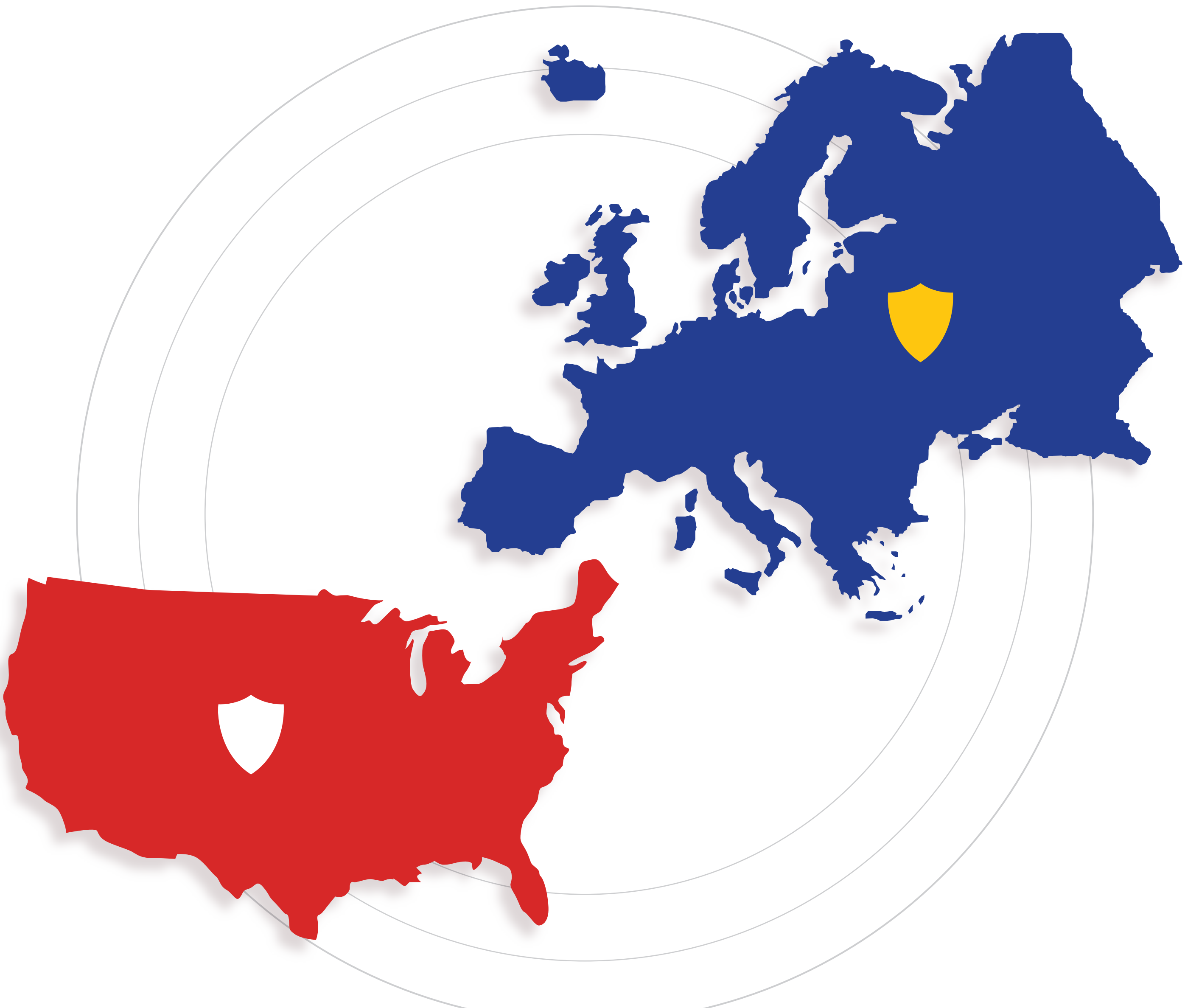
Aerospace and Defense Policy 2026 Preview

THE US BOOST TO DEFENSE AND THE EUROPEAN RESPONSE



CAPSTONE

About Capstone

Capstone is a global, policy-driven strategy firm helping corporations and investors navigate the local, national, and international policy and regulatory landscape.

Work with Us

We tailor our work to help our clients predict meaningful policy and regulatory backdrops, quantify their impact, and recommend strategies that unveil novel opportunities and avoid hidden risks.

