as Chart 1 shows, which has been a key factor in the AAA rating for Bunds.

Graph 15: Selected G7 General Government Debt/GDP Ratios



Source: IMF and FTSE Russell, Data to October 2025.

¹ Kiel Institute Autumn 2025 Economic Outlook.

We also need to bear in mind that Germany remains an economy with both a low debt/GDP ratio and low debt service costs relative to GDP both within the Eurozone, and globally, as Table 1 shows, which helps to explain the AAA rating retained by Bunds. In fact, it can be argued that Germany has more scope to make a significant fiscal stimulus than other major economies, on conventional fiscal metrics, as the Table shows.

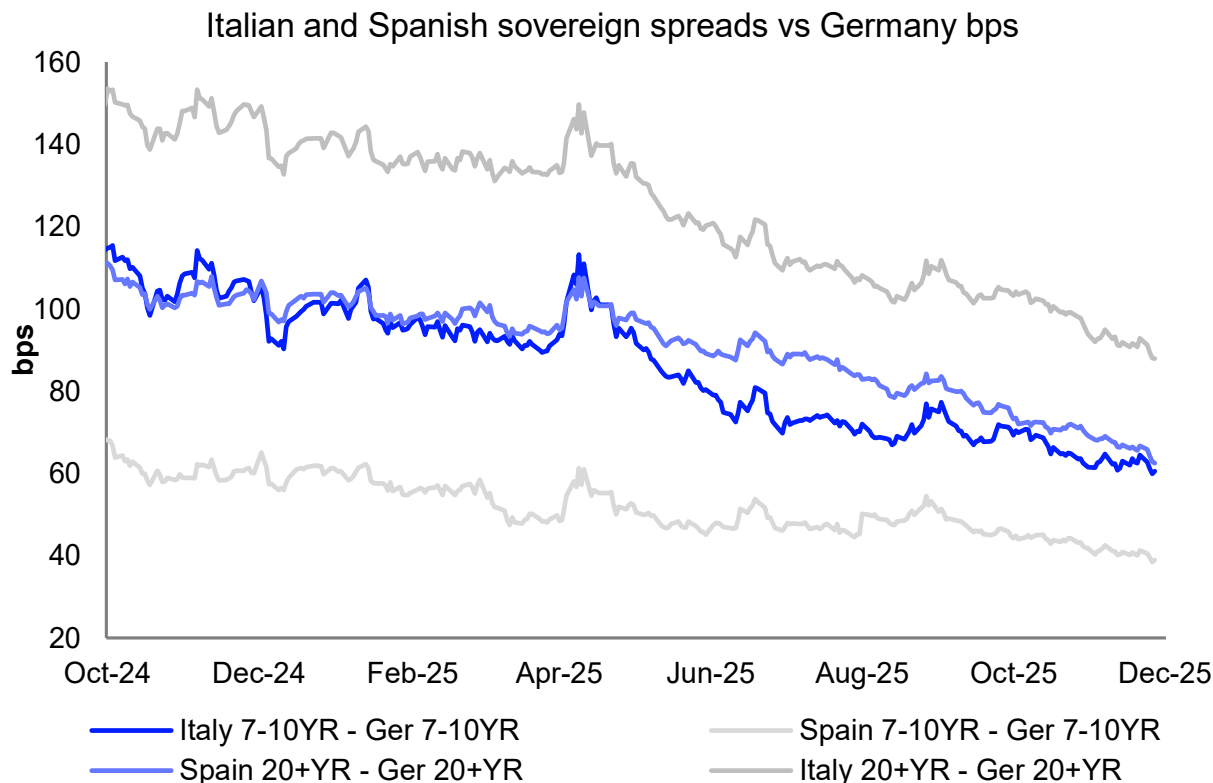
Table 2: Debt Service Costs and General Government Debt (in % of GDP)

	Germany	U.S.	UK	France	Spain	Italy	Japan
Debt Service Costs in % of GDP (2023)	0.87	3.86	0.40	1.87	2.40	3.69	1.20
General Govt. Debt/GDP in % (2024)	63.90	120.80	101.30	113.10	101.80	135.30	236.70

Source: IMF, World Economic Outlook, October 2025.

Given that the increased expenditure will be funded by additional borrowing, a key variable will be the reaction of Bund yields and debt service costs to increased issuance, as well as the impact on economic growth of higher capex. There has already been evidence of Bund yields rising relative to other Eurozone member states, as Chart 2 shows. The decline in medium and longer dated Spanish and Italian spreads has accelerated since March, after a brief risk-off spike in markets after the tariff turbulence increased in April.

