

Global Aerospace & Defense

Global Defense: Attack on Iran? Potential short-term upside for defense stocks, but then what? Instead, look to the budget



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The largest set of military assets since the 2003 invasion of Iraq has been deployed around Iran. It is unclear what the immediate action will be at this stage. It is also unclear what the endgame would be coming out of any attack on Iran. **President Trump has said a diplomatic solution is preferred, but that military action is an option. Defense stocks rose recently as the risk of war increased. Should a peace agreement be reached between the US and Iran, this would be a positive diplomatic outcome, but would likely result in a decline for US defense stocks.**

Historically, there are typically three upward phases for defense stock performance. First, geopolitical threats increase. Second, threats translate to budget increases with bipartisan support. Third, the budgets turn into rising revenues for defense companies. By the time revenues increase, it is usually too late for the stocks. However, **if a geopolitical event does not lead to a prolonged threat to US interests, driving budgets higher, any upside around the event tends to be short-lived.** Russia's invasion of Georgia and the Hamas attack on Israel were examples of events that did not lead to sustained upside for defense stocks. Operation Midnight Hammer, when the US bombed Iranian nuclear facilities had no impact on defense stocks.

We expect that a US attack on Iran is unlikely to lead to extended operations with broad political support in the US. **An attack may result in short-term upside for the stocks, but, more would be required for sustained upside.** Should the case be made from intelligence that an attack would be addressing an extensive threat (not yet communicated), if other countries (e.g., Russia) become actively involved, or if there are terrorist responses against the US, that could drive bipartisan support for higher budgets. **Such more extensive conflict scenarios would likely mean sustained upside for defense stocks.**

Apart from events involving Iran, **defense stocks had already risen after commentary by President Trump and Secretary Hegseth supporting a \$1.5 trillion 2027 defense budget.** An additional \$39bn is now being requested for reconciliation funds to be spent in 2026. While we have expected upward pressure on defense budgets, we do not expect a \$1.5 trillion level for 2027 (plans not defined, pressure from deficit hawks, potential Democratic control of Congress). The rise in defense stocks to relatively high valuations already makes it more difficult for actions related to Iran to lead to any additional sustained upside for defense stocks. Still, **should the Iran situation lead to an outcome that has broad support for more resources, some upside could be possible. But, we would be more focused on the evolution of discussions around the 2027 budget level.** There is certain to be more money for defense contractors on the horizon. The questions will be how much and how it will be spent.

BERNSTEIN TICKER TABLE

Ticker	Rating	Cur	26 Feb 2026		TTM Rel. Perf.	Reported EPS			Reported P/E (x)			
			Closing Price	Price Target		Cur	2025A	2026E	2027E	2025A	2026E	2027E
GD (General Dynamics)	M	USD	350.72	398.00	24.7%	USD	15.45	16.30	17.94	22.7	21.5	19.5
LHX (L3Harris)	O	USD	355.16	435.00	59.5%	USD	8.53	11.68	14.43	41.6	30.4	24.6
HII (HII)	M	USD	443.00	421.00	139.8%	USD	15.39	17.15	19.62	28.8	25.8	22.6
LMT (Lockheed Martin)	M	USD	641.63	654.00	29.3%	USD	21.49	30.03	31.57	29.9	21.4	20.3
NOC (Northrop Grumman)	M	USD	710.90	765.00	40.3%	USD	29.08	28.15	28.69	24.4	25.3	24.8
RTX (RTX)	M	USD	197.63	204.00	39.2%	USD	6.29	6.80	7.45	31.4	29.1	26.5
TXT (Textron)	M	USD	98.63	108.00	19.0%	USD	6.10	6.64	7.13	16.2	14.9	13.8
BA/.LN (BAE Systems)	M	GBP	2,118.00	2,200.00	44.1%	GBP	0.75	0.86	0.99	28.2	24.6	21.3
RHM.GY (Rheinmetall)	O	EUR	1,674.00	2,050.00	59.2%	EUR	17.83	25.21	38.14	93.9	66.4	43.9
LDO.IM (Leonardo)	O	EUR	56.38	60.00	37.0%	EUR	1.87	2.25	2.35	30.2	25.0	24.0
HO.FP (Thales)	O	EUR	254.20	275.00	20.3%	EUR	9.24	9.79	11.91	27.5	26.0	21.3
SPX			6,908.86									
EDME			1,571.96									

