Balancing risk and returns

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TRULY INDEPENDENT
Financial Advice for Everyone

UK government bonds, also known as gilts, are debt securities issued by the UK government. They are used to finance the government's borrowing requirements and are often seen as a safe haven asset by investors.

Gilts are traded on the London Stock Exchange and the payments on gilts are fixed, meaning that they provide a predictable income stream for investors.

Fixed income portfolio

Investors who place large portions of their portfolio in fixed income investments are usually looking for a regular, secure income stream. They are often retired and reliant on their investments or pension to provide a monthly income.

Gilts are typically issued with maturities of between one month and 30 years. During that lifetime, they usually pay a set amount of annual income – the 'coupon'. They can be held to maturity or sold prior to maturity if the investor needs access to the funds.

Significant growth

The UK government bond market is one of the deepest and most liquid markets in the world. It is also one of the most important financial markets. The size of the UK government bond market has grown significantly in recent years.

The main factors affecting the price of bonds are: Interest rate risk – the direction interest rates are moving; Credit risk – the perceived risk associated with the issuer; Duration risk – the amount of time left before the issuer has to repay the bond holder.

Heightened volatility

Shorter-dated bonds – those that will redeem within five years – are less price sensitive to interest rate movements than longer-dated bonds. This means prices tend to move up or down less when interest rates rise or fall.

Following the Mini-Budget and the government's fiscal plan announcements on September 23, the UK government bond market experienced heightened volatility, with the market posting some of its largest daily swings on record.

Interest rate hikes

As a result, gilt yields rose steeply as investors assimilated the expected £62.4bn increase in gilt sales over 2022/23, and substantially increased their expectations of interest rate hikes from the Bank of England. On the day of the announcement, the ten-year UK government bond yield rose from 3.45% before the Chancellor's statement to end the day at 3.83%, marking its largest one-day move for more than 30 years.

As a result, gilt indices fell 2.6% on the day. The yield subsequently rose above 4.5% before falling back to around 4% by the morning of Friday 30 September. This followed the Bank of England announcing on Wednesday 28 September a large-scale purchase.

Emergency intervention

The Bank launched its emergency intervention after an unprecedented sell-off in long-dated UK government bonds that threatened to collapse multiple liability driven investment (LDI) funds, widely held by UK pension schemes. On the day the Bank of England stepped up its bond-buying support, the International Monetary Fund stated that a 'change in fiscal policy' would help calm bond markets.

There are some mitigating factors that provide greater context to the market reaction, such as the fact that the Mini-Budget came at a time when global markets were looking fragile, with US bond yields and the US dollar both moving higher for much of September. Still, the relative moves compared to US and European equivalents suggest that there were clearly UK-specific factors at play following the Mini-Budget.

Securing the future you want

Whether you want to grow your wealth for a retirement income or a legacy to pass on to future generations, we can help you set goals and try to achieve them. To find out more and to discuss your options, please contact us.

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