

# Fortress Europe: The Birth of a €1 Trillion Sovereign Competitor

*How the war is federalizing European debt and creating a global competitor to the U.S. dollar.*

## Executive Summary

We are writing to you on March 5, 2026, at a point that history will likely mark as the definitive end of Europe’s long geopolitical coma. For decades, the continent operated under the illusion of subsidized security. That era ended at the 2025 Hague Summit.

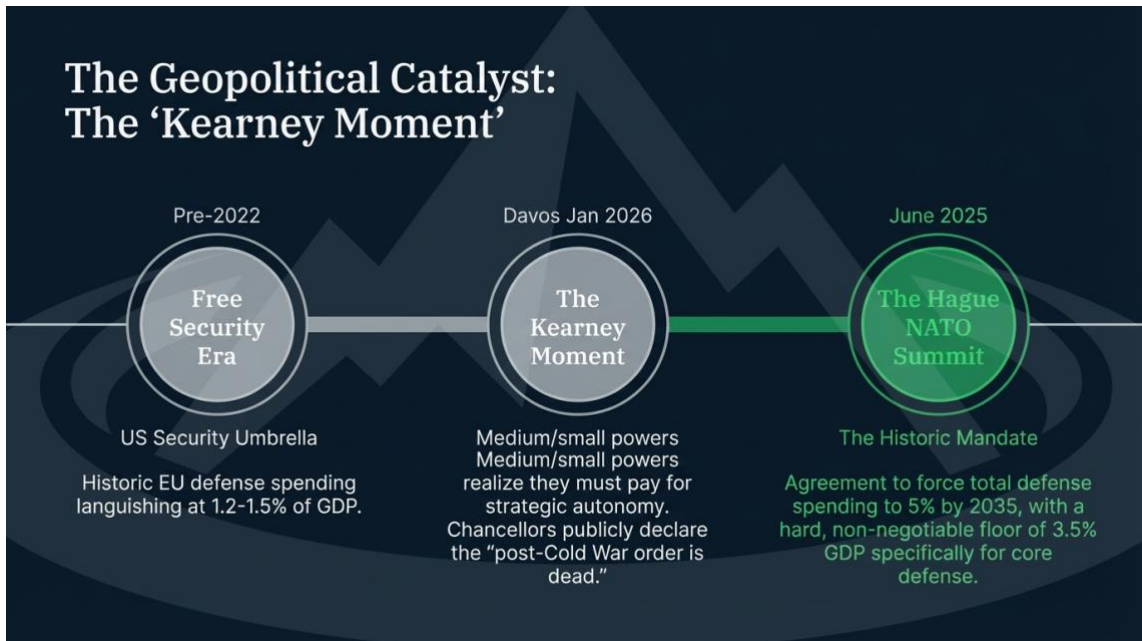


Figure 1. The geopolitical catalyst for Europe’s strategic turn

**Key takeaway:** The report starts from the end of the free-security era: the Hague Summit forced a structural defense response.

What we are witnessing now is far more than a new procurement cycle; it is a Hamiltonian Moment for the European Union. By federalizing debt to fund a defense market now exceeding €1 trillion, Europe is laying the foundations of a sovereign debt market capable of challenging the U.S. Dollar’s status as the world’s primary safe haven.

## Europe's "Hamiltonian Moment"

1790: United States	2025-2026: European Union
<ul style="list-style-type: none"> <li>• Alexander Hamilton federalizes fragmented state war debts.</li> <li>• Creates a unified, highly liquid US Treasury market.</li> <li>• Lays the foundation for global financial supremacy.</li> </ul>	<ul style="list-style-type: none"> <li>• The EU federalizes defense spending via the Savings and Investment Union (SIU).</li> <li>• Transitions from vulnerable, fragmented national debt to unified EU-Bonds.</li> <li>• Eliminates vulnerability to national spread blowouts.</li> </ul>

This 'Hamiltonian Moment' creates the first true structural competitor to US Treasuries—a €1T+ highly liquid, federalized debt instrument serving as a global safe haven.

Figure 2. Europe's Hamiltonian moment

**Key takeaway:** Our view is that Europe is moving from fragmented national financing toward a unified sovereign funding architecture.

With the EUR/USD reference rate at 1.1618 and 10-year German Bunds yielding 2.85%, the signs of a tectonic shift are already visible. Our core thesis is clear: Europe is exiting its passive stance and building a deep, liquid, AAA-rated bond market.

For investors, this implies three structural imperatives: we should prepare for a gradual, sustained appreciation of the Euro as central banks diversify reserves; we must recognize the growing competitive challenge to U.S. Treasuries, which will put upward pressure on U.S. yields; and we need to adjust portfolios to a durably Higher for Longer rate environment across the Eurozone. This European pivot is not a regional anomaly. It is a systemic development that sends immediate, reflexive ripples across the Atlantic.