O - Outperform, M - Market-Perform, U - Underperform, NR - Not Rated, CS - Coverage Suspended

RTX, TXT, BA/.LN, RHM.GY, HO.FP estimate is Adjusted EPS; RTX, TXT, BA/.LN, RHM.GY, HO.FP valuation is Adjusted P/E (x); RHM.GY, LDO.IM, HO.FP base year is 2024;

Source: Bloomberg, Bernstein estimates and analysis.

INVESTMENT IMPLICATIONS

A potential attack on Iran could drive defense stocks higher if the outcome is a more extensive military situation that receives broad political support. Should an attack turn out to be an isolated action, we doubt that there would be any more than a short-term rise in defense stocks. Instead, if a peace agreement is reached and US forces are largely pulled back, this would be a positive outcome for the world, but likely result in a drop in defense stocks prices. This behavior is analogous to what we have seen with European defense stocks when there appeared to be the possibility of a Ukraine/Russia peace agreement.

Instead of Iran, the important factor will be the US defense budget. More money is being added to the 2026 budget in the form of reconciliation funds. We still do not know where the 2027 budget will start (President's budget) and much less where it will end up. That will be the determining factor for defense stocks beyond any short-term moves around the Iran situation.

DETAILS

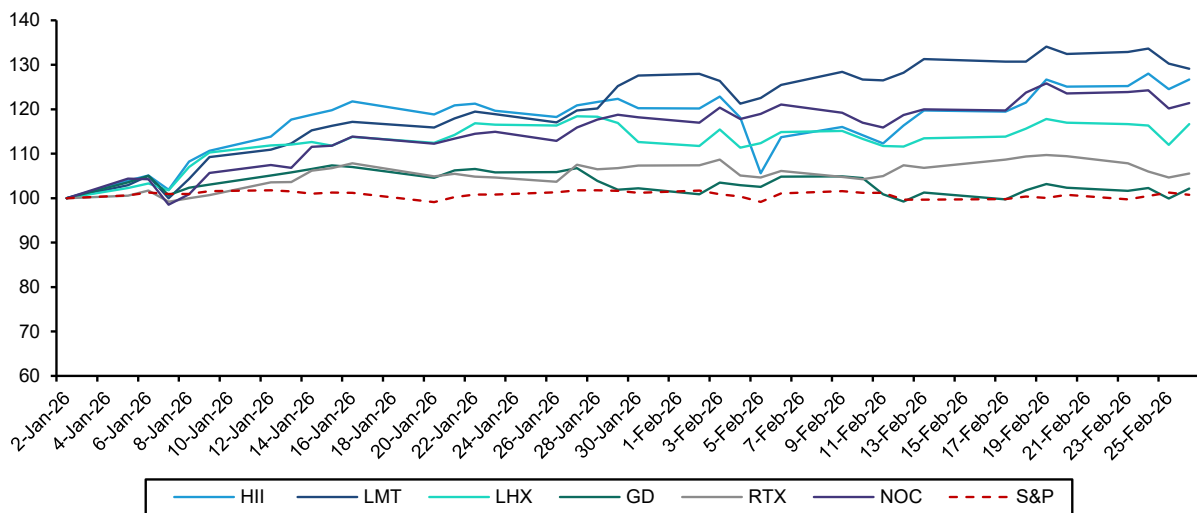
THE SITUATION WITH IRAN - HAS ALREADY LED TO DEFENSE STOCK UPSIDE

So far, the US had undertaken the largest regional military buildup since Operation Iraqi Freedom in 2003, which led to the invasion of Iraq. The aircraft carrier Gerald Ford is headed to the region through the Mediterranean and the Lincoln carrier strike group is already deployed near the Persian Gulf. Substantial additional assets are in place in the region, including substantial Israeli capabilities. As resources were being moved toward Iran, US defense stocks rose. President Trump has said that the preferred outcome is a diplomatic solution to stop any nuclear weapons program. Negotiations are ongoing. Any indications that a negotiated solution might be reached have led to brief pullbacks in the stocks. Volatility in defense stocks as sentiment shifts from potential war to potential peace is similar to what we have seen over the last three years with European defense stocks related to the Russia/Ukraine conflict.

