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ASSET MANAGEMENT

Q3 2025 | Thematic Specialist Morten Springborg

Defense in a Multipolar World

The transition from a unipolar to a multipolar world order – exemplified by simultaneous conflicts in Ukraine and the Middle East – underscores the strategic imperative of abundant energy and large manufacturing capacities.

NATO's commitment to 5% of GDP on defence, including 1.5% for critical infrastructure, will catalyse two investment super-cycles: core defence spending growing at roughly 12% CAGR to 2030, and electrification markets expanding at 10–30% CAGR alongside the expansion of manufacturing capacities in the West.

Robust investment in power generation, transmission, distribution, and end-user electrification will be indispensable to support advanced manufacturing. The multipolar contest will extend to industrial capacity: without energy, there can be no manufacturing – and without manufacturing, there can be no defence.

The conflicts in Ukraine and the Middle East are not isolated regional disputes but reflect the transition from a unipolar to a multipolar world order. These wars are not separate conflicts but strategic confrontations between China, Russia, Iran, and North Korea on one side and Western nations on the other, aimed at systematically challenging Western influence and the post-World War II liberal order. Conflicts like those in Ukraine, Iran, and Yemen are simply the most visible signs of this larger global struggle, featuring multiple pressure points intended to deplete Western military and economic resources[1].

This insight has implications for analysing the defence challenge and the investment opportunities in the coming decades.

The coalition against the West

The emerging axis of China, Russia, Iran, and North Korea represents a coordinated effort to challenge the post-WW2 liberal order. This coalition is forcing expensive military deployments across multiple geographies simultaneously, thereby depleting stockpiles of critical weapons and munitions and compelling the United States to stretch its resources thin instead of focusing on its main strategic adversary, China.

For example, the recent Israeli strike on Iran and Iran's counteroffensive have significantly drained US and allied missile supplies. The US reportedly used up 14% of its global THAAD missile stockpile within just days of fighting. The U.S. has supplied about a third of its inventory of certain missiles (Javelin, Stinger, GMLRS) to Ukraine. Patriot interceptor supplies were reportedly down to 25% of the minimum needed levels. The reality for Europe is that the opponent is not only an aggressive Russia but also the emerging axis behind Russia with its industrial might. This happens at the exact time when the US retrenches from the World Scene because of historical overreach. To face this challenge, Europe's response must be both a rebuilding of defence capabilities and an overall overhaul of its societal economic structures. Europe needs to realise that without abundant energy, there can be no manufacturing, and without manufacturing, there can be no defence.

Europe faces an unprecedented strategic challenge that transcends traditional "guns versus butter" economics. NATO's 2025 Hague Summit required Allies to lift defence spending to 5% of GDP, of which 1.5 percentage point is ring-fenced for civil preparedness and critical infrastructure, not least energy grids.

This insight explores why traditional thinking fails to address the necessary structural changes for 21st-century security. It explains why a 1.5 percentage point allocation is indispensable, how Europe's energy policy and power networks currently fail, and what lessons China's long-term "electrostate" strategy offers.

Defence companies challenged by indebted states and a monopsony market structure

Since war erupted in Ukraine, defence stocks have performed strongly, see figure 1. And no doubt, NATO's increase in defence spending will lead to solid top-line growth for well-positioned companies over the next decade. However, the industry setup is a monopsony, with governments the only major buyers. Coupled with political sensitivity, this restricts profit margins and returns on capital. While firms like Rheinmetall have benefited from favourable terms, those advantages may not last as attention shifts from initial excitement to upcoming debates about public finances and the sustainability of earnings growth for defence companies.

The market anticipates significant margin expansion from companies like Rheinmetall, with

1 According to several reputable reports from July 2025, Chinese Foreign Minister Wang Yi told the EU's top diplomat, Kaja Kallas, that Beijing "cannot allow Russia to lose the war in Ukraine." Wang Yi explained that a Russian defeat would be strategically unacceptable for China because it might enable the United States to fully shift its focus toward containing China in East Asia.

