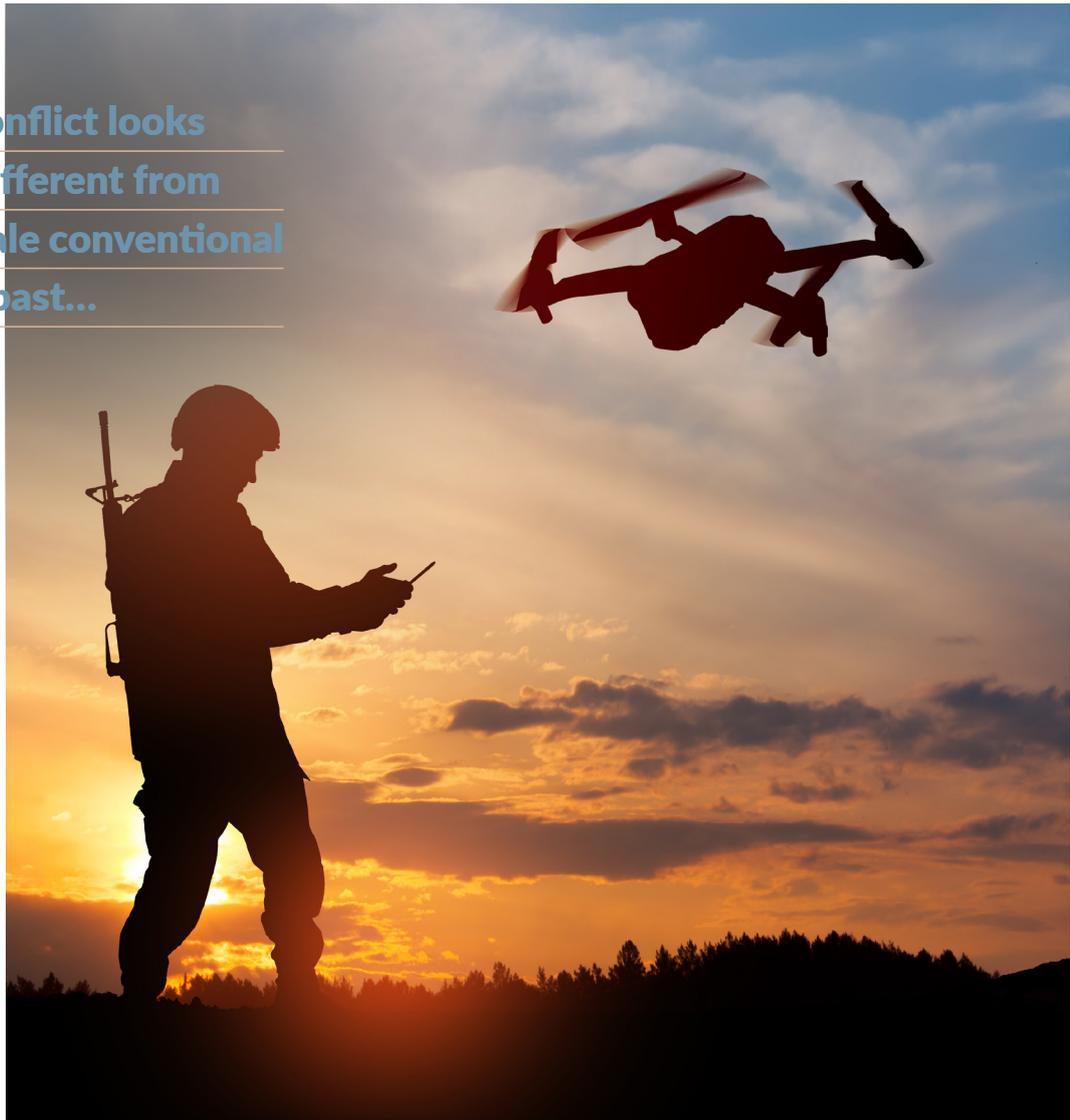


focus



Warfare is rapidly evolving, with drones, AI, cyber capabilities and space-based systems reshaping defence strategies. The sector is now deeply linked with technology, software, data and advanced manufacturing, blurring the line between civilian and military applications. At the same time, global defence spending is rising due to geopolitical tensions and shifting security priorities. While defence companies can offer exposure to long-term government spending, technological innovation and supply chain re-shoring, they also raise important ethical considerations for investors.

...Modern conflict looks materially different from the large-scale conventional wars of the past...



A complex conversation

Two major conflicts in recent years – Russia’s invasion of Ukraine in 2022 and the escalation of violence in the Middle East in 2023 – together with the more recent direct confrontation involving Iran and regional powers – have reminded investors that geopolitical risk remains real and destabilising. While markets often recover after the initial shock of war, the human cost is profound and ongoing.