At this stage, it is unclear if action will be taken. While Trump has said that a diplomatic outcome is preferred, he has also said that force could be used. The level of force that would be used is also not yet clear. The behavior of defense stocks YTD is shown in Exhibit 1.

EXHIBIT 1: Indexed performance for select defense stock vs S&P500

100= Jan 1 2026



Source: Bloomberg, Company analysis

WHAT HISTORY SAYS - THREATS TYPICALLY FOLLOWED BY BUDGET INCREASES

Threats drive defense stocks

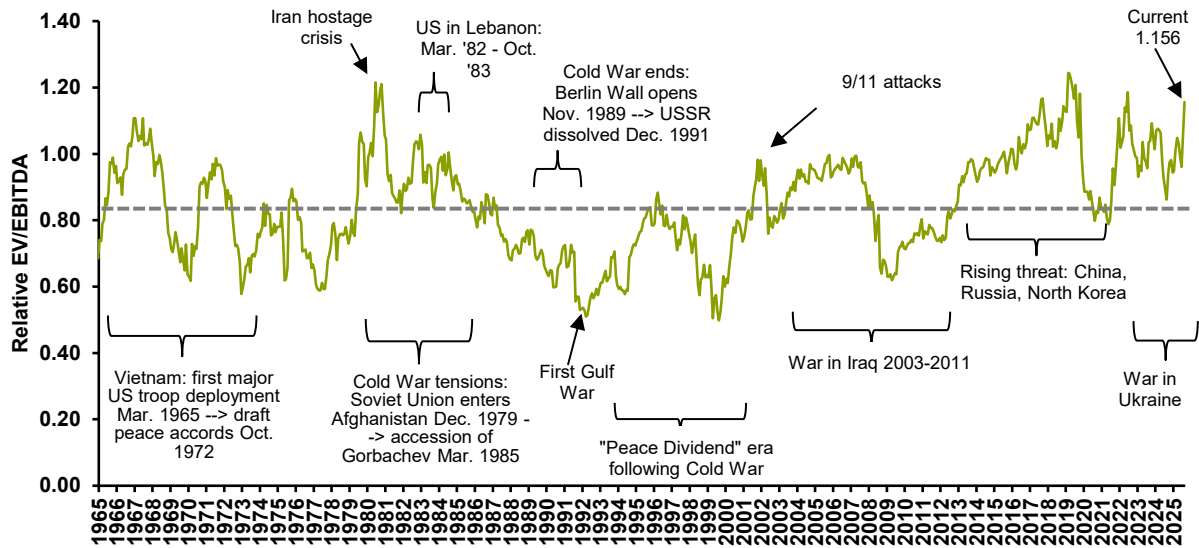
The overarching principle for investing in defense stocks is to recognize a sequence of events. First, threats arise. Second, the response to those threats manifests itself in higher budgets. Third, those higher budgets are translated into revenues. The best time to invest has normally been at the timing of rising threats. This philosophy is described in detail in our 2021 Black Book, “[Global Defense: Games Without Frontiers, War Without Tears](#)”. By the time revenues start to rise, it is usually too late, as the upside is already in the stocks. This strategy worked for US defense stocks through major crisis periods over many decades, going back to the Cuban Missile Crisis, Vietnam War, Cold War, and the Post-9/11 period. An important exception for US defense stocks was the 2023-24 period during which we would argue that geopolitical threats were rising by almost any measure (Russia/Ukraine, Israel/Iran/Gulf States, China/Taiwan), but defense stocks underperformed. The difference during this period was that a group of Republicans in Congress (right wing Freedom Caucus) put budget caps in place that prevented any real increases in defense spending, despite bipartisan support for higher budgets. These budget caps meant that spending (and ultimately defense revenues) could not respond to a perceived need, which meant that stocks did not move higher. Exhibit 3 through Exhibit 6 show the behavior of defense stocks relative to the S&P500 before and after major military geopolitical

events.