Figure 1

MSCI Europe Aerospace & defence Index in USD

Source: Bloomberg, 9th September 2025

defence EBIT margins projected in the 15–20% range, well above pre-war levels of 8–10%. For comparison, U.S. peers such as Lockheed, Raytheon, and Northrop operate under stricter government oversight and typically achieve 10–13% EBIT margins[2]. Maintaining current levels may depend on political tolerance for large defence profits amid rising fiscal pressure points.

As we explore below, modern warfare is changing rapidly by the day. Drones and domes already play a more significant role, which could reshape industry structure and competitive dynamics. Many of the best-positioned companies technologically are currently private, and while it's important not to underestimate incumbent defence firms, it's worth noting that many private companies are better positioned for the "defence of the future". This includes themes like Drones, AI, and Autonomous Systems (Helsing, Quantum Systems, ARX Robotics) and Missile Systems (MBDA, Cambridge Aerospace), see figure 1.

From narrow thinking to systems thinking

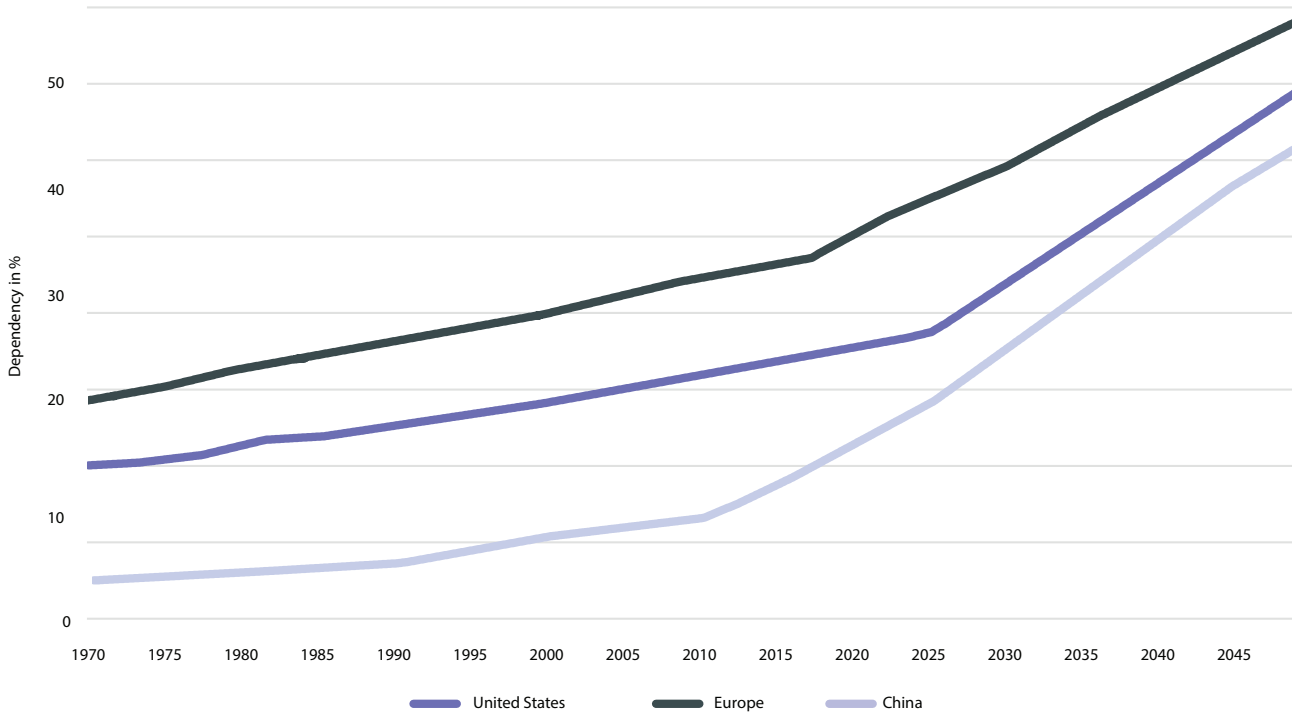
Thinking narrowly about defence spending may cause investors to overlook the most crucial thematic investment opportunity created by this

2 Behind paywall, September 2025

> Fewer workers must support growing defence budgets and expanding elderly populations, while the tax base contracts precisely when fiscal demands rise.