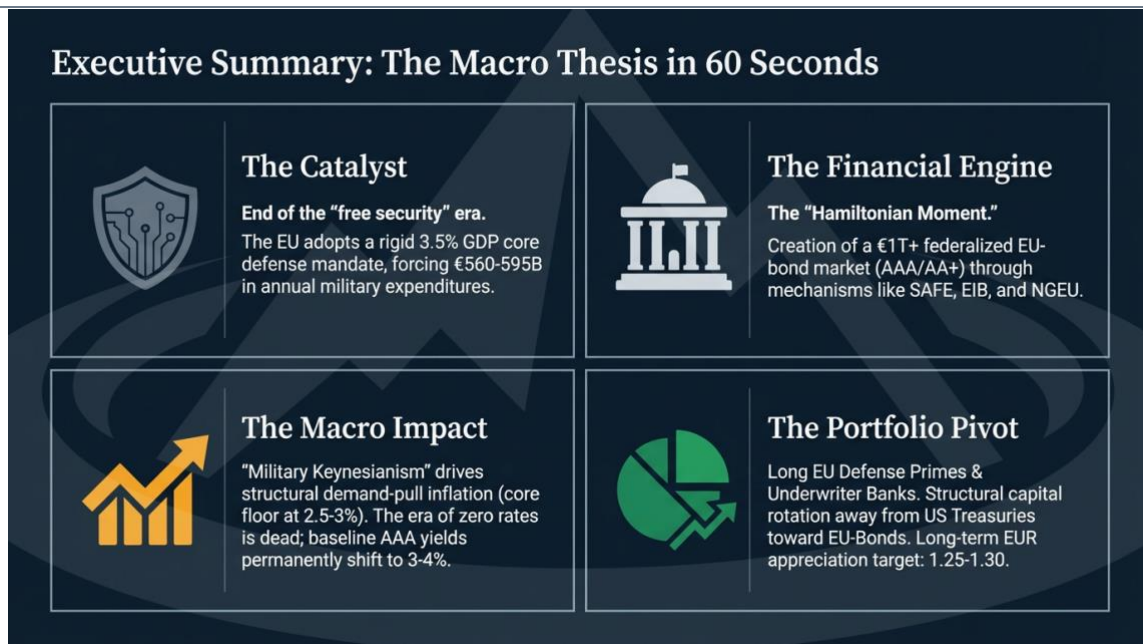


Figure 3. The macro thesis in one page

**Key takeaway:** The investment case combines a geopolitical catalyst, a federalized funding engine, higher structural inflation, and a portfolio pivot.

## Impact on U.S. Markets: The Challenge to the Safe Haven

The emergence of Fortress Europe directly challenges the historical safe-haven monopoly of U.S. Treasuries. This is a story of reflexivity: as Europe’s strategic autonomy strengthens, the sustainability of U.S. fiscal policy will face more intense global scrutiny.

The United States currently confronts a \$10 trillion annual debt rollover, with \$6.59 trillion of that total concentrated in short-term T-bills—21.3% of the market. This creates a fragile maturity wall. While 10-year U.S. Treasuries yield 4.10%, the political risk premium in the U.S. is rising. As the EU bond market gains scale and credibility, the traditional reflex of fleeing to \$TLT and \$IEF in times of global stress will no longer be the unquestioned default.

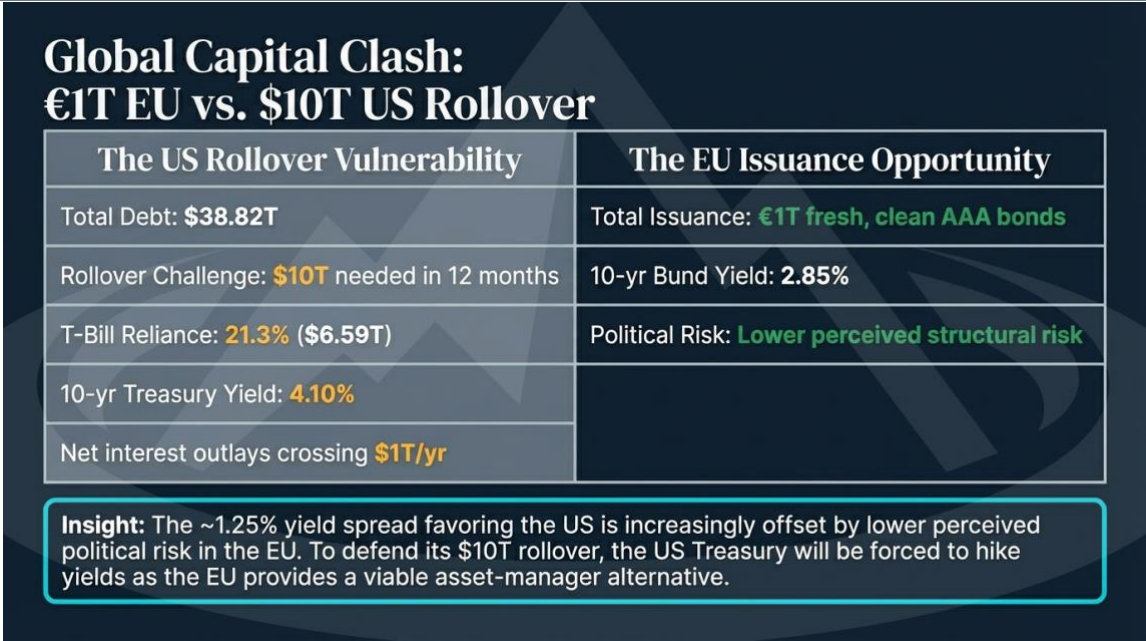


Figure 4. EU issuance versus the U.S. rollover wall

**Key takeaway:** As fresh EU supply scales, U.S. duration loses part of its scarcity premium and may need higher yields to compete for savings.