The European defense industry has been relatively immature, heavily dependent on US industry, and less directly involved in major conflicts. For that reason, there is not the same level of historical data. Nevertheless, the same principles hold. Those principles have been illustrated by the impact of the war in Ukraine and the pullback in direct support for European defense during the Trump administration. One can see the trends in our January 5, 2026 Research Call, "[European Defense: 2026 Outlook - How to Survive Peace? Upgrading Thales & TKMS. Downgrading BAE Systems & Dassault Aviation](#)"

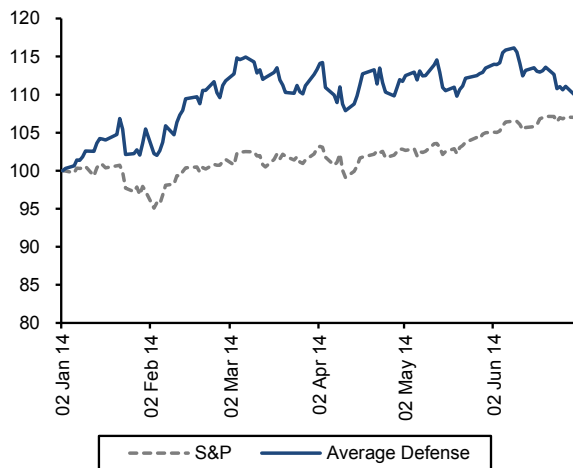
Exhibit 2 shows the history of defense stock valuations. Valuations rise well above the S&P500 level at times of serious geopolitical threats. We are already at a high level when compared to history.

EXHIBIT 2: **Relative EV/EBITDA Defense vs S&P**



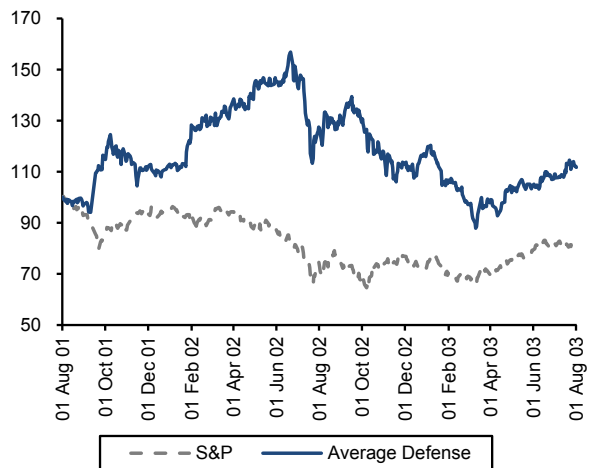
Data updated to Feb 20, 2026.
Source: Bloomberg, Bernstein analysis

