Overweight UK Gilts/Underweight World Government Bonds

Recommended since February 28, 2026

Investment thesis: We expect UK gilts to outperform world government bonds (GBP hedged), driven by attractive valuations, a domestic growth outlook that points to a relative fall in gilt yields, and positive yield carry. While fiscal risks remain, we believe they are captured in gilts to a greater extent than other government bonds and self-imposed fiscal rules should limit further repricing. The UK, though, is particularly exposed to external supply shocks, such as ongoing developments in the Middle East.

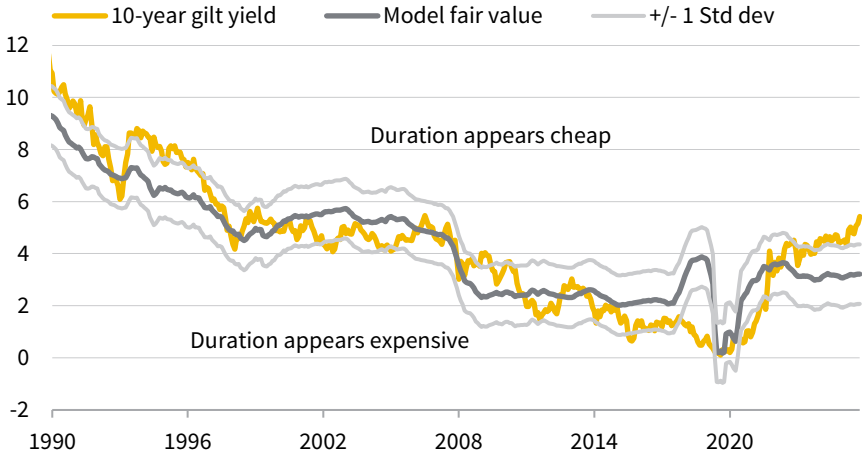
Key support 1: Gilts yields are trading more than 1 standard deviation above their model implied fair value level (model based on trailing growth and inflation data). Gilts have outperformed in previous episodes when they exhibit this level of "cheapness" and move lower toward the fair value range. Gilts yields are also trading high relative to other developed markets (DM) fixed income. Even without a change in yields, gilts should outperform based on positive carry—the yield on gilts is 1.27 percentage points higher than the world government bond underweight.

Key support 2: The balance of risks points to lower relative gilt yields. UK growth is set to remain weak and below that of many DM peers, with no clear catalyst for renewed domestic growth momentum and signs of increased economic slack emerging. In our view, the supply-side shock from the Iran War is more likely to further dampen demand than to lead to a protracted, broad inflation spiral from here, which should ensure the Bank of England tightens monetary policy by less than markets currently expect. Fiscal concerns are priced to a greater extent than other DMs due to self-imposed fiscal rules and market-imposed discipline.

Key risks: The Iran War is a scenario in which gilts underperform, especially if the war leads to a protracted inflationary impact, although domestic growth and inflation momentum had been waning prior to the war. Rising yields globally could increase focus on government borrowing, but the impact should be limited given the new prime minister has explicitly said the government will maintain the existing fiscal rules.

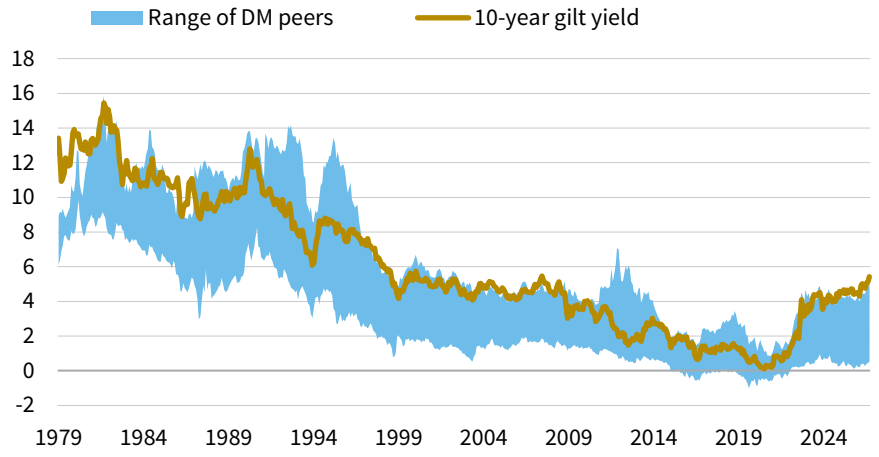
Valuations: 10-year gilts

December 31, 1990 – September 30, 2026 • Percent (%)



10-year UK gilt yield compared to the range of DM peers

January 31, 1979 – September 30, 2026 • Percent (%)



Sources: National Sources and Thomson Reuters Datastream.
Notes: For LHS, the model fair value is the predicted range of ten-year yields based on a multiple linear regression model that includes trailing ten-year real GDP and RPI/CPI change. CPI data are as of July 2026. For RHS, DM peers include the 11 G10 countries.

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