

PERSPECTIVES

# The arms portfolio: Reviewing the thematic and sustainability profiles of European defense stocks

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STOXX

# Reviewing the thematic and sustainability profiles of European defense stocks

**The rise in European defense stocks since 2022 amid escalated geopolitical tension has highlighted the importance of evaluating their role in asset allocation. This includes examining their revenue exposure and alignment with current sustainability regulations.**

Growing interest in European defense stocks has brought increased attention to what types of equipment these companies produce and to their sustainability profiles.

This heightened attention centers on two interrelated areas. First, investors are examining the sources of revenue for defense companies – specifically, whether earnings stem from military equipment or from civilian sectors, such as commercial aviation. Second, they are closely evaluating the sustainability credentials of defense holdings, particularly in relation to existing regulation and international agreements, as well as new guidance from policymakers.

STOXX has launched a range of thematic defense indices, which includes:

- STOXX® Europe Targeted Defence
- STOXX® Europe Total Market Defense Capped
- STOXX® Europe Total Market Defence Space and Cybersecurity Innovation
- iSTOXX® Europe Total Market Defense Enhanced

The distinct methodologies of these indices illustrate how index construction can be customized to address investor preferences – including, but not limited to, exclusionary screens and selection methodologies based on companies' revenues and intellectual property (patents).

These preferences are reflected early on in the exclusion criteria applied in defense portfolios. Here, choices have evolved noticeably in recent months, starting with Russia's invasion of Ukraine in 2022.

## An evolved view on defense stocks

That conflict has prompted a reassessment of defense strategies, as several European nations have expressed concern over the possibility of a direct confrontation with Russia. This shift has altered the normative view of defense stocks from a sustainability perspective, as the companies' products are now seen by some investors as necessary tools to defend human rights and democracy. Then there's also the financial perspective: the announcement of large military investments by European countries has lifted the profit outlook for makers of defense equipment. While all this has influenced the broader conversation among institutional investors, their responses remain nuanced.

Allianz Global Investors<sup>1</sup> and Finland's Varma<sup>2</sup> are among money managers and asset owners that have reassessed investment restrictions in the defense sector this year to increase allocations. This marks a reversal from the past decade, when limitations on defense stocks increased alongside the rise of more stringent responsible investment policies. According to Bruegel, 14% of all retail assets under management in Europe as of 2021 was subject to some restriction on weapons-related investments.<sup>3</sup>

## Controversial weapons

Investments in companies involved in controversial weapons – anti-personnel mines, chemical and biological weapons, cluster munitions and others – are restricted by national regulations in several countries across the globe.

<sup>1</sup> Reuters, '[Allianz scraps nuclear, military exclusions to back Europe's rearmament drive](#),' March 31, 2025.

<sup>2</sup> Varma, '[Varma updates its principles for investing in the defence sector](#),' June 16, 2025.

<sup>3</sup> Bruegel, '[Sustainability rules are not a block on EU defence financing, but reputational fears are](#),' March 2025.

The European Union regulatory framework does not legally prohibit investments in companies that are involved in controversial weapons, but it contains disclosure and exclusion requirements for sustainable investment products. This includes SFDR's Arts. 8 and 9, EU Paris-Aligned and Climate Transition Benchmarks, and [ESMA's ESG fund naming rules](#).

Figure 1 shows the minimum-standard controversial weapons exclusions for investments at the EU level (first four rows). National regulations and individual investors may have additional restrictions. Belgium, for example, bans investments in makers of depleted uranium ammunition and armor.

Danish pension fund PFA in May lifted a ban on investments in businesses involved in nuclear weapons only for European and US companies.<sup>4</sup> AkademikerPension, a Danish pension fund for academics, in June dropped an investment exclusion on the basis of nuclear weapons, provided the supplier is European.<sup>5</sup> The move, which enabled investments in six major European arms manufacturers, was reportedly aimed at supporting democracies in the region. SEB, a leading northern European financial services group, the same month updated its policy to allow "business relationships" with companies involved in nuclear weapons as long as they are headquartered in a NATO country.<sup>6</sup>

**Figure 1: Europe's minimum standards in controversial weapons exclusions**

Type of controversial weapon	Arms control instrument	Investment exclusion
Anti-personnel mines	Mine Ban Treaty	EU minimum exclusions according to SFDR PAI 14 / EU taxonomy / CTB / PAB / ESMA fund naming guidelines + national financing / investment prohibitions + investor human rights policies
Biological weapons	Biological Weapons Convention	
Chemical weapons	Chemical Weapons Convention	
Cluster munitions	Convention on Cluster Munitions	
Blinding laser weapons	Convention on Certain Conventional Weapons, Protocol IV	National financing/investment prohibitions + investor human rights policies
Weapons using non-detectable fragments	Convention on Certain Conventional Weapons, Protocol I	
Depleted uranium ammunition and armor	N/A	
Nuclear weapons (all)	Treaty on the Prohibition of Nuclear Weapons	
Nuclear weapons (outside NATO)	N/A	
Nuclear weapons (outside NPT)	Treaty on the Non-Proliferation of Nuclear Weapons (NPT)	
Incendiary weapons	Convention on Certain Conventional Weapons, Protocol III	Investor human rights policies
White phosphorus weapons	N/A	

Source: ISS Sustainability Solutions. Legal financing and investment prohibitions in individual countries are typically based on and included in these countries' ratification of respective arms control instruments through national legislation.