Figure 2

The old age dependency: US, Europe, and China



Source: Perplexity, September 2025

new multipolar world: the need for the West to refocus on energy and manufacturing if we want to regain relevance in the future.

The convergence of multiple crises – aging societies, fiscal constraints, technological disruption, and geopolitical challenges – creates systemic vulnerabilities that cannot be addressed through conventional policy responses.

These correlated risks expose the fundamental weakness in Western defence industrial capacity. Ukraine's daily consumption of 7.000 artillery shells, at least four times higher than Europe's total production, along with Ukraine's and Russia's goal of producing 4 million drones annually, highlights the considerable gap between modern warfare demands and Western manufacturing capacity.

European demographics present a crisis that makes traditional fiscal models outdated. By 2050, 22 out of 27 EU countries will face shrinking working-age populations, while the old-age dependency ratio in Europe is expected to rise sharply, see figure 2. The EU's old age dependency ratio will reach about 56.7% by 2050. This indicates there will be fewer than two working-age adults (20–64) for every person aged 65 or older – more than doubling the ratio from 2001 levels and a significant increase from today's roughly 34–35%.

This creates a vicious cycle: fewer workers must support growing defence budgets and expanding elderly populations, while the tax base contracts precisely when fiscal demands rise. How will European politicians maintain welfare states, dramatically increase defence spending, and avoid politically toxic tax increases?

Fiscal sustainability is a prerequisite for a sustainable and strong military. If the fiscal house is not in order, it will undermine any nation's ability to defend itself in the long term.

France serves as an example: As of July 2025, France's defence budget was still only 2% of GDP. President Macron had previously announced plans to increase France's defence budget by €6.5 billion over two years, to reach €64 billion by the end of 2027. However, this increase still falls short of the new NATO targets, as the annual military budget would need to reach approximately €100 billion to get to 3% of GDP by 2030. Ongoing political instability and upcoming government changes could further hinder France's ability to fulfil these NATO spending commitments.

First-order political thinking centres on immediate trade-offs: cutting pensions to fund missiles, introducing wealth taxes to buy tanks, or issuing debt to delay the crisis. First-order investment thinking emphasises direct defence-related investments but overlooks the larger issues of demographics, debt, and technological acceleration. It also ignores the core challenge—the industrial capacity to turn spending into capability no longer exists at a competitive scale in the West. This exposes the core weakness in Western defence planning: the belief that technological advantage can replace industrial capacity. Removing Russia from Eastern Ukraine would be impossible without a level of Western military commitment that has proven politically unattainable. The same limitations would be even more severe in a Pacific conflict with China.

Modern warfare and private sector incentives

Modern warfare has fundamentally shifted from the industrial paradigms that shaped Cold War thinking. For example, drones account for 60-70% of kills and equipment damage in Ukraine.

This represents a manufacturing challenge fundamentally different from traditional weapons production. It requires consumer electronics supply chains, software integration, and rapid iteration cycles that favour software-driven production systems over legacy defence contractors. These consumer electronics supply chains are mainly located in China. China has restricted the export of electronic components, especially drone parts, to Ukraine (as well as to the U.S. and broader Western markets). These controls cover finished drones and critical components such as motors, batteries, cameras, flight controllers, and navigation units. Meanwhile, Chinese exports of these materials to Russia have continued[3].