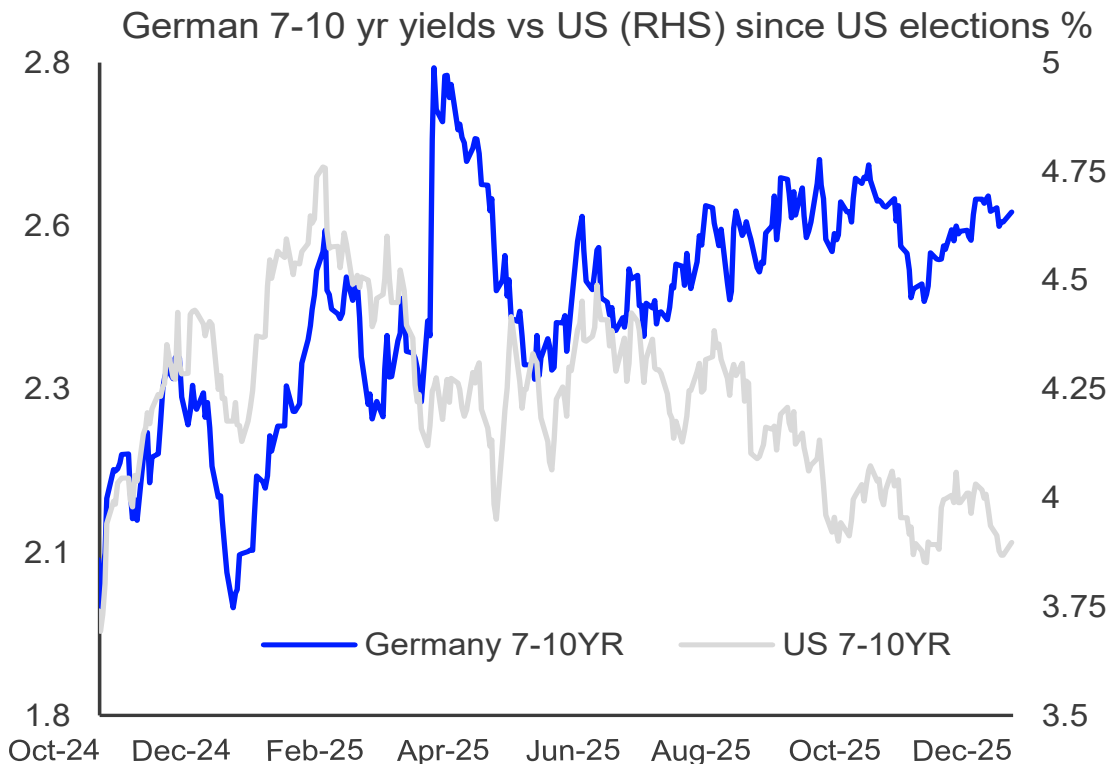
Graph 16: Italian and Spanish Sovereign Spreads vs Germany (in bps)



Source: FTSE Russell, December 2025

The other point to make here is that although the ECB has reduced short interest rates sharply in the Eurozone, to 2% in 2025, from 4% since June 2024, government borrowing costs have been increasing in Germany in outright terms, in the 7-10 yr area of the yield curve. Chart 3 shows this and also shows how German borrowing costs have increased relative to US borrowing costs since late-2024.

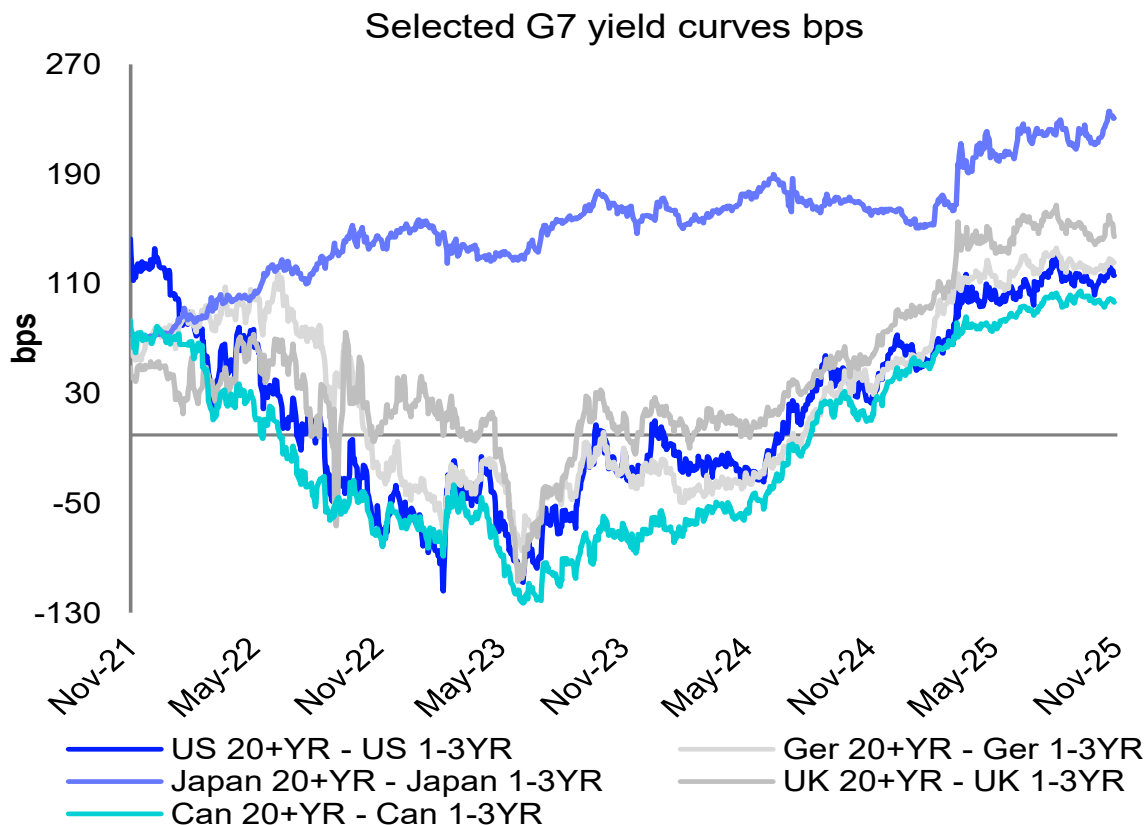
Graph 17: German 7- 10 Year Yields vs U.S. (RHS) Since US Elections (in %)