Contact Us

To learn more about our products, services, and solutions, reach out to sales@capstonedc.com or visit our website at capstonedc.com.

Aerospace and Defense Policy 2026 Preview:

Capstone believes new investment in defense and homeland security-focused capabilities will accelerate in 2026 as Washington restores focus on the Western Hemisphere in what it is calling the Trump Corollary to the Monroe Doctrine. The perception of a US retrenchment also is driving Europe to reinvest in its own capabilities, leading to what we believe will be a 60% increase in defense spending in major European markets by 2030.

THE BOTTOM LINE

Outlook at a Glance

- PIVOT TO HOMELAND DEFENSE WILL DRIVE 2026 PENTAGON PRIORITIES, BUT RUSSIA AND CHINA WILL CONTINUE TO TEST US RESOLVE
- RISING NATO DEFENSE SPENDING TO DRIVE SIGNIFICANT WHITE SPACE FOR A&D SECTOR WITH 60% INCREASE IN SPEND EXPECTED BY 2030

Pivot to Homeland Defense Will Drive 2026 Pentagon Priorities, but Russia and China Will Continue to Test US Resolve

Winners	Homeland security-oriented defense technology firms such as Anduril Industries, Palantir Technologies Inc. (PLTR), Leidos Holdings Inc. (LDOS), and Elbit Systems of America (ESLT); US critical minerals developers; Western infrastructure and energy firms
Losers	None

MIDTERM DYNAMICS WILL DOMINATE TRUMP ADMINISTRATION FOREIGN POLICY IN 2026

The Trump administration faces competing factions vying for control of US foreign policy. Traditional Republican hawks advocate for aggressive postures toward adversaries, while Make America Great Again (MAGA) constitutionalists push for non-interventionism—particularly seeking an end to the Ukraine conflict and restraint in Venezuela. Despite these tensions, two strategic priorities unite the administration: 1) pivoting toward Western Hemisphere defense to counter crime, drug trafficking, and illegal immigration; and 2) degrading Chinese dominance of critical mineral supply chains that are essential to US defense and energy sectors. Venezuela policy, Ukraine negotiations, and China strategy heading into 2026 must be viewed through this lens.

The White House sees crackdowns on drugs, crime, and immigration as resonant political messages heading into the 2026 midterms, particularly for a MAGA audience skeptical about foreign intervention. President Trump also will likely seek to lower energy prices to address affordability concerns, and getting Russian and Venezuelan oil and minerals back on the market would advance that goal. Treasury Secretary Scott Bessent explicitly referenced the link between Ukraine, Venezuela, and oil prices stating: "[I]f something happens with Russia-Ukraine, if something happens down in Venezuela, we could really see oil prices go down even more. Oil and gasoline prices are down substantially under President Trump, and that is really the key to affordability: lower energy. And energy goes into food prices." Vice President JD Vance also framed ending the Ukraine war in terms of focusing on US domestic economic challenges.

While there are significant disagreements on issues like combating Chinese military and economic influence, defending US borders and targeting drugs will serve as a point of unity in President Trump's foreign policy. The Trump administration's National Security Strategy (NSS), released this month, underscores these domestic security priorities. We believe this pivot will create opportunities for companies focused on homeland defense, particularly with the US Department of Homeland Security (DHS) and the US Customs and Border Patrol (CBP), US Coast Guard, and those with enabling technologies for inspections, detections, and supply chain mapping.

Companies that are already supporting the administration in border security-related efforts include Anduril, Palantir, and Elbit and they will likely be among the beneficiaries of the $550 million in the One Big Beautiful Bill Act (OBBBA) to fund the construction of a smart wall comprised of physical barriers and other infrastructure, as well as technological solutions. Several infrastructure and construction groups also have been awarded CBP funds under OBBBA as of October 2025, and more will likely follow.

The Trump administration and Congress will likely also prioritize protecting critical undersea fiber-optic cables in the Western Hemisphere from Chinese and Russian threats through deployment of sensors, surveillance satellites, and joint Coast Guard patrols with regional allies and partners—measures recommended by the US-China Economic and Security Review Commission, as even a pivot to "homeland defense" does not reduce the intensity of the global competition between the US and China.

