Morgan Stanley
INVESTMENT MANAGEMENT

The New Defense Economy



TALES FROM THE EMERGING WORLD | EMERGING MARKETS EQUITY TEAM | November 2026

For three decades after the fall of the Soviet Union, Europe treated defense capacity like an insurance policy it could afford to underfund. Their arsenal existed on paper, but the supply chain behind it had atrophied. Ukraine, the Middle East and rising tensions in Asia have shown that deterrence depends on replacement capacity as much as on tanks, aircraft or missile systems. What gets deployed in a matter of months of high-intensity conflict takes years to replace. That shift is creating a new defense economy, and enabling select emerging markets (EM) to help rebuild the West's armament.

Decades of lean procurement left the West with defense industries designed for peacetime, unprepared for sustained conflict. Modern war consumes shells, interceptors, drones and spare parts faster than those industries were built to supply. Industrial capacity now constrains defense as much as budgets do.

After years of anemic growth, global military spending hit a record $2.9 trillion in 2025. Last year, NATO's European members and Canada raised spending 20% in a single year, its highest growth since 1953. Poland alone now spends 4.5% of GDP on defense, the largest in the alliance. Polish arms imports were nine times higher in 2021-2025 than in 2016-2020 and Europe now sits at the center of the defense rebuild because the threat is close by and the underinvestment deepest.

We believe that creates an investment theme beyond the traditional U.S. defense complex. While Europe is driving the demand, some of the most interesting supply-side beneficiaries sit in EM, where exporters offer capability, speed and lower costs.

AUTHORS



DIDIER ROSENFELD
Executive Director, Emerging Market Equities



ROSE KIM
Executive Director, Emerging Market Equities



SAUMYA JAIN
Vice President, Emerging Market Equities

Europe's Demand Shock

For much of the post-Cold War period, Western Europe spent below today's NATO benchmark, leaving thin ammunition stocks, aging platforms and an industrial base calibrated for peacetime procurement. The return of a high-intensity war to Europe changed the continent's strategic thinking, where uncertainty over the durability of U.S. support has accelerated this shift.

Europe's military spending rose 14% in 2025. France alone has more than 180 combat aircraft on order, almost all of them Dassault Rafale fighter jets. At the 2025 Hague summit, NATO members committed to spending 5% of GDP on defense and related security requirements by 2035.

Budgets take time to turn into missile factories, propellant lines, trained welders and shell stockpiles. NATO's procurement agency has indicated ammunition deliveries to Ukraine can take 24 to 36 months, while the UK's plan to sharply increase 155mm shell production has been delayed by at least six months, with full operation expected in 2027. Europe's catch-up cycle is likely to be long and uneven, held back by bottlenecks across the industrial base *(Display 1)*.

The threat set has also widened. Cyberattacks, navigation jamming, disinformation campaigns and attacks on critical infrastructure add risks that conventional firepower does not address. Europe needs a broader industrial base, faster procurement and suppliers that can deliver quickly.

Drone Warfare

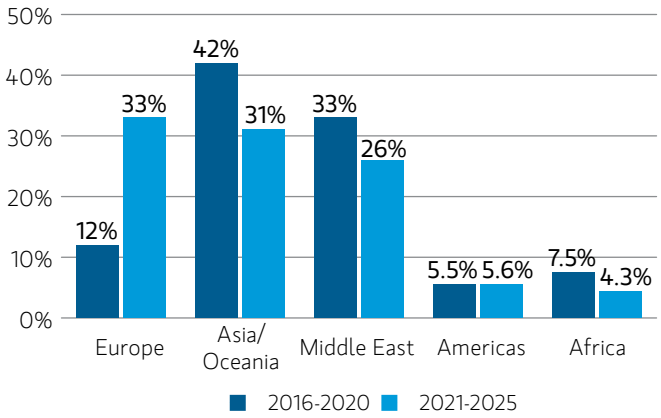
Drones have lowered the cost of combat, even as the core force structure remains conventional. Cheap, expendable systems can now provide surveillance, precision strikes, electronic warfare and long-range attacks. Drones are relatively easy to mass produce and have become ubiquitous in recent conflicts in Armenia, Ukraine and the Middle East. Ukraine is now a leader in first-person-view (FPV) drones, rapidly increasing their monthly unit production capacity from 20,000 in 2024 to 200,000 in 2025, having planned to triple it to 600,000 in 2026.

The U.S. National Defense Authorization Act has earmarked about $1.7 billion for small unmanned aerial systems, more than quadruple what it spent in 2022, but still well under one percent of the overall defense budget. U.S. Foreign Military Sales approvals to the Middle East topped $45 billion in Q1 2026 alone, more than the global drone market generates in a full year.