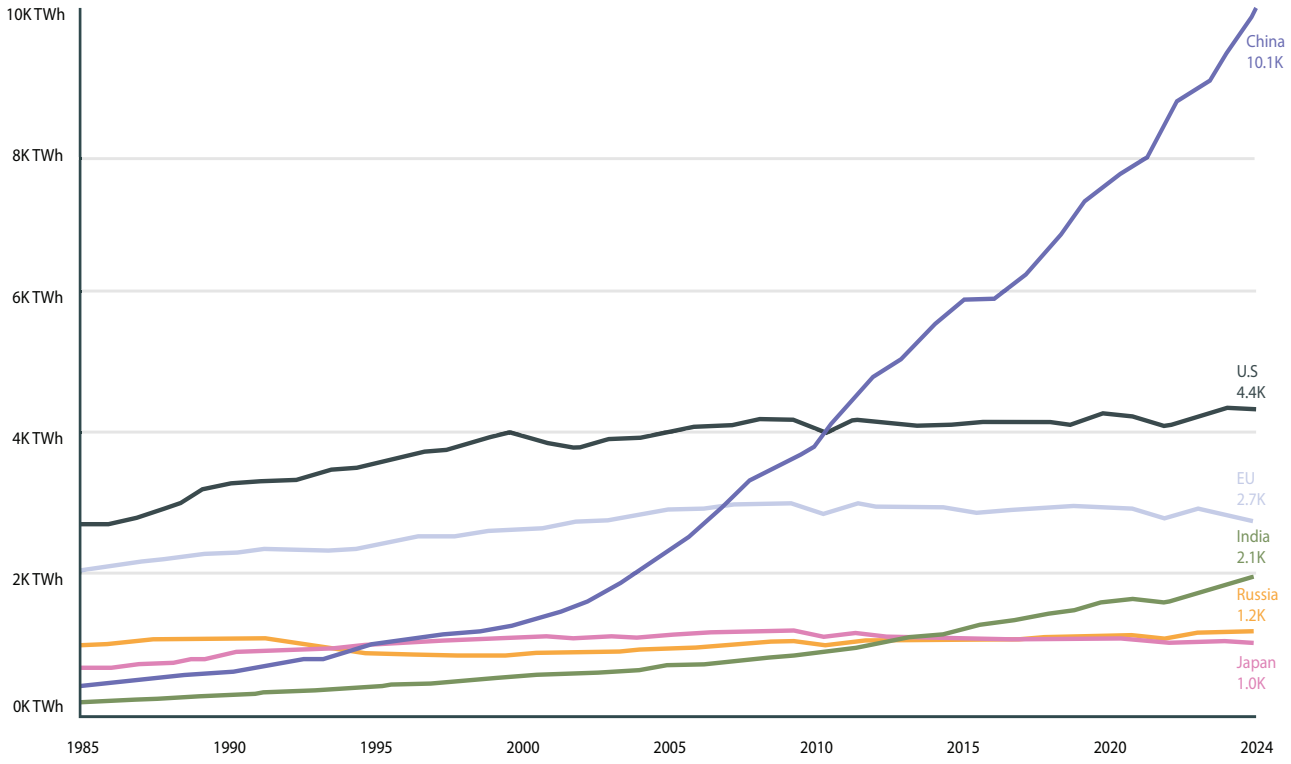
Traditional defence procurement – designed for decade-long development cycles and specialised production facilities – cannot adapt to the pace of technological change driving modern conflict. The natural conclusion is that a traditional focus on defence alone, financed by an almost bankrupt public sector, cannot solve the task itself, and massive investments by private enterprise are required if Europe wants to tip the scales of geopolitics in its favour.

This requires incentives. As the Draghi Report on competitiveness outlines, EU bureaucracy has stifled European entrepreneurship and needs to be changed. Lowering capital taxes should encourage risk-taking more. Otherwise, capital will not to the degree needed support the upgrade of European manufacturing and electrification, which is essential for a stronger European defence system.

3 https://www.perplexity.ai/search/when-does-social-security-in-t-h3._G_oRTRq1vn.24kzAAg#3

Figure 3

Top power producing countries



Source: Our World in Data, September 2025

Modern infrastructure & China's electrostate

China's strategic advantage lies not only in its current military capabilities but also in its massive industrial capacity and its systematic electrification of its economy. While the West focused on financialisation and services, China built the world's first "electro state"– with electricity comprising 28% of total energy use compared to the global average of 20%. Today, China consumes as much electricity as the EU, the US, India, and Russia combined, see figure 3.