The long-awaited National Security Strategy (NSS) that the US Department of Defense (DOD) published on December 5th reflects this hemispheric shift and cites what it calls the Trump Corollary to the Monroe Doctrine. The NSS serves as a compass and doctrinal justification for the administration's defense policies and spending priorities. While the document acknowledges China as a major national security threat, it nevertheless signals a pronounced pivot toward the Western Hemisphere—a departure from decades of focus on the Middle East, in particular. This shift will signal spending priorities on the defense industrial base, allies, and adversaries for the next four years. US Southern Command is now, and will likely remain, a major locus of US military activity in 2026.

MAJOR FOREIGN POLICY ISSUES IN 2026

Venezuela: Sustained US Military and Diplomatic Engagement

US military action against Venezuelan President Nicolas Maduro's regime appears increasingly likely, with the hawkish faction led by Secretary of State Marco Rubio prevailing for now over MAGA non-interventionists. At a minimum, we expect unprecedented levels of US military engagement in Venezuela to pressure President Maduro to leave office. In addition to combating narco-terrorism and organized criminal activity, the Trump administration also is eyeing the restoration of the country's vast oil production to global markets, as well as enabling US firms to develop the country's critical minerals and rare earth resources—both of which would require a US-aligned government in Caracas.

Should the Trump administration succeed in toppling the Maduro regime, there will be intensive diplomatic efforts to negotiate unfettered commodity access with a US-aligned successor government. However, achieving this objective will demand continued US military involvement to stabilize any transition and enforce agreements. Significant uncertainties surround post-Maduro governance, including whether an opposition-led government would emerge friendly to US interests or military factions would continue to dominate. Additionally, rebel groups currently control areas containing most of Venezuela's critical mineral deposits, meaning a new government will require US military support to assert territorial control sufficient to guarantee supply access.

A stable, democratic post-Maduro Venezuela is unlikely to emerge and sustain itself in 2026 given the decades of dictatorship, economic disarray, and anti-American stance across Venezuela's political spectrum. And a disorderly transition could further pressure other US priorities, such as reducing the flow of migrants to the US border. As a result, the year ahead is will likely be only the beginning of a renewed US engagement in

Venezuela and the broader region that will drive resources and attention for the DOD and the defense industrial base.

Ukraine-Russia: Expect More Pressure

The administration will continue pressuring Ukraine toward a final peace agreement as President Trump is quite eager to achieve his campaign promise of negotiating an end to the war in Ukraine. But the details of this agreement matter greatly and will set the conditions for the long-term stability of the country and for NATO and European security architecture. More tactically—but of great interest to markets—is, absent White House support, Congress is unlikely to advance its sweeping Russia sanctions legislation in the near term as President Trump and a small group of advisers will continue to set the terms of US policy. The administration's policy remains divided on how best to resolve the conflict and manage Russia, with the fault line between Secretary Rubio's hawkish approach and Vice President Vance's push to reduce US involvement on terms more favorable to Moscow, remaining as wide as ever.

Russian President Vladimir Putin's intransigence will likely generate calls for additional sanctions against Moscow. The Kremlin continues raising obstacles to negotiation, including claims that there is no legitimate government in Kyiv with which to conclude a peace agreement. As the 2026 midterms approach in the US, congressional Republicans will loudly encourage the White House to escalate pressure on Russia should no deal be reached. While likely to undergo additional revisions, we believe the current sanctions package that Republican Senator Lindsey Graham (R-SC) and others support would present underappreciated risks to global energy markets in general and the uranium market in particular.

Under more positive scenarios, a sustainable peace deal between Russia and Ukraine would kick off a vast reconstruction of the war-torn country, providing numerous investment opportunities for Western firms, with billions already committed by European governments and international funding mechanisms. Winners will be large construction conglomerates and energy companies tapped to rebuild Ukraine's energy infrastructure. US, European Union, and Asian defense companies also will benefit, with EU countries likely providing security commitments.

Indo-Pacific and China: The Year Before 2027

Capstone believes 2026 also will be notable because it is one year shy of the often referenced 2027 date by when the People's Liberation Army has been ordered to achieve the capabilities to invade Taiwan. Capstone expects hostile rhetoric over Taiwan to accelerate in 2026, and how the Trump administration handles the Ukraine conflict will serve as a critical indicator for how the US could be expected to defend Taiwanese interests in the event of an invasion or hostile actions that, while short of an invasion, test decades of US policy.