DISPLAY 1

Europe Has Become the Demand Shock

*Share (%) of global arms imports**



Source: Stockholm International Peace Research Institute (SIPRI) Military Expenditure Database. As of 3/31/2026. *Global arms imports are based on volume of transfers of major arms. The SIPRI uses a unique pricing system, the trend-indicator value (TIV), to measure the volume of deliveries of major conventional weapons. The SIPRI TIV measures transfers of military capability rather than the financial value of arms transfers.

Conventional platforms remain the backbone of military forces, and that is where the bulk of new spending continues to be directed. The future battlefield is likely to pair drones with conventional forces that will still require depth and replenishment.

South Korea: Speed and Scale

South Korea is one of the more credible EM beneficiaries of the global defense cycle. Its advantage is structural: decades of procurement linked to the North Korean threat have supported continuous investment in weapons systems, large-scale domestic production and specialized supply chains. As a major U.S. treaty ally, South Korea has developed its defense industry within a Western-aligned security framework, while retaining greater manufacturing continuity and scale than many of its Western peers.

This matters more as Western buyers prioritize near-term, battlefield-tested delivery coupled with sustainable after-sales support for defense systems. South Korean suppliers offer a broad portfolio across tanks, self-propelled artillery, missiles, ammunition and armored vehicles with shorter delivery schedules and, in many cases, pricing below comparable Western systems. Large domestic orders also improve fixed-cost absorption and support production at scale. That continuity has developed technical expertise, established supply chains and economies of scale that many Western producers are now trying to recreate.

Poland has emerged as an anchor customer, accounting for approximately 46% of South Korean defense exports in 2025. Total exports increased from roughly $7.3 billion in 2021 to $15.4 billion in 2025, reflecting South Korea's ability to convert manufacturing capacity into large, multi-platform export contracts (*Display 2*). The next phase depends on continued order inflows and the speed of rearmament among NATO, Indo-pacific and Middle East partners.

Brazil: Specialized Platforms

Brazil is a slimmer chapter of the EM defense story. It lacks South Korea's breadth and production scale but has built expertise in military transport aircraft, rocket artillery and armored vehicles. Brazil's aerospace and defense sectors have produced military transport aircraft now flying with several NATO members, evidence that EM platforms can pass developed market's procurement standards. The flagship of the aerospace sector is the C-390 Millennium military aircraft.

Rocket artillery and locally built armored personnel carriers round out an export catalogue aimed at budget-conscious militaries in Latin America, Africa and the Middle East. The opportunity is still maturing. As export volumes build and government support solidifies, Brazil could become more visible in EM defense, though its role is likely to remain more specialized than South Korea's.

India: Localization Runway

India is not yet an export power like South Korea and its spending cycle is less rapid than Europe's. The country still relies on Russia, France, Israel and other suppliers for many advanced systems. For example, India approved the purchase of 114 Rafales in February.

India has a large domestic market and a clear policy preference for localization. The challenge is execution: procurement remains bureaucratic, technology gaps persist and the industrial ecosystem is still developing. India's opportunities are likely to be selective rather than broad. The more investable areas are expected to be electronics, radars, sensors, missiles and ammunition, where domestic suppliers can participate in import substitution.