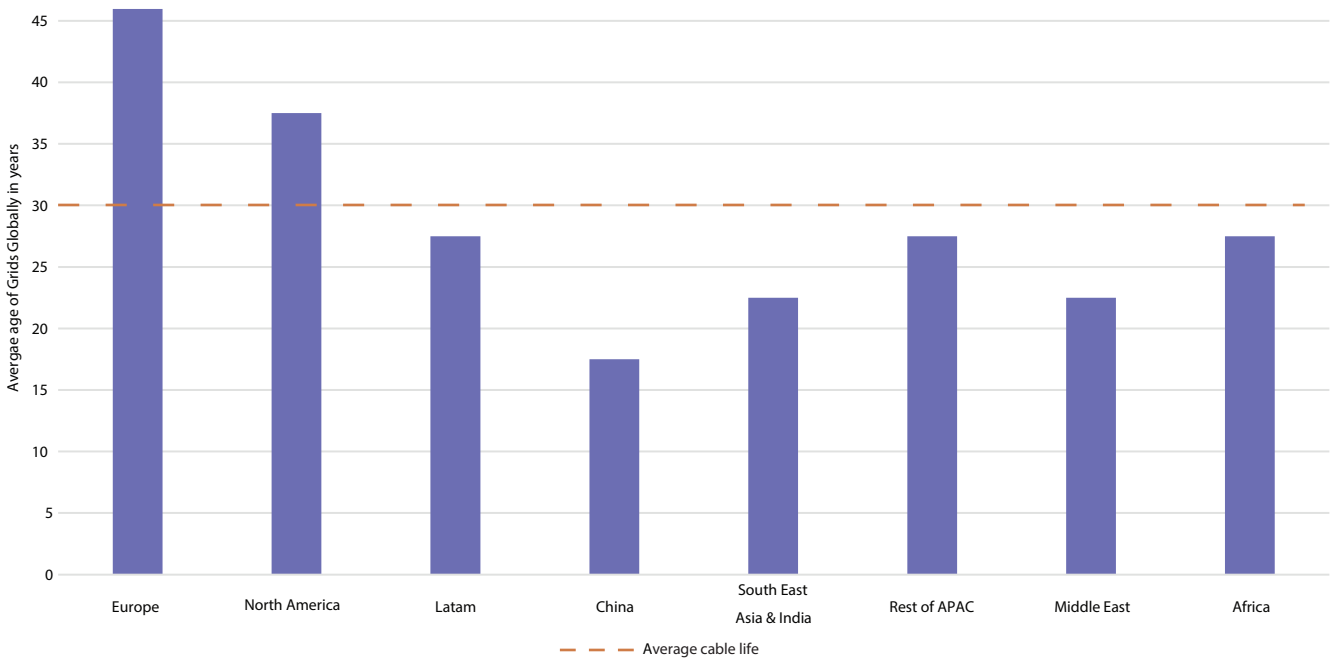
China's electrification strategy aims to reduce its vulnerability to imported energy, particularly oil shipped from the Middle East – a logistical chokepoint that the US could potentially block in a crisis. Recognising this risk, China decades ago embarked on a large-scale transition to substitute domestically sourced energy for imported fossil fuels. Europe has done precisely the opposite over the last few decades, shutting down domestic fossil and nuclear production, while low-density renewables[4] have been ineffective in covering for the shortfall of legacy production. So, while China's import dependency on energy has been halved from 26% to 13% 2000-2024, Europe has over the same time seen a moderate increase in import dependence to 58%, see figure 4. This huge strategic vulnerability will take decades to correct, but it also opens up very large investment opportunities.

China leads the world in new installations of coal, nuclear, hydro, wind, and solar power and has made significant investments in grid modernisation and the electrification of transport and industry. This push for electrification allows the country to supply more of its economy with domestic energy sources and has supported manufacturing dominance

4 The-struggle-to-achieve-net-zero-emissions.pdf

Figure 4

Grids in Europe and North America are older than the average cable life



Source: Bernstein, June 2025

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As autonomous systems become a larger part of modern defence technology, blurring the lines between consumer electronics and military applications, China’s firm control of these “dual-use” supply chains becomes a strategic issue.

across critical technologies. Europe needs to copy this to rebuild resilience.

China’s 42 ultra-high-voltage (UHV) transmission lines – each capable of carrying 5-12GW over 2,000+ kilometres with minimal losses – represent more than energy infrastructure. They constitute a manufacturing advantage that enables the rapid addition of power generation and industrial production scaling anywhere within China’s territory.

Europe’s and America’s old grids, constrained by conventional high-voltage systems limited to 1-3GW capacity over shorter distances, cannot support the industrial loads required for modern manufacturing at Chinese scales. This infrastructural gap translates directly into limitations in manufacturing. The current scramble to get power connections for AI Datacentres in Europe and the US is a case in point.