China will remain the "pacing threat" that drives US defense spending toward more advanced technologies and modernization, particularly efforts to fortify the US defense industrial base. The Trump administration also will continue to invest in critical minerals projects, leveraging defense appropriations and Development Finance Corporation infrastructure funding to secure supply chains. The administration will build on Biden-era initiatives to deepen military partnerships with South Korea, Japan, and Southeast Asian allies, including the Philippines and Malaysia.

These relationships will generate significant defense procurement opportunities, particularly for emerging technologies such as unmanned aerial systems and autonomous maritime vehicles, in shipbuilding, and across the defense industrial base. The administration also will prioritize countering Chinese threats to undersea cable infrastructure in the region, among other challenges.

To be sure, the NSS states that Washington seeks to "maintain a genuinely mutually advantageous economic relationship" with China. But Capstone believes the Indo-Pacific theater will remain a key area of defense planning and investment in 2026 to maintain military superiority, regardless of how the relationship evolves along trade and economic fronts.

Middle East: Economic Cooperation over Military Spending

The US and its Gulf partners are consolidating gains following two years of dramatic regional developments, including US strikes on Iran, Israeli operations targeting Hamas and the degradation of Hezbollah, and the conclusion of the two-year Israel-Gaza conflict. MAGA constitutionalists will continue pressuring the administration to withdraw US forces from the Middle East and reduce support for Israel. However, these efforts are unlikely to successfully shift policy in 2026.

Instead, the Trump administration will prioritize economic engagement over new military commitments. Capstone expects intensified efforts to deepen US-Gulf cooperation on artificial intelligence (AI) investment, data center infrastructure development, and technology partnerships, particularly as Gulf States position themselves as critical nodes in global AI supply chains. Defense cooperation will continue at current levels, focusing on maintaining existing security architectures rather than expanding the US military footprint. This approach aligns with the administration's broader strategy of leveraging economic statecraft while redirecting military focus toward the Western Hemisphere. The Gulf States' massive capital reserves and appetite for advanced technology infrastructure create natural alignment with US objectives to secure AI capabilities and counter Chinese technological dominance without requiring sustained military escalation in the region.

Rising NATO Defense Spending to Drive Significant White Space for A&D Sector with 60% Increase in Spend Expected by 2030

Winners	Dassault Aviation SA (AM on the Paris exchange), BAE Systems Plc (BA on the London exchange), Safran SA (SAF on the Paris exchange), Leonardo SpA (LDO on the Milan exchange), Rheinmetall AG (RHM on the Frankfurt exchange), KNDS Group, Thales SA (HO on the Paris exchange), Hanold AG (HAG on the Frankfurt exchange), MBDA, Naval Group, Fincantieri SpA (FCT on the Milan exchange), PGZ SA, and Airbus SE (AIR on the Paris exchange). Hanwha Aerospace (012450 on the Korean exchange), Korea Aerospace Industries (047810 on the Korean exchange)
Losers	None

LASTING IMPACT OF UKRAINE WAR IS THE REANIMATION OF NATO DEFENSE INDUSTRIAL BASE

NATO member state commitments to revitalize domestic defense industrial supply chains are growing teeth, accelerated by the ongoing war in Ukraine that is now seeing Russia test European border and aerial defenses, and increasing concerns about the durability of US security commitments to the European defense. With strategic autonomy in the minds of many European policymakers, major defense spending packages will be largely targeted to domestic markets and will catalyze both public and private sector investment across defense value chains.

In the top five European defense markets, comprised of Germany, the UK, France, Italy, and Poland, Capstone estimates that even a conservative investment trajectory could lead to a nearly 60% boost in spending by 2030, from $346 billion in 2025 to $550 billion in 2030.

The investment case is clear. European defense capabilities have atrophied substantially since the end of the Cold War and there is a significant disparity between the demands on NATO militaries today and their capacity to meet them. Even the largest European militaries struggle to field full-spectrum capabilities similar to those of the US. Now, rising uncertainty over their security in light of Russia's invasion of Ukraine and the Trump administration's mercurial approach to trans-Atlantic defense issues are shifting the emphasis on increasing defense capacity that is less reliant on US support. To be sure, coordination with the US—which necessitates enhanced interoperability—as well as the leading position of US industry in key areas will still create opportunities for US defense firms. European NATO counterparts are not yet capable of meeting short-term Continental needs for high-end military capabilities, including air and missile defense and precision strike capabilities. As a result, US firms will continue to have ample opportunity to participate in the revitalization of Europe's defense industry as local governments strive for longer-term parity. However, it is and will continue to be a key priority of European policymakers that the majority of spend flows to domestic companies.

