2 Reasons Defence Stocks Need to Stay on Your Radar in October

Description

In 2018, investors have seen several key sectors thrown into the spotlight. Rising oil and gas prices propelled Canadian energy stocks in the spring and early summer. Cannabis stocks struggled with volatility for much of the year before taking off in August. That rally has proven to have some solid momentum, as investors await the October 17 legalization date.

The Canadian defence sector is not discussed very often, likely because of its size relative to the giant that is the U.S. defence sector. That does not mean that there are not opportunities for Canadian investors, both on the TSX and in U.S. markets. Of course, investors may be paying a premium, especially considering the high U.S. dollar.

Today, we are going to go over two reasons defence stocks should remain on your radar in October.

Defence budgets blowing up worldwide

Back in April, I'd discussed how both the Canadian and U.S. governments had pledged to increase military spending going forward. The United States authorized a $717 billion defence budget for fiscal 2019. This includes a base budget of $639 billion and overseas contingency operations funding totaling $69 billion. The budget is slated to increase in 2020 and beyond, as the U.S. Army has identified six modernization priorities in the next decade, some of which include air and missile defence, long-range precision firepower, network capabilities, and others.

Lockheed Martin (NYSE:LMT) has been a huge beneficiary of this growing budget. Its stock has climbed 7.7% in 2018 as of close on September 28 and shares are up 11% year over year. In the second quarter, the largest defence contractors in the world reported sales of $13.4 billion over $12.6 billion in the prior year. For the first six months of 2018, Lockheed has reported net earnings of $2.32 billion compared to $1.74 billion last year. It also reported a stunning backlog of $105 billion.

Canada may dwarf the United States in overall spending, but it is by no means a small spender on the world stage. The Stockholm International Peace Research Institute released its latest report on global military spending and Canada came in at 14, above Turkey and behind Australia. Canada has already pledged to increase its defence budget by 70% over the next decade to $32 billion.

CAE (TSX:CAE)(NYSE:CAE) stock has climbed 12.3% in 2018 and it is up 20% year over year. In the first quarter of fiscal 2019, CAE reported a 10% year-over-year increase in revenue to $722 million. Earnings per share rose 18% to $0.26 and the company reported an $8 billion backlog. The board of directors also approved an 11% quarterly dividend increase to $0.10 per share, representing a 1.4% dividend yield.

Defence revenue at CAE rose 3% to $268.3 million in the quarter. The defence backlog reached $3.9 billion at the end of the quarter.

Geopolitical tensions are rising

Although the world geopolitical situation is always fluid, this may be the most crucial point going forward. Back in 2017, U.S. defence secretary James Mattis declared that the U.S. military had to prepare for a new era of “great power competition.” The concentrated rearmament of the U.S., Canada, and its allies shows that other nations are also preparing for this geopolitical reality.

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