China’s transportation electrification strategy demonstrates the most visible aspect of its energy independence drive. The country now produces over 60% of all electric vehicles globally, accounting for more than half of global EV sales. This dominance extends beyond manufacturing to the entire EV ecosystem, creating a self-reinforcing cycle of energy independence and powerful competitive moats in multiple industries.

China’s High-Speed Rail (HSR) network, covering over 45,000 kilometres and representing two-thirds of the world’s high-speed rail capacity, operates entirely on electricity, reducing dependence on imported petroleum products for mobility. The strategic complementarity between China’s high-speed rail (HSR) network, rising EV demand, decreasing air transportation demand, and lowered energy import dependency demonstrates sophisticated long-term policy planning. HSR lessens the need for long-distance travel by car and air transportation. Although China’s population is four times larger than the US, domestic air travel levels are similar.

China’s oil demand contracted 0.6% in 2024 while electricity consumption grew 6.7%.

China’s dominance in electric vehicles (EVs) and battery technology has significant implications for other fast-growing fields such as drones and humanoid robots. The technological advancements, cost reductions, and established supply chains for EVs—especially lithium-ion batteries, electric motors, controllers, and related electronics—are the foundational components that drive cutting-edge robotics and autonomous systems.

China now controls a large portion of the supply chains for essential technologies used in drones and humanoid robots, as well as key raw materials. This makes Western efforts to develop or expand autonomous systems highly reliant on Chinese suppliers. In practical terms, anyone in the West working on advanced drones or robots will probably need Chinese-made batteries, sensors, or power electronics — or face higher costs and limited capabilities if they attempt to get supplies from non-Chinese sources.

Furthermore, as autonomous systems become a larger part of modern defence technology, blurring the lines between consumer electronics and military applications, China’s firm control of these “dual-use” supply chains becomes a strategic issue. Efforts in the US to slow the growth of EV technology, such as the hostility shown by the Trump administration[5], risk weakening the broader American ability to compete in autonomous systems and robotics,

5 Exclusive: Trump transition team plans sweeping rollback of Biden EV, emissions policies | Reuters

> The West faces a strategic challenge that goes beyond traditional fiscal policy debates and enters the realm of system transformation

both commercially and militarily. In short, without a strong domestic EV and battery industry, the US and its allies face long-term dependence on China for the next stage of defence innovation.

European Governments should understand that spending more on conventional defence procurement will not generate competitive military capabilities if the underlying industrial ecosystem cannot deliver modern systems at scale and speed.

The Ukrainian conflict demonstrates this. Commercial drones adapted for military use, produced in consumer electronics factories, prove more tactically relevant than expensive traditional systems designed in the 1990s. Rather than simply increasing defence spending percentages, Western governments must acknowledge that security in the 21st century requires manufacturing competitiveness across electrified industrial systems.

This includes diversifying supply chains away from potential adversaries and building technological sovereignty in critical sectors while managing the fiscal constraints imposed by ageing societies and debt burdens.

The West faces a strategic challenge that goes beyond traditional fiscal policy debates and enters the realm of system transformation. China's systematic electrification over three decades has created geopolitical advantages that cannot be overcome through increased defence spending alone.

Broader investment opportunities

EU NATO members spent €327 billion, or approximately 1.9% of GDP, on defence in 2024. Assuming 3% nominal growth of GDP and 3.5% spending on defence by 2035, this translates into total defence spending of EUR 830 billion or a CAGR of 9%. The 1.5% allocation to broader defence-related areas will lead to a new stream of investment opportunities, an area we think the market does not discount today. This portion is dedicated to defense related infrastructure, resilience of energy grids, distribution networks, critical infrastructure protection (including cybersecurity), and military mobility corridors.

Europe, like the US, has old transmission and distribution networks, see figure 4. These networks have become the main bottleneck for increasing renewable capacities in Europe. Additionally, modern defence relies heavily on energy, especially electricity. From data-driven command systems to energy-hungry AI data centres, military effectiveness today depends on reliable and cyber-secure power. Recognising this, NATO now requires 1.5% explicitly allocated to civil preparedness and critical infrastructure, including energy grids. According to Bernstein, spending on power grids in the four major European countries has increased by about 80% over the past five years. Europe spends roughly €63 billion on power grids annually, with around €28 billion for electricity transmission and €35 billion for distribution. Before the new 1.5% allocation, Bernstein expected this to more than double by 2030.