With U.S. net interest outlays projected to exceed \$1 trillion in 2026, the arrival of a €1 trillion AAA-rated competitor will force U.S. yields higher to attract a shrinking pool of global savings.

This change does not stop at fixed income. It hits U.S. equities as well. The S&P 500 and Nasdaq are losing the benefits of the free-rider era in defense. U.S. defense contractors must now compete head-on with well-funded European peers backed by long-cycle sovereign demand. At the same time, as central banks begin diversifying away from their 56.32% U.S. Dollar share of global reserves into new European federal debt, the DXY index faces a structural headwind.

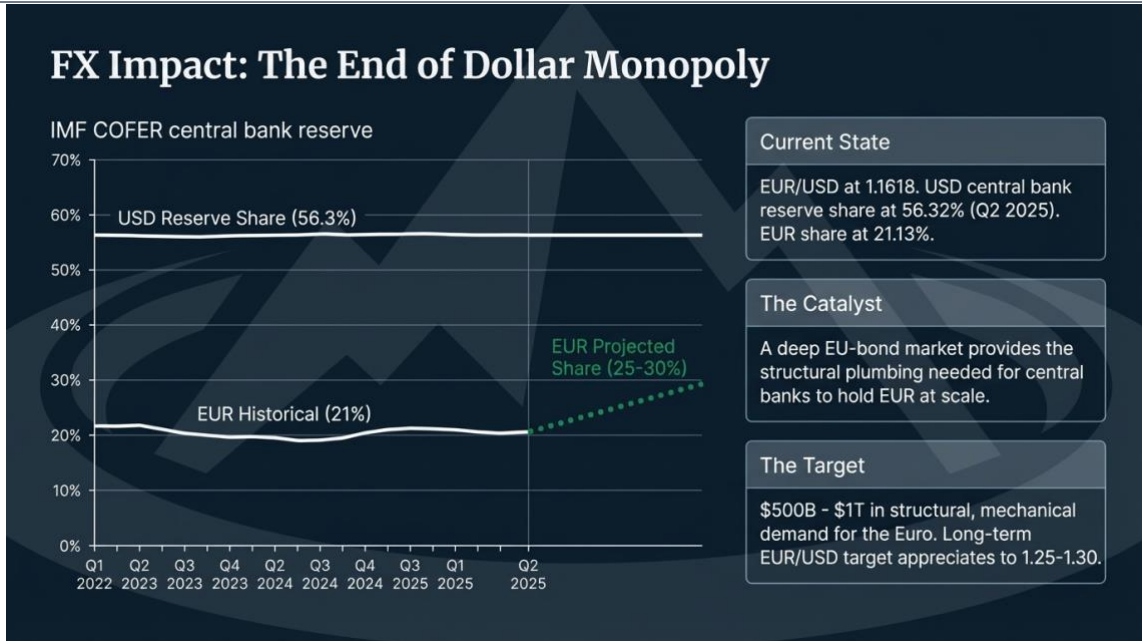


Figure 5. Reserve diversification and the EUR/USD channel

**Key takeaway:** A deeper EU bond market gives reserve managers a scalable euro asset, supporting gradual reserve reallocation and euro appreciation.

We are moving from a monocentric, Dollar-dominated system to a more bi-polar global financial architecture, with Europe emerging as a credible sovereign alternative.

## Impact on Europe and Global Markets

The Fortress Europe framework rests on four pillars of strategic autonomy: food, energy, finance, and defense. The first three were stress-tested and reshaped during the 2022–2023 crises. Defense is now taking center stage as the primary driver of fiscal policy.

We call this the Moment Carney—a term popularized after the January 2026 Davos summit with the Canadian Prime Minister—signifying the point at which states are forced to choose strategic autonomy and the fiscal tools required to fund it.

The shift from a 2% of GDP defense floor to a 3.5% floor is nothing short of a fiscal revolution. For an EU economy with €16–17 trillion in GDP, a 3.5% allocation equates to €560–595 billion in annual defense spending.