Why Emerging Markets Matters

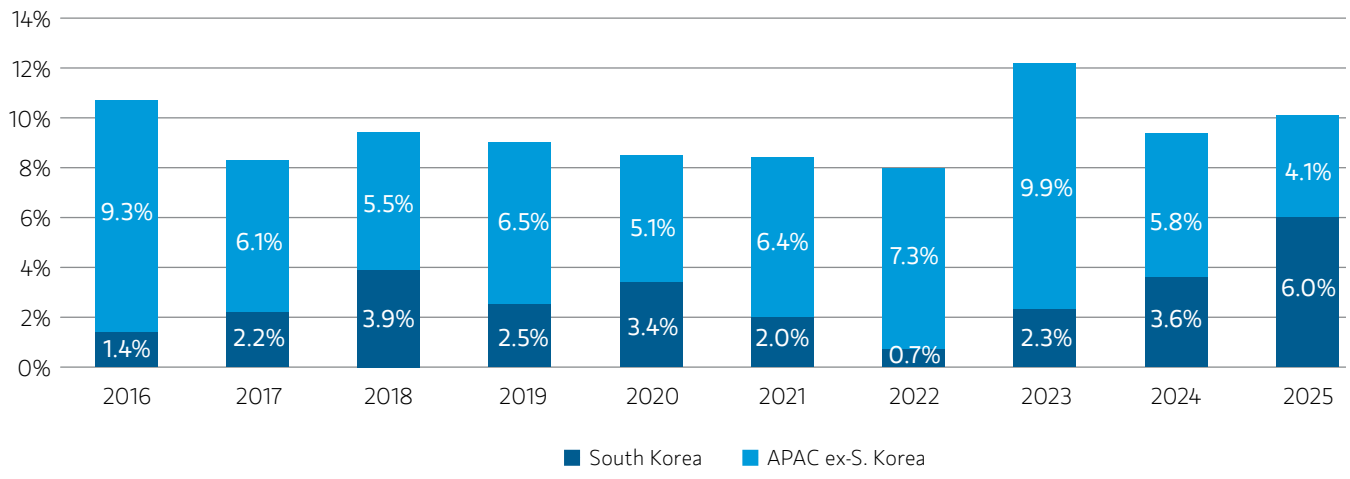
The U.S. remains the world's dominant defense supplier, the largest defense spender and the leading exporter of advanced weapons systems. Countries still want U.S. equipment, but they also want local support, faster delivery and confidence that contracts will be fulfilled.

For EM defense companies, the opportunity lies in the categories where buyers need speed, affordability and supply assurance. As the West retools deterrence after decades of underinvestment, Europe's demand shock is already translating into tangible market share gains for selected EM defense suppliers.

DISPLAY 2

South Korea's Share of Global Arms Exports Is Rising

% of global arms exports



Source: SIPRI Military Expenditure Database. As of 3/31/2026.

Risk Considerations

There is no assurance that a portfolio will achieve its investment objective. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. In general, **equities securities' values** also fluctuate in response to activities specific to a company. Investments in foreign markets entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in **emerging market countries** are greater than the risks generally associated with investments in foreign developed countries. Investing in companies in anticipation of a catalyst event, such as **Artificial Intelligence (AI)** adoption, carries the risk that such catalysts may not happen, or the market may react differently than expected. Companies focused on AI may have limited product lines, markets, or financial resources, and the management of such companies may be more dependent upon one or a few people. A Portfolio may be particularly impacted by events that adversely affect AI adoption, such as rapid changes in technology product cycles, product obsolescence, government regulation, and competition, and may fluctuate more than that of a portfolio that does not invest significantly in companies adopting AI.

IMPORTANT DISCLOSURES

Charts and graphs provided herein are for illustrative purposes only. **Past performance is no guarantee of future results.**

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market.

A separately managed account may not be appropriate for all investors. Separate accounts managed according to the particular Strategy may include securities that may not necessarily track the performance of a particular index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required.

For important information about the investment managers, please refer to Form ADV Part 2.

The views and opinions and/or analysis expressed are those of the author or the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively "the Firm"), and may not be reflected in all the strategies and products that the Firm offers.

This material has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such information and the Firm has not sought to independently verify information taken from public and third-party sources.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

This material is not a product of Morgan Stanley's Research Department and should not be regarded as a research material or a recommendation.

The Firm has not authorised financial intermediaries to use and to distribute this material, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries are required to satisfy themselves that the information in this material is appropriate for any person to whom they provide this material in view of that person's circumstances and purpose. The Firm shall not be liable for, and accepts no liability for, the use or misuse of this material by any such financial intermediary.

This material may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this material in another language, the English version shall prevail.

The whole or any part of this material may not be directly or indirectly reproduced, copied, modified, used to create a derivative work, performed, displayed, published, posted, licensed, framed, distributed or transmitted or any of its contents disclosed to third parties without the Firm's express written consent. This material may not be linked to unless such hyperlink is for personal and non-commercial use. All information contained herein is proprietary and is protected under copyright and other applicable law.

DISTRIBUTION

This material is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

MSIM, the asset management division of Morgan Stanley (NYSE: MS), and its affiliates have arrangements in place to market each other's products and services. Each MSIM affiliate is regulated as appropriate in the jurisdiction it operates. MSIM's affiliates are: Calvert Research and Management, Eaton Vance Management, Parametric Portfolio Associates LLC, Parametric SAS, and Atlanta Capital Management LLC.

This material has been issued by any one or more of the following entities:

EMEA:

This material is for Professional Clients/Accredited Investors only.

In the EU, MSIM materials are issued by MSIM Fund Management (Ireland) Limited ("FMIL"). FMIL is regulated by the Central Bank of Ireland and is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at 24-26 City Quay, Dublin 2, DO2 NY19, Ireland.