EXHIBIT 3: **Annexation of Crimea**



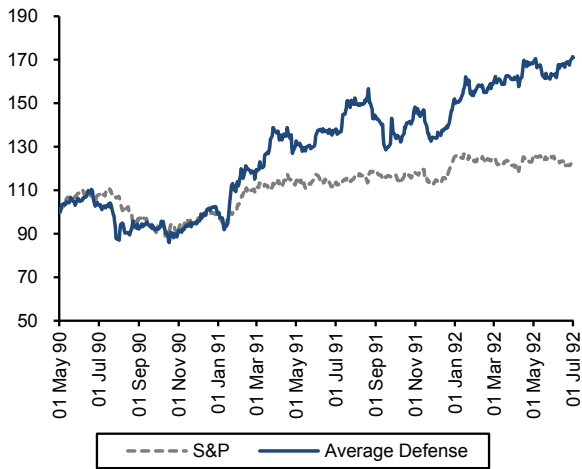
Source: Bloomberg, Bernstein analysis

EXHIBIT 4: **9/11 attacks**



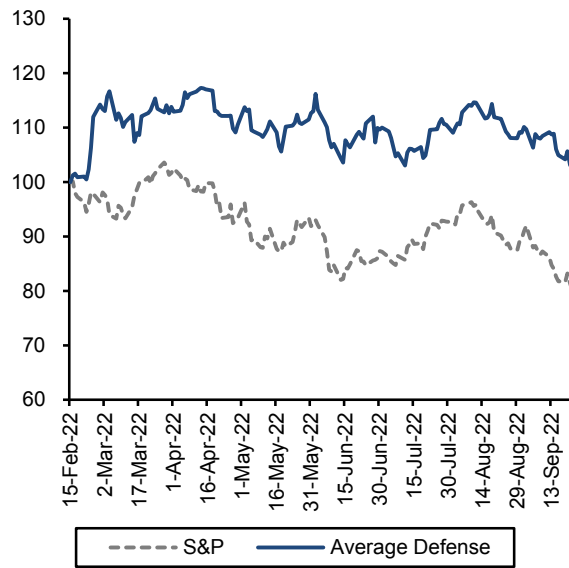
Source: Bloomberg, Bernstein analysis

EXHIBIT 5: **Operation Desert Storm - First Gulf War**



Source: Bloomberg, Bernstein analysis

EXHIBIT 6: **Russian Invasion of Ukraine (2022)**

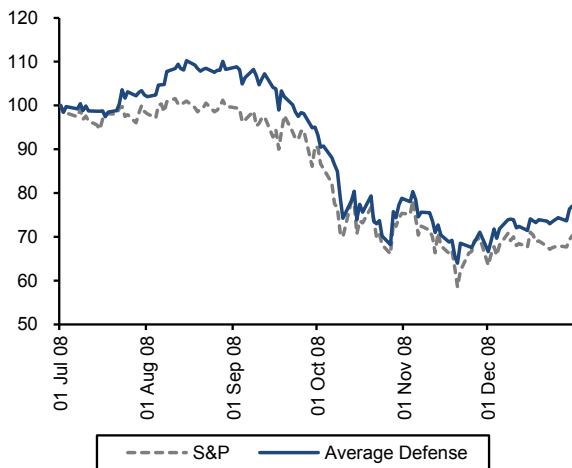


Source: Bloomberg, Bernstein analysis

SHORT TERM EVENTS - OFTEN A LIMITED IMPACT

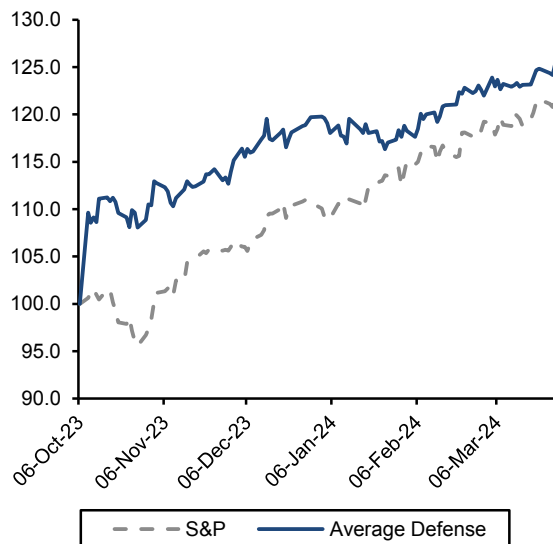
While defense stocks have historically moved when long-term geopolitical tensions rise, they also respond to short-term events. One can look at events such as Russia’s invasion of Georgia and the Hamas attack on Israel as triggering short-term outperformance by defense stocks. But, in cases in which the headlines are big, but do not result in extended tensions that drive budget growth, there is little impact. When Hamas attacked Israel in 2023, defense stocks rose in the short-term, but that upside only lasted for a few months, as this attack did not alter the threat situation for the US. Subsequently, when the US bombed Iranian nuclear facilities in Operation Midnight Hammer there was no movement in defense stocks, again, because the overall US defense situation did not change.