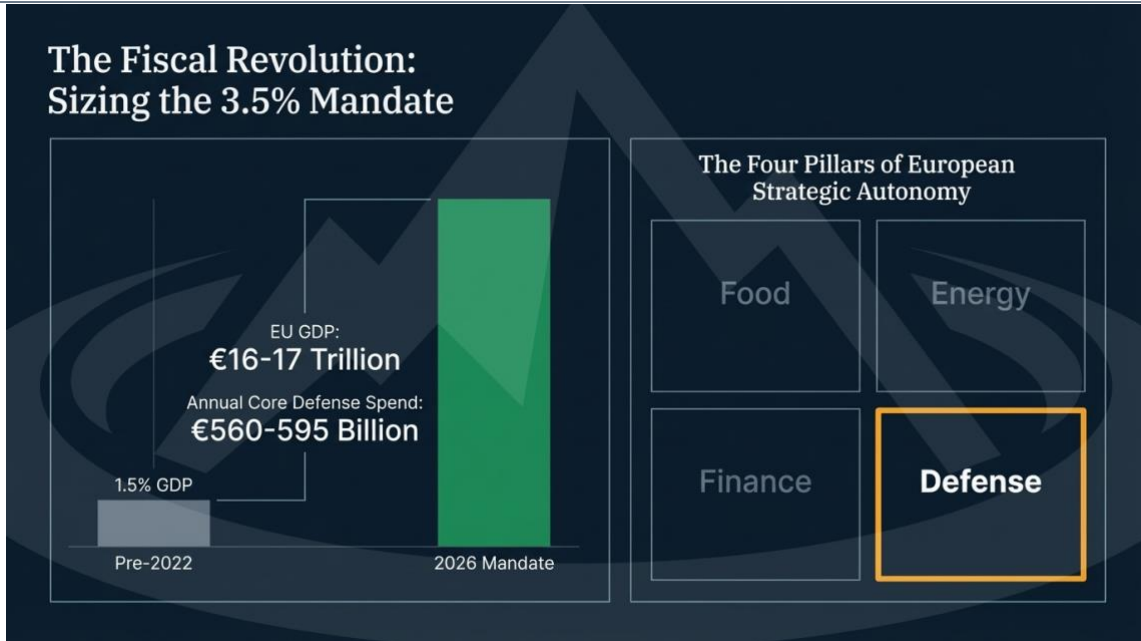


Figure 6. The scale of Europe's 3.5% defense mandate

**Key takeaway:** Moving to a 3.5% floor implies a step-change in annual spending and a durable shift in the fiscal regime.

This is Military Keynesianism in action: large-scale government expenditure that drives demand without increasing the supply of consumer goods, thereby embedding structural inflationary pressure in the system.

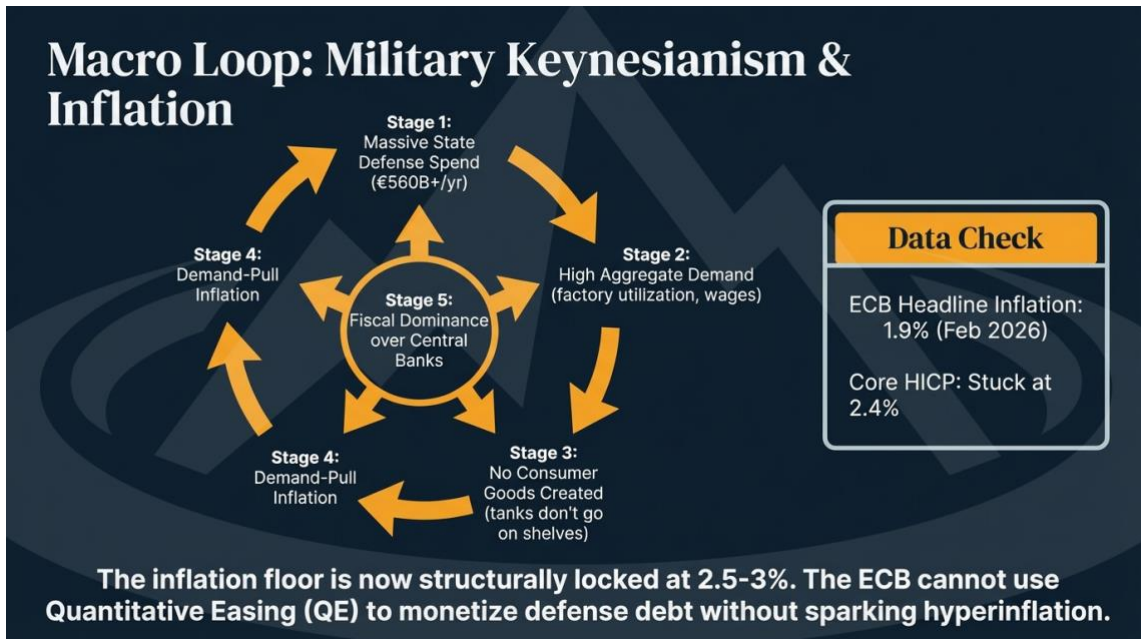


Figure 7. Military Keynesianism and the inflation loop

**Key takeaway:** Defense-led fiscal expansion can keep demand firm without adding consumer supply, reinforcing a higher-for-longer inflation regime.