Of 1,878 companies in the broad [STOXX® Europe Total Market](#), 25 have a verified involvement in controversial weapons, according to ISS Sustainability Solutions' Controversial Weapons Research analysis. None of the involvements detected are for the four EU minimum standard exclusions, i.e., anti-personnel mines, cluster munitions, biological or chemical weapons.

## Going nuclear inside NATO

Nuclear weapons is an area where exclusions have been largely left to the discretion of individual investors. Recently, there have been some changes in these policies.

The European Commission clarified in a notice this year that "the EU sustainable finance framework is compatible with investing in the defence sector," and provided guidance to interpret the framework's various regulations for defense stocks. The notice's "aim is to help prevent any undue discrimination of the sector in investment decisions, and ensure a better understanding and recognition of the sector's potential to contribute to social sustainability," it said.

<sup>4</sup> PFA, 'PFA expands opportunities to invest in the defence industry,' May 19, 2025.

<sup>5</sup> European Pensions, 'AkademikerPension relaxes restrictions on arms manufacturers to support European defence efforts,' June 26, 2025.

<sup>6</sup> SEB, 'SEB updates sector policy on arms and defence,' June 16, 2025.

Investors should expect further clarifications on defense investments when an ongoing SFDR review ends. The Commission has also introduced a package that facilitates up to EUR 800 billion in defense investments in the Union over the next four years.

## Military revenues as signal for portfolio construction

While investors have worried about what to exclude from a defense stocks portfolio, they have been equally focused on what to include.

STOXX's defense thematic indices use different methodologies to select companies that are most likely to benefit from increased defense spending. Revenues is one popular metric to do so. ISS Sustainability Solutions' Military Equipment and Services revenue data can be employed to identify companies with a significant share of sales from military equipment (both combat and non-combat). This is a key filter to minimize exposure to traditional Aerospace & Defense sector constituents with large sales in non-military segments such as commercial aerospace.

It is also an important screen to identify companies involved in military equipment outside of the traditional industrials sector and in different industries, such as technology or telecommunications, as certain types of military equipment – including advanced combat aircraft – become more reliant on sophisticated technology and software.

The ISS Sustainability Solutions dataset covers production and distribution of military equipment as well as the provision of related services designed or modified on the basis of specific military requirements, and applies a Risk Flag warning for potential current or imminent issuer involvement.<sup>7</sup>

The scope of military equipment covered is based on international arms export control standards. Corporate involvement is differentiated by equipment type, based on its lethality. The screen does not cover dual-use equipment or products not designed or modified on the basis of military specifications.

<sup>7</sup> In terms of international arms export controls standards, the screening list of covered military equipment is aligned with the Wassenaar Arrangements Export Control for Conventional Arms Munitions List.

Combat equipment includes lethal items such as tanks, combat aircraft, missiles and combat ammunition. It also covers certain sub-systems and components directly tied to the lethality of weapons, such as fire control, arming, deployment and detonation systems.

Non-combat equipment, meanwhile, includes non-lethal systems and their specifically designed components, such as unarmed vehicles, naval surveillance vessels and training aircraft, as well as ammunition for non-combat purposes (e.g., training). Also included are protective and training equipment, encrypted communication systems and radars.

## Thematic purity through revenues

Taking eleven of Europe's largest defense stocks, Figure 2 shows the percentage of their revenues derived from military equipment and services, according to ISS Sustainability Solutions.