EXHIBIT 7: **Russian invasion of Georgia**



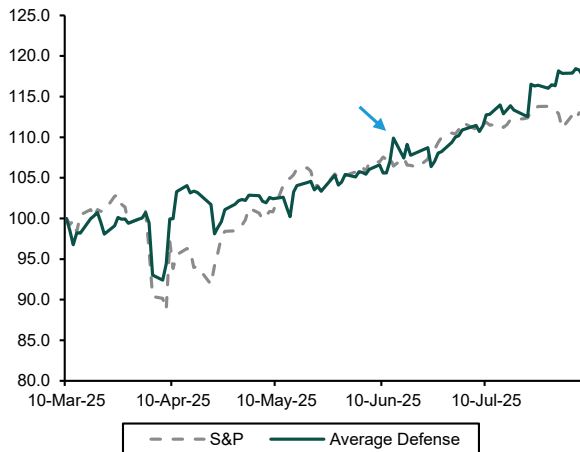
Source: Bloomberg, Bernstein analysis

EXHIBIT 8: **Hamas attack on Israel (October 2023)**



Source: Bloomberg, Bernstein analysis

EXHIBIT 9: After the Bumbing of Iran* (Jun 2025)



*Arrow shows timing of Midnight Hammer bombing
 Source: Bloomberg, Bernstein analysis

THE BUDGET CONTEXT - STOCKS UP ON HIGHER 2026 BUDGET AND POTENTIAL FOR 2027

A large 2026 budget increase

One of the reasons that defense stocks have risen recently is the rising budget. The 2026 budget that was recently passed totaled \$953bn, which was done through a combination of appropriations and reconciliation in Congress, which included \$113bn of reconciliation funds (\$89bn to investment). While this was a large increase, more importantly, the increase in investment spending (Procurement plus RDT&E) was even higher. The 27% increase for investment was the largest we have seen in more than two decades. That said, this budget alone did not lead to much upside in defense stocks. That was because there was no clarity about what budgets we would see in subsequent years.

2026 budget becoming even larger with more reconciliation money requested

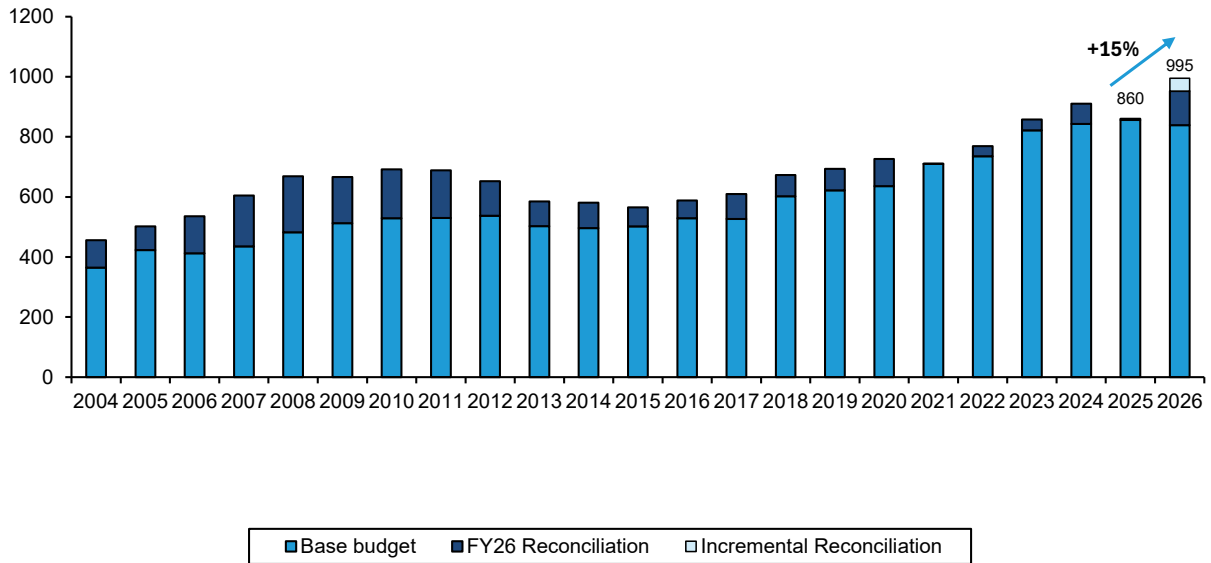
The \$113bn in reconciliation funds for 2026 was part of a larger \$152bn in reconciliation funds, with the remainder set to fund later years. However, the request was made this week by the administration to move the remaining money into the 2026 budget because of a need for more funds. It is not entirely clear how that money will be spent. We are assuming the same proportion will go into investment. If that is the case, investment would be up - an even larger 37% over 2025 enacted. This is clearly positive for defense stocks. But, we are now looking at a huge amount of money in the 2026 budget that needs to be spent by October 1, coming after the longest continuing resolution we have seen. This raises questions about the ability of the Pentagon to actually get the funds under contract. The history of the total budget and the investment portion are shown in Exhibit 10 and Exhibit 11