## The Sovereign Debt Landscape: 2026–2030 Horizon

Feature	US Treasuries (2026)	EU-Bonds (SAFE/NGEU/EIB)
Credit Rating	AA+	AAA / AA+
Current Yield (10Y)	4.10%	2.85% (Bunds) / 3.0–3.5% (EU)
Liquidity Potential	Primary / \$30T+	High / €1T+ by 2030
Political Risk	High (Fiscal Gridlock)	Improving (Strategic Unity)

Europe’s project is therefore not only about security; it is about re-engineering the global sovereign debt hierarchy.

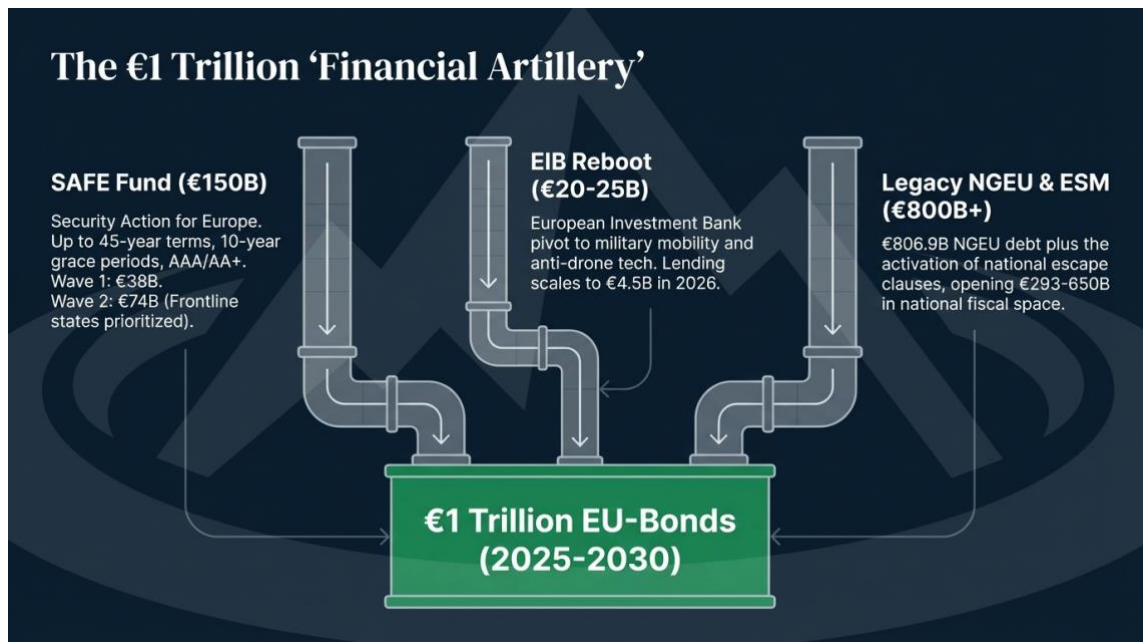


Figure 8. The funding channels behind Europe’s €1 trillion bond complex

**Key takeaway:** SAFE, EIB, and legacy EU facilities form the financing stack that can turn strategic autonomy into durable benchmark supply.

## Sectoral Movements and Actionable Tickers

To understand the current defense surge, we apply Capital Cycle Theory. We are in the high-return phase of the cycle, following decades of underinvestment during the trough, when capacity was cut and capabilities atrophied. Today’s sudden demand shock is colliding with high barriers to entry, allowing for significant margin expansion before new competition can fully enter and saturate the market.

### The Defense Giants

We see \$RHM.DE (Rheinmetall) as the icon of Europe’s defense renaissance. With a €64 billion backlog and orders expected to reach €80 billion this year, Rheinmetall is targeting an EBIT margin of 18–20%. Even at a share price of €1,638, structural demand remains far from satisfied.

Alongside Rheinmetall, we maintain core positions in \$LDO (Leonardo) and \$HO (Thales). Thales, in particular, has become the technological core of Europe's air defense and satellite systems, anchoring the continent's move into higher-end, networked capabilities.