Outside the EU, MSIM materials are issued by Morgan Stanley Investment Management Limited (MSIM Ltd) is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

In Switzerland, MSIM materials are issued by Morgan Stanley & Co. International plc, London (Zurich Branch) Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland.

Italy: MSIM FMIL (Milan Branch), (Sede Secondaria di Milano) Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy. The **Netherlands:** MSIM FMIL (Amsterdam Branch), Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. **France:** MSIM FMIL (Paris Branch), 61 rue de Monceau 75008 Paris, France. **Spain:** MSIM FMIL (Madrid Branch), Calle Serrano 55, 28006, Madrid, Spain. **Germany:** MSIM FMIL, Frankfurt Branch, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Denmark:** MSIM FMIL (Copenhagen Branch), Gorrissen Federspiel, Axel Towers, Axeltorv2, 1609 Copenhagen V, Denmark.

MIDDLE EAST:

Dubai International Financial Centre: This information does not constitute or form part of any offer to issue or sell, or any solicitation of any offer to subscribe for or purchase, any securities or investment products in the UAE (including the Dubai International Financial Centre and the Abu Dhabi Global Market) and accordingly should not be construed as such. Furthermore, this information is being made available on the basis that the recipient acknowledges and understands that the entities and securities to which it may relate have not been approved, licensed by or registered with the UAE Central Bank, the Dubai Financial Services Authority, the UAE Securities and Commodities Authority, the Financial Services Regulatory Authority or any other relevant licensing authority or government agency in the UAE. The content of this report has not been approved by or filed with the UAE Central Bank, the Dubai Financial Services Authority, the UAE Securities and Commodities Authority or the Financial Services Regulatory Authority.

Abu Dhabi Global Market ("ADGM"): This material is sent strictly within the context of, and constitutes, an Exempt Communication. This material relates to content which is not subject to any form of regulation or approval by the Financial Services Regulatory Authority of the Abu Dhabi Global Market (the "FSRA").

Saudi Arabia: This financial promotion was issued and approved for use in Saudi Arabia by Morgan Stanley Saudi Arabia, Al Rashid Tower, Kings Sand Street, Riyadh, Saudi Arabia, authorized and regulated by the Capital Market Authority license number 06044-37.

U.S.: NOT FDIC INSURED. OFFER NO BANK GUARANTEE. MAY LOSE VALUE. NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY. NOT A DEPOSIT.

Latin America (Brazil, Chile Colombia, Mexico, Peru, and Uruguay)

This material is for use with an institutional investor or a qualified investor only. All information contained herein is confidential and is for the exclusive use and review of the intended addressee, and may not be passed on to any third party. This material is provided for informational purposes only and does not constitute a public offering, solicitation or recommendation to buy or sell for any product, service, security and/or strategy. A decision to invest should only be made after reading the strategy documentation and conducting in-depth and independent due diligence.

ASIA PACIFIC

Hong Kong: This document has been issued by Morgan Stanley Asia Limited, CE No. AAD291, for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This material is disseminated in Singapore by Morgan Stanley Investment Management Company, Registration No. 199002743C. This material should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This material has not been reviewed by the Monetary Authority of Singapore. **Australia:** This material is provided by Morgan Stanley Investment Management (Australia) Pty Ltd ABN 22122040037, AFSL No. 314182 and its affiliates and does not constitute an offer of interests. Morgan Stanley Investment Management (Australia) Pty Limited arranges for MSIM affiliates to provide financial services to Australian wholesale clients. This material will not be lodged with the Australian Securities and Investments Commission.

Japan: For professional investors, this material is circulated or distributed solely for informational purposes. For non-professional investors, this material is provided in connection with Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIMJ")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This does not constitute a recommendation or solicitation of transactions nor offers any particular financial instruments. Under an IMA, with respect to the management of client assets, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIMJ accepts such commission. The client shall delegate to MSIMJ the authorities necessary to make such investment decisions. MSIMJ exercises these delegated authorities accordingly, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above. Indirect charges also may be incurred, such as brokerage commissions for underlying securities. Since these charges and expenses vary by contract and other factors, MSIMJ cannot present the rates, upper limits, etc. in advance. All clients should read thoroughly the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This material is distributed in Japan by MSIMJ, Registered No. 410 (Director of Kanto Regional Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, the Investment Management Association of Japan and the Type II Financial Instruments Firms Association.

morganstanley.com/im

© 2026 Morgan Stanley. All rights reserved.

RO 6046691 Exp. 11/30/2028 Q4260136 A4