**Figure 2: Share of military equipment and services revenues over total – 'Defense 11'**

Company	Military equipment revenue share of total
BAE Systems Plc	50–100%
Dassault Aviation SA	50–100%
Hensoldt AG	50–100%
Leonardo SpA	50–100%
Rheinmetall AG	50–100%
Saab AB	50–100%
Thales SA	50–100%
Rolls-Royce Holdings Plc	25–50%
Safran SA	20–25%
Airbus SE	15–20%
MTU Aero Engines AG	5–10%

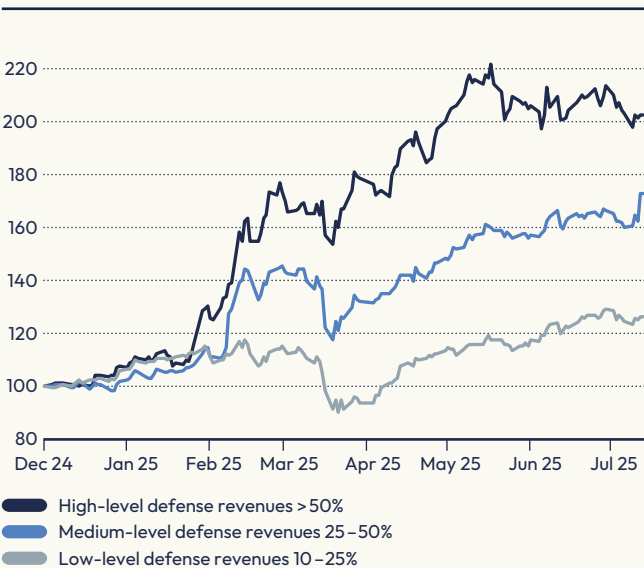
Source: ISS Sustainability Solutions. This factor identifies the estimated or reported range of revenue derived from involvement in military equipment and services as a percentage of the issuer's total revenue in the latest financial year. It covers both combat and non-combat equipment.

## Military revenues tier performance

Market returns suggest investors have sought exposure to ‘pure’ defense players. The STOXX Europe Targeted Defence index selects companies with high military revenues (>50% of their total sales), medium (>25%) and low (>10%), based on ISS Sustainability Solutions’ Military Equipment and Services Revenue data. Companies with negligible military revenues (for example, those making sales from commercial aircraft) are excluded.

Figure 3 shows the performance of stocks in the index methodology’s three revenue tiers. Through August 1, 2025, the high military revenues basket rose 102% this year, compared with 73% for the medium tier and 26% for companies with low military revenues.

Figure 3: YTD performance – based on defense revenues (High/Medium/Low)



Source: STOXX. Data through August 1, 2025.

“Thematic strategies succeed when the right stock selection methodology is applied and thematic purity is preserved,” said Ladi Williams, Head of Thematics and Alternative Strategies, Product Management, STOXX. “Revenue analysis is one possible selection criterion, but others may also be appropriate. Achieving a successful thematic outcome requires thoughtful evaluation of the theme’s evolution and close collaboration with the client from concept to completion.”

## Europe’s defense stocks – key sustainability issues

Finally, the sustainability profile of a defense portfolio is increasingly becoming a focus for many asset allocators.

Figure 4 presents the average scores across seven selected sustainability metrics for both the **STOXX® Europe 600** and the ‘Defense 11.’ The topics reflect key sustainability issues for the defense industry. Defense stocks, on average, have a significantly lower ESG performance score than the STOXX Europe 600. They lag the market in five out of seven key areas for their industry, particularly in the handling of substances of concern and in their environmental impact.

Figure 4: Sustainability metrics comparison<sup>8</sup>

	Defense 11 average	STOXX Europe 600 average
Corporate governance	2.44	2.61
Business ethics	3.30	3.12
Environmental management system	3.32	2.91
Environmental impact of product and services	1.76	2.07
Substances of concern	1.33	1.86
Product safety	2.15	2.50
ESG performance score	48.33	54.16

Source: ISS Sustainability Solutions. These factors provide a numeric score from 1 (D-) to 4 (A+) linked to the rated entity’s Business Ethics rating. All scores are simple, equal-weighted averages. ESG performance score ranges from 0 to 100 and is comparable over all rated entities across industries. Scores (except ESG performance score) are categorized in the following four brackets: 1.00–1.75 is Poor, 1.75–2.50 is Medium, 2.50–3.25 is Good and 3.25–4.00 is Excellent.

<sup>8</sup> **Definitions: Sustainability metrics**

**Corporate governance** is based on performance across key metrics, including board independence, shareholder democracy, executive compensation and shareholder structure.

**Business ethics** key indicators include a company’s code of business ethics, compliance procedures and controversies relating to business ethics.

**Environmental management system** includes implementation of an environmental management system and certification of the environmental management system to an international standard.

**Environmental impact of product and services** indicators include environmental impacts of the product portfolio and strategy shift towards a more environmentally beneficial product portfolio.

**Substances of concern** includes substances of concern in products and production processes, responsible use of nanotechnology and controversies relating to substance of concern.

**Product safety** is based on key sector-specific indicators.

## Thorough examination

The rise of defense stocks since 2022 has underscored investors' interest in evaluating the companies' role in asset allocation – not only in terms of revenue exposure

but also regulatory alignment. Investors now have a wider range of metrics at their disposal to assess and construct portfolios that align with investment goals, regulatory requirements and policy considerations.

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