Then there is the 2027 budget - How big can this be?

In January, we heard both President Trump and Secretary Hegseth call for a \$1.5 trillion budget for 2027. We believe such an increase is highly unlikely, as we have described (see, "[US Defense: 2026 outlook - Twelve things to watch as dangers rise; L3Harris still our top choice](#)"). But, defense stocks have already risen in response to the president's statements. We expect to see upward pressure on the budget, which is positive for defense stocks, but not up to the \$1.5 trillion level.

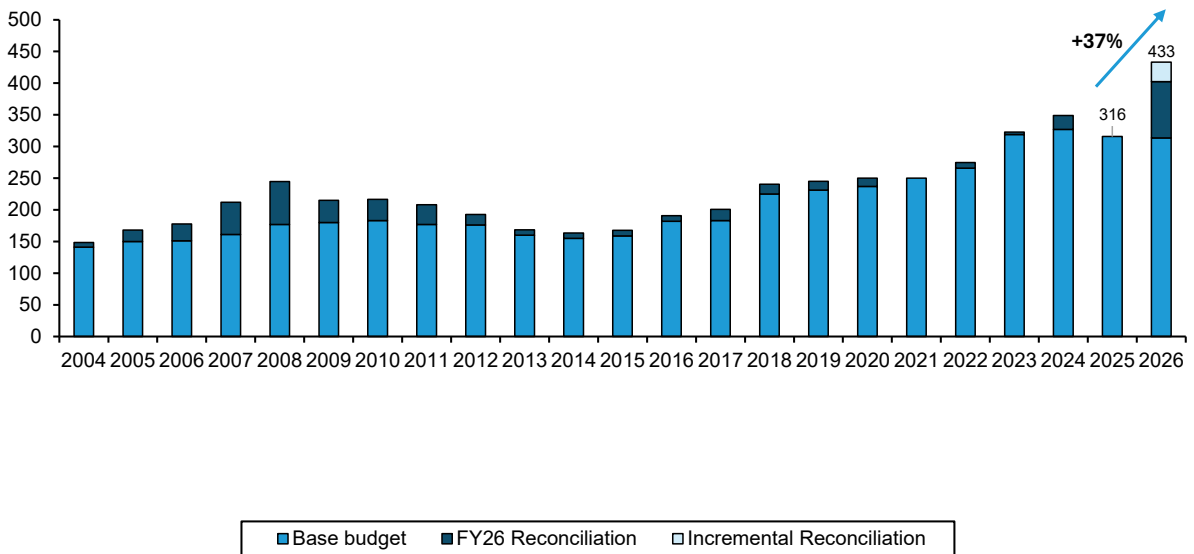
As discussed in the report referenced above, there is substantial uncertainty around the 2027 budget, which the Republicans would need to do by reconciliation. With a narrow House majority it is unclear what can pass, given the influence of several Republican deficit hawks. In addition, should the Democrats take control of either the House or the Senate, reconciliation would no longer be possible. We believe that the majority of Democrats support higher defense spending. But, there will be an inevitable budget fight as Democrats seek more non-defense spending and Republican seek tax cuts. The timing is short to get to a solution.

EXHIBIT 10: **Total Defense Budget (\$bn)**



Source: DoW, the Congress, Bernstein analysis

EXHIBIT 11: **Total Inv Account (RDT&E + Procurement) Budget (\$bn)**



Source: DoW, the Congress, Bernstein analysis

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