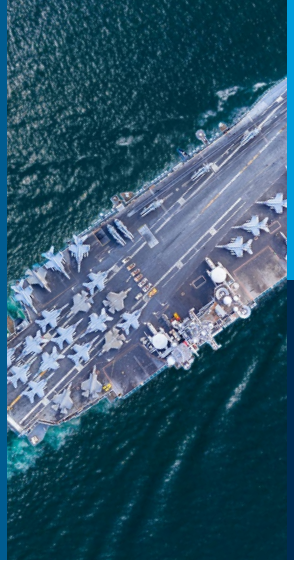
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The New Defense Economy

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.

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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

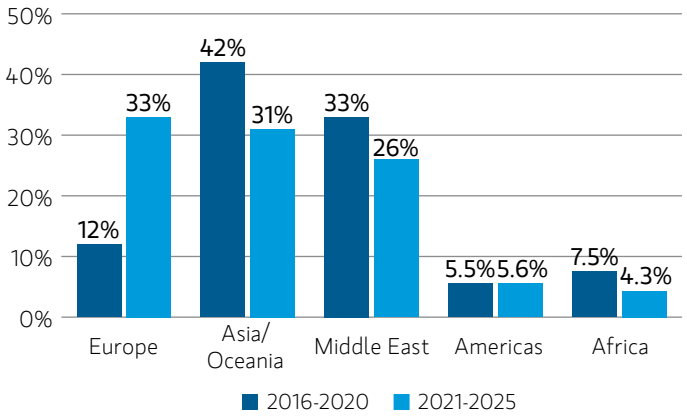
Drones have lowered the cost of combat, even as the core force structure remains conventional. Cheap, expendable systems can now provide surveillance, precision strikes, electronic warfare and long-range attacks. Drones are relatively easy to mass produce and have become ubiquitous in recent conflicts 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

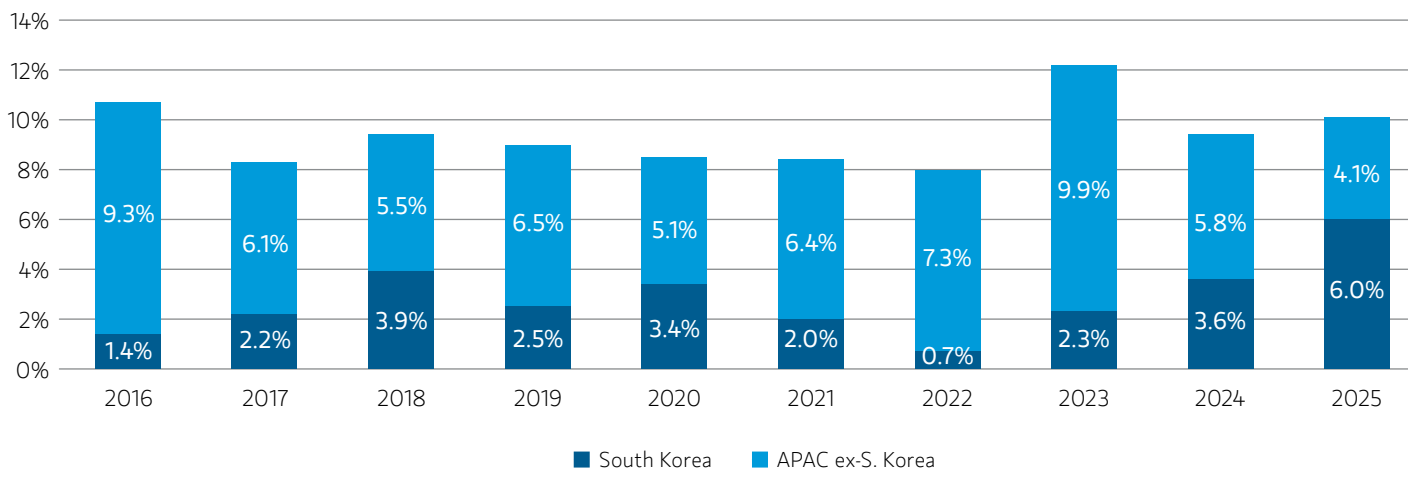
The U.S. remains the world's dominant defense supplier, the largest defense spender and the leading exporter of advanced weapons systems. Countries still want U.S. equipment, but they also want local support, faster delivery and confidence that contracts will be fulfilled.

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.

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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.

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