Acknowledging the political sensitivities and complex dynamics around defense spending across NATO member countries, Capstone nevertheless believes the geopolitical environment sets the conditions for serious and durable commitment to bolstering European security. We believe this to be true whether or not Russia and Ukraine reach agreement in the year ahead.

COUNTRY-LEVEL INVESTMENT DYNAMICS

Based on the new NATO 2025 guidance and countries' public plans for increased defense spending, Capstone believes Germany, the UK, France, Italy, and Poland will continue to be leaders in domestic spending for the next several years, both in aggregate dollar values and on a growth rate basis. Should the five largest European defense spenders close half the gap between their current spending levels and the goal of 3.5% of GDP by 2030 (and Poland remain steady at its current rate), Capstone projects that their collective spending will increase by 59%, or approximately $204 billion annually (see Exhibit 1). This will create a significant uplift for the major European defense players, as well as the entire defense industrial base across these markets and beyond.

Capstone's "halfway framework," where the five largest European defense spenders close half the distance between their current defense spending in percent GDP and the 3.5% target, showcases directionality and magnitude of the defense industry opportunity in Europe while acknowledging that domestic political factors within each of these five countries could meaningfully impact actual spending and timelines.

Germany

Germany is positioned to drive the largest increase in defense spending for the aerospace & defense industry within Europe. Capstone predicts its defense spending will rise by $69 billion in current-year dollars annually, or by 72%, should the nation close half the country's gap with the 3.5% goal by 2030. Beginning with former Chancellor Olaf Scholz's landmark Eigengene speech following the Russian invasion of Ukraine, when he announced the creation of a special €100 billion special defense fund, Germany has made dramatic moves to reinvest in the country's defense and defense industrial infrastructure. Current Chancellor Friedrich Merz continues to expand the last government's drive to increase defense investment with new plans reportedly calling for doubling national defense spending as of June 2025, independent of NATO guidelines.

The German defense industry is advanced and capable, and national champions such as Rheinmetall, Hensoldt, and its portions of multinationals Airbus, MBDA, and KNDS are well-positioned to benefit from new German spending. Leaked German procurement plans also reveal an interest in keeping new equipment purchases within Europe as feasible. Of €80 billion in new equipment procurement proposed for the next year, only 8% by value would be US-sourced.

United Kingdom

Capstone projects that the UK will hold steady as the second-largest European defense market in 2030. The country has maintained comparatively high defense spending levels through the early 2000s as the rest of Europe cut spending in this sector. As a consequence of this, the British defense market would require less growth to reach NATO's 2035 goals. However, the current government's significant political commitments to meet NATO's spending targets notwithstanding, the country is far more hamstrung by fiscal constraints than Germany or some other European states. Should the UK close half the percent GDP gap with NATO's 3.5% target by 2030, its defense budget as defined by NATO would rise by $56 billion current-year dollars annually, or 61%.

The UK defense industrial base is well-established and home to major international player BAE Systems, as well as a range of other firms across the defense industrial supply chain. The UK's participation in major multinational defense programs such as the next-generation Global Combat Air Programme (GCAP) highlights national capabilities. The UK also has maintained strong defense industrial ties with the US to a degree unlike other European players, including Germany and France. This relationship has been further strengthened in recent years via the US-UK-Australia AUKUS partnership, and new regulatory work will enable further technology transfers.

France

French President Emmanuel Macron has been a highly prominent advocate for a Continent-driven approach to European security and increased freedom of action independent of the US. His government has championed major increases in European defense spending, a stronger emphasis on building out the European defense industrial ecosystem, and a larger role for the EU and Europe-centric constructs in continental security. Capstone predicts that, should France close half the country's gap with the 3.5% goal by 2030, its national defense spending will rise by $38 billion current-year dollars annually, or 57%.