Source: FTSE Russell, December 2025

Lower policy rates but higher medium to longer dated yields in Germany are reflected in the steepening of the Bund yield curve in 2025. Other G7 markets also show a steepening in yield curves, during the period of falling policy rates, since short yields have fallen more than medium or long yields, as Chart 4 shows.

Graph 18: Selected G7 Yield Curves (in bps)



Source: FTSE Russell, data to Nov 30, 2025.

...but there are trade-offs and continuing economic stagnation carries its own risks

Overall, however, there are important trade-offs here. Higher German debt issuance to finance the fiscal stimulus should be seen against the possible alternative of continuing economic stagnation, and its impact on debt/GDP ratios, unemployment, and budget deficit strains. Tension with the EU Commission’s fiscal rules should be seen in that context, and the forecasting uncertainties for nominal GDP are clearly high for the later years anyway.

Summary and Outlook

Themed mutual funds and ETFs are often seen as an attempt by product promoters to take profit from an emerging investment trend in a market niche or sector. To do so, the promoters are often marketing the respective products aggressively since any trend can be over immediately, since investors can become reluctant to invest in products which are launched to participate in an investment trend or theme.

I would tend to agree with this, but in some cases themed investment objectives make sense, especially if an investment theme is emerging from a broader demand in societies or the corporate world. From my point of view, defence is such a theme, as governments around the globe and especially NATO members are increasing their defence budgets to maintain their ability to defend themselves and/or to modernize their military since modern warfare is not comparable to armed conflicts in the past.

The investment rationale for defence-themed mutual funds and ETFs got even stronger when NATO members agreed on June 25, 2025, to increase their defence spending from 2% to 5% of their respective GDPs until 2035. These 5% are split up in 3.5% in core defence requirements and 1.5% toward protecting critical infrastructure, defending networks, ensuring civil preparedness and resilience, enhancing innovation, and strengthening the defence industrial base. The decision to explicitly include defence-related infrastructure spending in the overall defence spending goal may lead to new defence-themed investment products or an extension of the investment objective of the existing products to include infrastructure. For investors, it seems to be more important that the new spending goal is a long-term goal, which means that the defence investing theme has become a long-term investment theme. Nevertheless, investors need to bear in mind that most NATO members did not even hit the 2% goal, and some member states are still reluctant to increase their overall defence spending due to budget concerns.

However, it is unclear how the respective countries will fund their additional defence spending, since budgets are already tight and any additional spending has to be refinanced. In turn, this means it is also still unclear if and by how much the NATO member states will really increase their defence spending.

That said, as in general and especially for themed or sector products, investors need to conduct their research carefully because no mutual fund or ETF within this study has the same portfolio structure when it comes to the country weightings and, as a result, also with regard to underlying companies. This means that even as all these products share a common investment theme, their performances may vary broadly in the future.

More generally, after the outbreak of the war in Ukraine some investors made the point that investments in defence should be eligible for ESG-related products since the protection of democratic structures contributes to the overall freedom and wealth of societies. Even as this is obviously true, there was a broad discussion about this, and a number of investors agree with this point of view. One needs to bear in mind, however, that controversial weapons are generally excluded from ESG-related investments, so this means any provider who wants to offer a defence-themed product which is aligned to the “S” of ESG needs to analyse the respective investment universe very carefully to avoid a breach of the more general rules for ESG products.

In conclusion, it can be said that defence is an investment theme which has a high relevance in the real world and can't therefore be seen as a pure marketing story. From an external view, it is to be expected that the increasing defence spending by NATO members should lead to higher revenues for the producers of the weapons and equipment needed by those states to achieve their goals over the course of the next 10 years. Nevertheless, investors need to be cautious when investing in any kind of themed investment products, as the trend in the stock markets can stop or revert, if it falls out of favour—even if the investment rationale is still in place. This means that the respective products can show a negative (relative) performance, even when the underlying theme is still working.

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