Top picks in defense, aviation, and related ETFs for 2022

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As we start 2022 one area of concern is global geopolitical uncertainty. In particular, Russia continues to threaten Ukraine, and China threatens almost everyone. The biggest Chinese threat, for now, is probably to Taiwan. Then there is always the threat posed by North Korea. Given the increasing global tensions, it is not surprising that many countries are boosting their defense spending. This leads to an opportunity for investors who want to be ahead of the game just in case a war or conflict breaks out.

Furthermore, it is starting to look like 2022 will see some recovery in the civilian aviation sector, assuming we are near the end of the COVID-19 pandemic, or at least getting back to more normal living.

Research groups also see a recovery ahead for U.S aerospace and defense. Fitch stated in December 2021: “Fitch Ratings views the 2022 Aerospace & Defense (A&D) sector outlook as improving following a bottoming out in early 2021 and a moderate improvement in 2H21.” Deloitte also forecasts a recovery in 2022.

Below are three defense or aviation stocks/ETFs to consider in 2022.

Defense stocks can offer some safety to a portfolio especially if we get any conflicts in 2022

iShares U.S. Aerospace & Defense ETF

The iShares U.S. Aerospace & Defense ETF (ITA) seeks to track the investment results of an index composed of U.S. equities in the aerospace and defense sector. The advantage of using the ITA ETF is the broad exposure to the U.S aerospace & defense sectors, which are sure to gain if there are any global breakouts of hostilities.

The current top 5 holdings are:

- Raytheon Technologies Corporation. (NYSE: RTX) (20.83%)
- The Boeing Company (NYSE: BA) (18.38%)
- Lockheed Martin Corporation (NYSE: LMT) (5.27%)
- Northrop Grumman Corporation (NYSE: NOC) (4.71%)
- TransDigm Group Inc. (NYSE: TDG) (4.66%)

The ITA ETF trades on a PE ratio of 26.59, with a dividend yield of 0.9%pa.

An alternative to the ITA ETF is the SPDR S&P Aerospace & Defense ETF (XAR) with a key differentiator being that XAR takes an equal weighted approach. XAR describes its approach as an "equal weighted index which provides the potential for unconcentrated industry exposure across large, mid and small cap stocks". XAR trades on a weighted average PE of 24.75.

Northrop Grumman Corporation (NYSE: NOC)

Northrop is one of the world's largest weapons and military technology providers. It is also a large U.S military aircraft manufacturer. What I like about Northrop is that it is well diversified and provides products and services across the air, land, sea, space, and cybersecurity sectors. Over the years Northrop has grown organically but also via takeovers, including that of Orbital ATK Inc., a global aerospace and defense systems company. This has enhanced Northrop's capabilities especially in

the area of Ground-Based Interceptor ('missile') products.

In March 2021 it was reported that Northrop had won a US defense contract for up to $3.9 billion to design the next-generation interceptor for the U.S. missile defense network. The report stated: The new interceptors would be a part of the Ground-based Midcourse Defense (GMD) system here, a network of radars, anti-ballistic missiles and other equipment designed to protect the United States from intercontinental ballistic missiles (ICBMs). Northrop's stock rallied on the news, but there is still the possibility of a contract extension or expansion as Reuters stated: "The next-generation interceptor program could be worth as much as $10-$12 billion over its lifetime as the contractor works to make the technology capable of defeating current threats and future technological advances from countries like North Korea and Iran." There is also the next possibility of a space based defense system (read "a space-based sensor layer for ballistic missile defense").

Northrop trades on a market cap of US$62 billion and has a current PE ratio of 16.1. Not bad when you consider the U.S S&P 500 PE is currently 33.8.

The Boeing Company (NYSE: BA)

When it comes to U.S companies with massive exposure to defense, aerospace and civilian aviation there is none bigger than Boeing. I like Boeing in 2022 as it stands to benefit both as the aviation industry recovers post-COVID-19, and if we get any rise in the defense stocks due to global conflicts.

Boeing is an aerospace company that manufactures commercial jetliners and defense, space and security systems. Its products, and tailored services, include commercial and military aircraft, satellites, weapons, electronic, and defense systems, launch systems, advanced information and communication systems, and

performance-based logistics and training.

Boeing trades on a market cap of US$125 billion and has a 2022 PE ratio of 32.8. Not cheap but remember Boeing is potentially at the early stage of an earnings recovery as global airlines look again to open their airline order books. One example of this is today's news of U.S. carrier Allegiant Air rumored to be buying 50 Boeing 737 MAX jets valued at US$5 billion.

Closing remarks

We never know when the next terrorist attack or a global conflict will breakout. Given the tensions building after a tough two years enduring the COVID-19 global pandemic, it would not be surprising to see a geopolitical event spark in 2022. Will it be Ukraine, Taiwan, North Korea, the South China Sea, the Middle East, a terrorist attack on Western soil, or an unforeseen black swan event? It is hard to predict, but one thing is certain, and that is that buying up some 'defense' stocks as insurance, early at very reasonable market valuations, makes a lot of sense as we enter 2022.

Finally, the aviation sector looks poised to come out from its worst-ever downturn caused by COVID-19 in 2020 and 2021.

It now looks like it is time to book a seat and invest back into the defense, aerospace and aviation sectors in 2022. Fasten your seat belt and enjoy the ride, hopefully with much less turbulence in 2022.