Following NATO's 2025 Hague meeting, President Macron announced plans to speed planned defense spending hikes, doubling France's defense budget from 2017 levels. Despite his strong rhetoric and commitment to expanding France's role in European security, the nation's high debt loading and political instability present challenges for his administration and the broader French establishment to navigate.

France has traditionally pursued a highly capable and independent domestic defense industry. French companies such as Thales, Safran, Naval Group, and Dassault offer world-class capabilities and are well-positioned to take advantage of rising domestic defense spending. France also is home to major portions of large European multinationals such as MBDA and KNDS, driving further integration into the continental ecosystem.

Italy

Even compared to other European NATO members, Italy's defense budget has been a comparatively small percentage of national GDP. Capstone predicts that, should Italy close half the country's gap with NATO's 3.5% goal by 2030, national defense spending will rise by $28 billion current-year dollars annually, or 57%

Italy faces major economic pressure, similar to the UK and France, against increasing defense spending and must balance NATO commitments against sizable welfare spending needs and an often euro-skeptic public. Despite these challenges, the Italian government has taken meaningful steps to advance defense investment. Reflagging Italian Coast Guard components as military units to count under NATO spending rules, or attempting to treat a new bridge as critical military infrastructure have drawn criticism. However, Italy also has applied for €15 billion in Security Action for Europe (SAFE) low-interest loans from the European Union and is planning to take advantage of EU policies that would allow it to increase its deficit to fund defense spending.

Despite long-term budgetary challenges, Italian defense firms such as Leonardo and Fincantieri have a long history of providing up-to-date offerings for the domestic armed forces and collaborating with other European players on major international programs, including the Eurofighter and GCAP aircraft programs.

Poland

Unlike the preceding four highest European defense spenders, Poland's defense budget is already quite high in terms of percent GDP at 4.5%. And this is particularly true in comparison to other European states. Polish spending is driven by the country's close proximity to Russia and the ongoing war in Ukraine, dramatically driving up the NATO ally's perceived risks. While

Poland projects even higher defense spending in the medium term, the country has less room to grow compared to its counterparts. This defense spending has placed pressure on Poland's fiscal situation but has robust political backing. Poland requested that national defense spending be excluded from the EU's national deficit rules similar to Italy in order to increase borrowing.

Poland is a major defense buyer, but has a less developed domestic defense industrial base than the other included countries. State-owned PGZ (Polish Armaments Group) is Poland's primary military supplier. Notably, in recent years Poland has entered into a strategic partnership with South Korea to field large quantities of that country's arms and has begun domestic production of South Korean weapons. While South Korea has seen increasing arms export success within Europe, Poland stands alone as by far the largest South Korean arms importer within the continent signing deals worth billions of dollars. Continued Polish defense spending, therefore, also increased the opportunity for Korean firms to grow into the European market, alongside US firms who have traditionally dominated Polish defense imports. Poland is largely balancing a high-low mix of imports, where slower to deliver and more expensive US capabilities form the high end and still very capable but less expensive Korean weapons form the low end.

EXHIBIT 1

Projected Top Five Largest European Defense Budgets in 2030

	2025 Defense Spend ($	2025 Defense Spend % of GDP	2030 Projected Defense Spend % GDP	2030 Projected Spend (current $)	% Change in Defense Spending 2025e-30	2030 Additional Defense Spending Value over 2025e ($)
Germany*	$96 billion	2.4%	3.0%	$165 billion	72%	$68 billion
UK	$91 billion	2.4%	3.0%	$146 billion	61%	$56 billion
France	$67 billion	2.1%	2.8%	$104 billion	57%	$38 billion
Italy	$49 billion	2.0%	2.8%	$76 billion	57%	$28 billion
Poland	$44 billion	4.5%	4.5%	$58 billion	32%	$14 billion
TOTAL	$346 billion			$550 billion	59%	$204 billion

Source: NATO; IMF; *NATO budget data for Germany unavailable, separately sourced from the Bundestag and Reuters

About Capstone

Capstone is a global, policy-driven strategy firm helping corporations and investors navigate the local, national, and international policy and regulatory landscape.

Work with Us

We tailor our work to help our clients predict meaningful policy and regulatory backdrops, quantify their impact, and recommend strategies that unveil novel opportunities and avoid hidden risks.

Contact Us

To learn more about our products, services, and solutions, reach out to sales@capstonedc.com or visit our website at capstonedc.com