The April 2025 Iberian blackout demonstrated how high renewable penetration without robust grids can lead to blackouts. The 2023 EU Action Plan for Grids and the upcoming European Grids Package aim to streamline permitting, encourage proactive investment, and fund €584 billion in upgrades this decade. In September 2025, Goldman Sachs[6] analysed the longer-term supply-demand outlook for European electricity markets and concluded that the Regulated Asset Base (RAB) of grid companies will compound

6 Goldman Sachs Research - Marquee (behind paywall)

at 15% for the foreseeable future. This will benefit regulated utilities like SSE, Eon, and Iberdrola.
However, electrification offers compelling investment opportunities across many different sectors. In Power Generation, renewable sources attract the most investment. An increasing recognition that renewables alone cannot ensure stable and affordable electricity will boost demand for gas generation and the deployment of nuclear power in the long term. Transmission and distribution infrastructure are expected to expand significantly, benefiting market leaders such as ABB, Siemens Energy, and Schneider Electric, which dominate transformer and grid infrastructure markets, as well as leading global cable companies Nexans, Prysmian, and NKT. These companies provide comprehensive solutions ranging from high-voltage transmission to distribution automation systems.

Siemens Smart Infrastructure focuses on the "grid edge"— where electricity connects with end users in buildings and industrial facilities. Siemens is a major player in low-voltage switchgear and is also active in high-growth sectors like data centres and energy storage.

Likewise, Schneider Electric is also a key player in Data centres. The company furthermore focuses on energy management and the digital transformation of electrical infrastructure. As manufacturing expands in Europe, the industrial electrical equipment sector, working with building automation, factory electrification, and smart grid integration, will experience growth.

Total power investments will have to rise to 3000 bn € over the coming decade to cope with historical underinvestment and expected growth in demand.

This leads to the conclusion that Europe's new defence focus leads to two simultaneous investment "super-cycles". Core defence procurement must

Figure 5

Total addressable markets (bn EUR)

End Market Growth	2024	2030	CAGR
EU NATO Core defence (3.0% GDP 2030)	326	650	12%
Defence-related infrastructure (1.5%)	0	325	New steam
Transmission & Distribution, global	333	730	14%
of which the EU	63	140	14%
Electricity Capacity for GenAI	31	155	31%
Low, medium, voltage incl. Data Centre	169	264	8%

Source: CWW, Bernstein, Redburn Atlantic, September 2025

> **Total power investments will have to rise to 3000 bn € over the coming decade to cope with historical underinvestment and expected growth in demand.**

more than double, increasing at roughly 12% CAGR to 2030, while spending on electricity infrastructure, storage, mobility, cyber security, and power electronics is expanding at 10–30% CAGR, depending on segment. Figure 5 on page 10 shows that electrification markets will outpace this historic re-armament, opening total addressable markets (TAMs) measured in the trillions and offering equity investors broader, faster-growing runways than traditional defence primes.

Conclusion

EU Europe's pledge to spend 5% of GDP on security is historic. Europe's transition from austerity-driven policies to infrastructure and defence-led growth represents a fundamental paradigm shift with profound implications for economic performance and equity markets. The combination of substantial fiscal multipliers, strategic industrial transformation, and attractive valuations positions European markets to potentially rival US returns for the first time since the 2000s.

The cyclical benefits of this spending transformation, supported by fiscal multipliers and the structural advantages of strategic autonomy and technological spillovers, give reasons to believe that Europe is entering a new era of growth potential. Utilities like SSE, Iberdrola, RWE, and Eon, TSOs, electrical capital goods companies like Schneider and Siemens, and cable and transformer vendors are well placed to deliver attractive returns with growth matching defence majors. As this investment cycle matures and European industrial capacity expands, the region's equity markets appear well-positioned to capitalise on this transformation, while supporting the continent's long-term economic competitiveness and security independence.

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