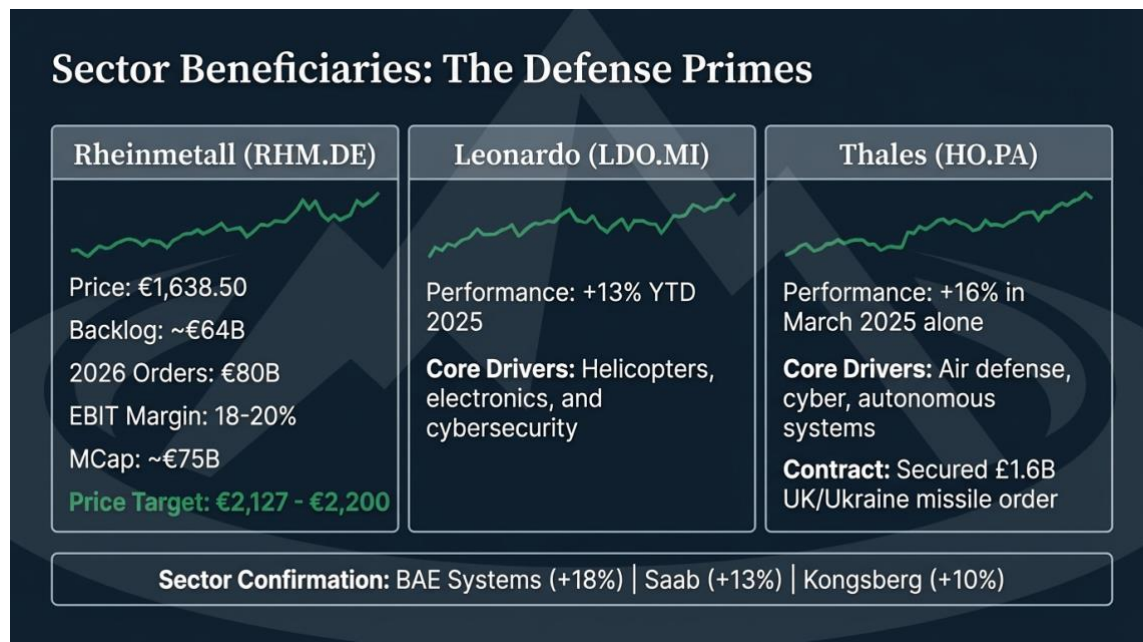


Figure 9. Listed defense primes positioned for Europe's rearmament cycle

**Key takeaway:** Rheinmetall, Leonardo, and Thales sit at the center of the demand shock, with backlog visibility supporting earnings leverage.

## The Secondary Tier

We also monitor a second tier of key players: \$BA. (BAE Systems), which delivered an 18% return in 2025, \$SAAB (+13% in 2025), \$KONGSBERG (+10% in 2025), and \$SAFRAN. These firms are essential to autonomous systems, air defense, and advanced platforms. Their importance to Europe's long-term security architecture remains undervalued by market consensus.

## The Financial Intermediaries

The creation and expansion of EU-level bonds is a windfall for European financial intermediaries. Institutions such as \$DBK (Deutsche Bank), \$BNP (BNP Paribas), \$UCG (UniCredit), and \$GLE (Société Générale) are acting as primary underwriters of this new sovereign supply.

In H1 2026 alone, these banks are handling €90 billion in new placements, benefiting from fee income and from holding high-quality Euro-denominated assets yielding 3–4% on their balance sheets. In many ways, they are becoming the plumbing of Europe's sovereign renaissance.

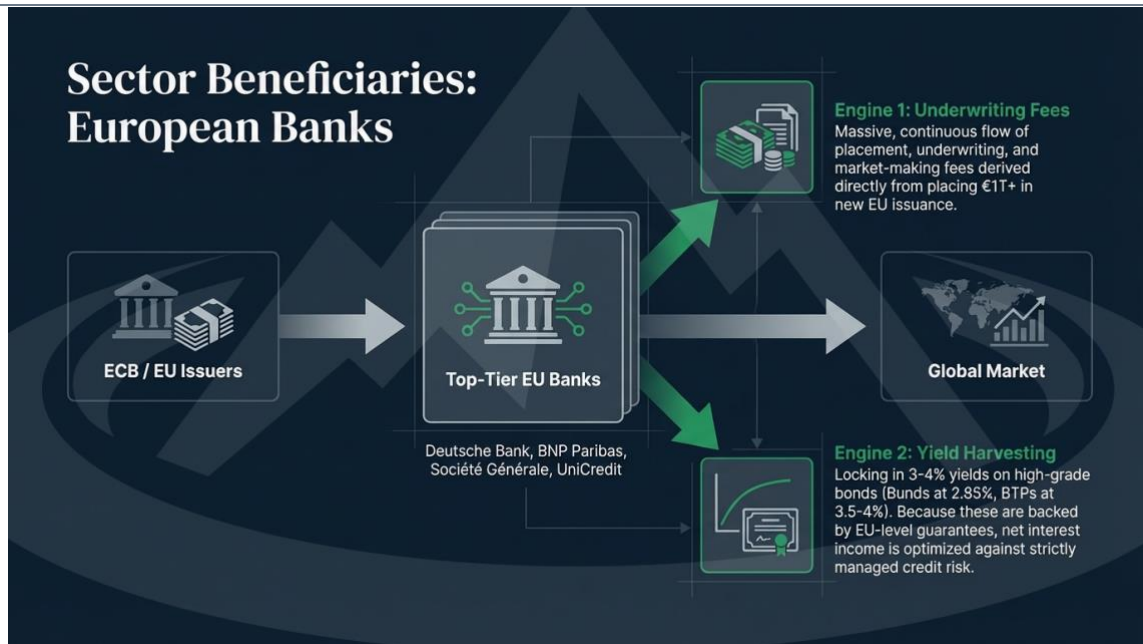


Figure 10. European banks as underwriters and balance-sheet beneficiaries

**Key takeaway:** The banking complex benefits from issuance fees and from holding more high-quality euro assets at materially better yields.

