

Hymans Robertson Investment Services (HRIS)

# Update on the Gilt Market

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Over the last few days you may have seen some news headlines around rising government borrowing costs (i.e. increase in gilt yields) and the pound weakening.

The 10y yield on gilts has risen from around 4.2% in early December to 4.8% now (gilt prices fall as yields rise) and the pound has fallen from around \$1.27 against the US dollar to \$1.23 in the same period (see charts below). You can also see from the charts that gilt yields have been rising since September from a low of around 3.8%. Over the past few months this increase has been in line with global government bond markets and has been driven by a combination of strong US economic growth and stickier inflation which has dramatically lowered the expectation of rapid interest rate cuts from the likes of the Federal Reserve, but also the Bank of England. Trump's victory and Labour's Budget have also increased concerns over widening fiscal deficits and large government borrowing on both sides of the Atlantic.

Over the last week or so this seems to have become more of an acute issue for the UK however, yields on gilts have been rising faster than global peers. This is because investors have become more aware of the issue that the Chancellor may soon have with meeting her fiscal rules. Last October's Budget gave the Chancellor very little headroom in meeting her fiscal rules meaning even a small decrease in the economic growth forecast or a mild increase in gilt yields would mean she was no longer meeting her rules. Both look like they're set to happen. This would leave the Chancellor with the choice of either increasing taxes again or less spending.



Source: Trading Economics

Higher yields normally attract more global investors, strengthening the currency. The fact that both gilt prices and the pound are falling is a sign that overseas investors may be selling. However, the comparison to the Liz Truss mini-budget is, for now, overdone. What complicated it for Truss was the speed of the gilt yield rise – yields rose by 1% in one day then!

Gilts remain a pretty small part of HRIS portfolios and the lower interest rate duration positioning has likely been positive for relative performance at the lower risk end of portfolios. The weaker pound is generally positive for performance, as overseas assets will increase in value in sterling terms. The increase in bond yields may present an attractive entry point for investors into bond markets.



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#### **Risk warning**

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