These events have also prompted renewed client questions: Should we invest in defence companies? Should we exclude them? How do we reconcile national security with the devastation war brings? There is no single correct answer. But there is value in approaching the question deliberately and transparently.

War has changed

Modern conflict looks materially different from the large-scale conventional wars of the past.

Recent conflicts have demonstrated the growing role of:

- Low-cost drones and unmanned systems
- Artificial intelligence and autonomous capabilities
- Cyber warfare and attacks on digital infrastructure
- Space-enabled surveillance and communications

The barriers to asymmetric warfare have fallen. A relatively inexpensive drone can disable multi-million-dollar equipment. Cyber capabilities

can disrupt energy grids and financial systems without a single soldier crossing a border. Defence is now increasingly intertwined with technology, software, data and advanced manufacturing. The line between civilian and military applications has blurred.

A structural lift in defence spending

Governments have responded to rising geopolitical tensions with increased defence budgets.

According to the Stockholm International Peace Research Institute (SIPRI), global military expenditure in 2024 reached approximately US\$2.7 trillion, the highest total on record and a 9.4% rise on 2023 – the steepest annual increase since the end of the Cold War. This includes rising defence budgets across all five world regions.

Total military spending as a share of world GDP – rose to 2.5% in 2024, also the highest level in decades.

Europe saw defence spending in 2025 of c.US \$563 billion, up around 12.6% year-on-year, driven by NATO commitments and procurement spending. Several European nations have announced multi-year rearmament and procurement programmes following decades of underinvestment.

China's 2026 defence budget has been proposed at roughly CNY 1.9 trillion (~US \$275–\$278 billion) – a ~7% increase on 2025 – emphasising military modernisation amid geopolitical competition.

For defence companies, this has translated into expanding order books and, at times, strong share price performance during periods of conflict. However, that a sector may benefit financially from rising geopolitical tension and human devastation is precisely what makes this a values-sensitive area for many investors.

The ethical tension

Defence capability can act as a deterrent. Sovereign nations have a recognised right – and arguably an obligation – to defend their citizens and territorial integrity. At the same time, war results in civilian casualties, displacement, infrastructure destruction and long-term trauma. Companies involved in the manufacture of weapons can face allegations that their products are complicit in human rights violations.

Historically, many of our clients have written policies preventing investment in:

Companies domiciled in, or operating within, countries directly involved in conflict

Companies whose products may be associated with human rights abuses

Defence and arms manufacturers, depending on the client's values and mandates

Drawing boundaries in this space is no longer straightforward. Defence companies can range from manufacturers of controversial or prohibited weapons to providers of communications systems, logistics, or dual-use components. The definition of what is "acceptable" differs from one investor to the next.

Bottom line

It is worth acknowledging that defence stocks have, at times, rallied during periods of conflict. That dynamic can create discomfort: financial gain coinciding with human suffering. For some investors, this is sufficient reason to exclude the sector entirely. For others, the argument that credible defence capability underpins peace and stability carries weight. The global events currently playing out are, understandably, causing some investors to reassess the approach they have chosen.

Practical approaches for investors

Where clients wish to reflect their values in their portfolios, clarity is essential.

Common approaches include:

Excluding controversial or prohibited weapons (e.g. cluster munitions, anti-personnel mines, chemical or biological weapons), often on a zero-revenue threshold.

Setting revenue thresholds for broader weapons exposure (e.g. excluding companies deriving more than 10% of revenue from dual-use components that may be used in weapons systems).

Excluding companies directly linked to specific conflicts, informed by international law or credible external lists.

Avoiding companies listed in or domiciled within certain jurisdictions.



...Investing...in defence companies is ultimately a question of values as much as valuation...

Given the intersection of technology and defence, clients are also now beginning to think about the role of Communications and AI companies for 'security enabling' capabilities.

Each approach has trade-offs. Narrow exclusions may leave some indirect exposure. Broader exclusions can materially reduce the investment universe and affect portfolio construction.

Importantly, exclusions within externally managed funds or Exchange Traded Funds can typically only be implemented on a best endeavours basis.

A cautious lens

War is tragic. The destruction and loss of life cannot be abstracted away in an investment discussion. At the same time, national security remains a core function of sovereign states, and defence spending is rising in response to a more fragmented world. Investing – or choosing not to invest – in defence companies is ultimately a question of values as much as valuation.

If working through this predicament is something you have been thinking about, please don't hesitate to contact your adviser. We can help clients articulate their own values, understand the portfolio implications, and implement decisions in a practical and transparent way.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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