## The Gray Rhinos: Underestimated Signals

To understand the bull case, we must first examine the fault lines that could cause it to unravel. Inversion is a useful discipline here: by mapping the paths to ruin, we better understand the resilience of our base case.

The most visible Gray Rhino is the Italian spread. At 63–65 basis points, the spread between Italian BTPs and German Bunds is anomalously low. We assign a 30–35% probability to a localized crisis as markets begin to show a clear preference for AAA-rated EU bonds over BBB-rated Italian debt.

A second structural risk lies in German fiscal politics. The collision between the *Schuldenbremse* (debt brake) and the urgency of ramping up defense spending is unresolved. Constitutional and political disputes in Berlin could still delay or dilute the implementation of the €1 trillion Fortress Europe vision.

On top of this, Europe’s defense sector faces two major blind spots: a heavy reliance on U.S. and Asian semiconductors and a shortage of skilled engineers. While the EU Chips Act offers a long-term path to technological sovereignty, the labor shortage is a hard constraint on rapid scaling and will remain a drag on the speed of implementation.

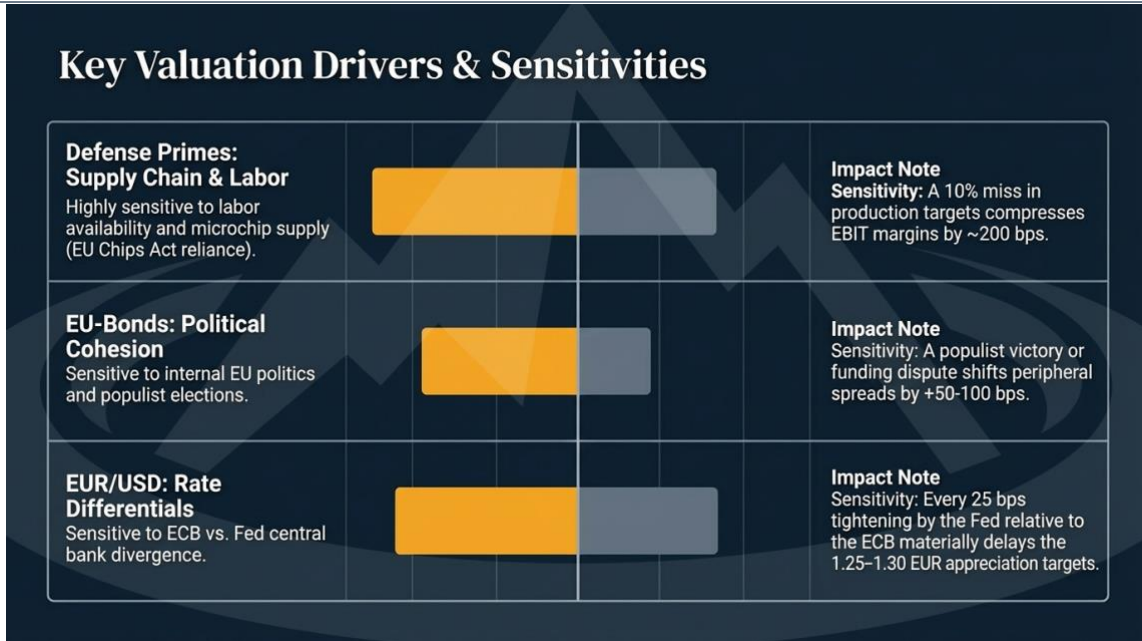


Figure 11. Key valuation drivers and portfolio sensitivities

**Key takeaway:** The opportunity set is attractive, but labor, politics, and rate differentials can materially shift margins, spreads, and FX outcomes.



Figure 12. Gray rhinos across politics, spreads, and industrial capacity

**Key takeaway:** Italy, German fiscal constraints, and supply-chain bottlenecks are the clearest paths by which the base case could be delayed or repriced.

## Scenarios and Probabilities (2026–2030)

We frame the coming years through three core scenarios within our MoatPeak Strategic Scenarios framework:

Scenario	Probability	Currency (EUR/USD)	Bond Yields (Bunds)	Equity Impact
<b>Fortress Europe (Base)</b>	60%	1.25-1.30	3.0%-3.5%	Defense outperf. 30-50%
<b>Fragmentation (Bear)</b>	25%	1.00-1.05	Spreads widen	Flight to USD/Gold
<b>Trump-Shock (Tail)</b>	15%	0.85-0.90	QE returns	High Inflation/Defense Surge



Figure 13. Scenario dashboard for 2026-2030

**Key takeaway:** Our base case remains Fortress Europe, but fragmentation and a U.S. security shock create materially different FX, rates, and equity paths.

The key dynamic to monitor is scenario drift. A shift from the Base (Fortress Europe) scenario to the Tail (Trump-Shock) scenario would likely be triggered by a sudden withdrawal or sharp reduction of U.S. security guarantees. In such a world, we expect the ECB would be pushed toward an aggressive return to monetary financing (QE) specifically targeted at defense.

That path would imply a sharp Euro devaluation, high nominal returns for defense equities, and negative real yields for bondholders. It would be a world where security is purchased at the price of currency debasement.

## Insights From Us: The MoatPeak Synthesis

As we look back on the end of the Zero-Interest Rate Policy (ZIRP) era, we must accept that the rules have changed. We have entered a regime of FISCAL DOMINANCE.

With core inflation at 2.4%, consistently above the ECB's 2% target, the central bank's room to ease meaningfully is structurally constrained. Monetary policy is no longer the primary driver; fiscal imperatives—most notably defense—are in the lead.

Intellectual honesty forces us to confront a simple reality: defense spending is inflationary by design. It generates wages, industrial activity, and long-term contracts without directly producing consumable goods for households. As a result, even in a downturn, rates are unlikely to revert to the ultra-low floors of the last decade.

In this sense, the Golden Age of Bonds has returned, but only for those who understand and correctly price the new geopolitical risk premium. Safe yields now come packaged with sovereignty risks that must be actively managed rather than ignored.

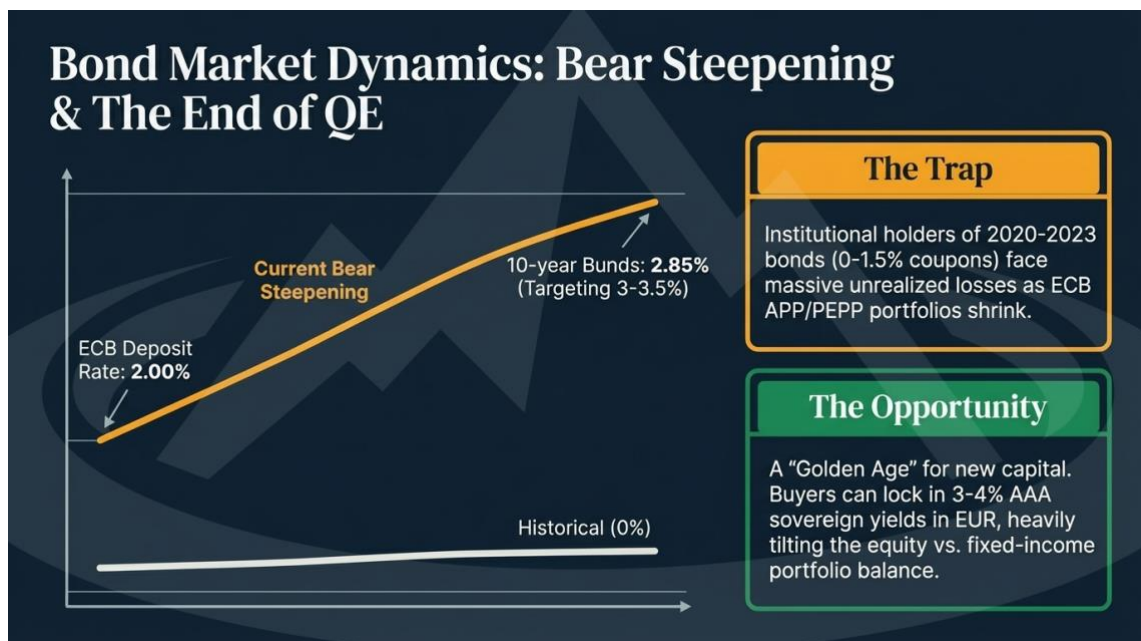


Figure 14. Bear steepening and the end of the QE backstop

**Key takeaway:** The rates view is structural rather than tactical: fiscal dominance raises the floor for bund yields and reduces the odds of a return to zero-rate conditions.

## Strategic Capital Allocation in the Sovereign Renaissance

To navigate the Fortress Europe theme, we believe investors must balance participation in defense-led growth with explicit hedges against persistent inflationary pressure.

We are no longer in a world where European debt is a low-yield, peripheral bucket. Euro-denominated sovereign and supranational bonds are becoming a core anchor of any serious multi-currency strategy.

For the 2026 outlook, we advocate a strategic rebalancing between Equities and Fixed Income. The availability of 3-4% yields in high-quality Euro bonds offers a credible alternative to \$TLT and similar USD duration plays. We should treat these yields not as a cyclical spike, but as the new normal in an era where sovereignty must be self-funded.



Figure 15. Portfolio decision checklist for the Fortress Europe regime

**Key takeaway:** Implementation centers on rotating into new EU duration, overweighting defense and underwriter banks, increasing long-term EUR exposure, and monitoring invalidation triggers.

Ultimately, sovereignty has a price. For decades, that price was partially subsidized by the Atlantic alliance. That subsidy is fading. The bill is now being presented by markets.

Fortress Europe is, in our view, the defining macro trend of this decade. As these tectonic plates shift, the most compelling opportunity lies in recognizing the birth of a new global benchmark before consensus fully internalizes its implications.

We position ourselves accordingly.

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Our research integrates insights from global investment banks, asset managers, and macroeconomic data sources, translated into clear, actionable perspectives for long-term, strategic investors.

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