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UK Gilt Yields Hit Highest Level Since 1998 – Here's What It Means For Portfolios

UK Government borrowing costs have soared in the wake of its Autumn Budget, with some gilt yields reaching levels not seen since 1998.

Yields on the 30-year UK Gilt have reached above 5.22% – higher than at any point since 1998, as the Government looks to sell fresh bonds in order to fund its spending commitments.

Fresh auctions of long-term gilts by the UK Government – selling around £6.5 billion of fresh debt – has caused yields to spike, which has led to the 30-year bond reaching the significant milestone.

UK gilts have come under renewed pressure after Labour spelled out its plan to issue near-record fresh debt, while the UK base rate remains higher than markets expected thanks to ongoing inflation concerns.

Understanding Government bonds

The UK Government sells a wide variety of bonds, commonly referred to as 'gilts', which come with a wide spectrum of maturity dates.

For example, 30-year gilts refer to those which have a 'maturity' 30 years from now. An investor who holds a gilt can expect to redeem their principal investment (the amount of money initially invested) at the maturation date. In the time the investor holds the bond, they can expect to earn a yield.

However, investors are not obliged to hold the bond until maturation – they can be bought and sold on the bond market. Bonds values and yields rise and fall depending on day-to-day market conditions. The yield level depends on a variety of factors but is always inverse to the face value of the bond. As such, when bond values rise, yields fall – and vice versa.

Until the cost-of-living crisis in 2021, bond values went through a 40-year 'bull market', rising in value over consecutive decades, which led to years of falling yield levels.

However, once central banks began to hike interest rates in order to quell inflation, bond yields began to soar while values fell. This was because it became less risky for investors to just hold cash in savings that offered improving rates of interest, while the value of the cash would remain stable.

The bond selloff was not confined to the UK, but UK gilts have been additionally affected by political decisions by successive recent governments. This was most notable in the wake of the now-infamous 'mini budget' of September 2022, in which former Chancellor Kwasi Kwarteng, under the leadership of Prime Minister Liz Truss, made a series of unfunded tax cut promises.

Investors reacted extremely poorly to this, selling off gilts which sent yields soaring. This in turn led to the so-called LDI crisis, which forced pension funds to liquidate gilt investments to get their hands on cash. This in turn created a spiral of selling, which ultimately required Bank of England intervention to stop.

Why are yields rising again?

Yields on UK Government gilts have been rising again, after having reduced somewhat in the wake of the cost-of-living crisis and mini budget.

While it has been a slower process, yields have risen in anticipation of – and in response to – the new Labour Government planning spending and borrowing increases. UK Government debt passed 100% of annual GDP in September 2024.

The market has reacted negatively to these circumstances, particularly given the UK's outlook for economic growth remains very sluggish, failing to grow at all in the last few months of 2024.

Yields on the two-year, five-year, 10-year and 30-year gilts are all now higher than they were in the immediate aftermath of the mini budget as a result. This reflects growing concern about the rising debt levels and spending of the Labour Government. It is in effect an implicit judgement from the market that the UK is now a riskier place to invest money.

What does this mean for portfolios?

In terms of investments and diversified portfolios, government gilts are typically seen as one of the 'safest' relative options for long-term investors. This is because governments are judged – in the long term – much more likely to be able to pay back their debts than companies because governments have the power of taxation.

A typical portfolio will be diversified between a mixture of assets such as government bonds, company bonds, and equities (stocks and shares) – with other assets such as gold providing alternatives too.

Younger investors tend to have a much lower concentration of bonds in their portfolios, because they lack the long-term growth potential of stocks. But older investors will typically have a higher allocation to bonds, which are less volatile and easier to use to preserve wealth that has already been accrued.

Those investors might now see some pull backs in their portfolio values. However, as a part of a diversified portfolio of assets, this should be limited and mitigated by growth in other areas.

What is essential for anyone concerned about what is happening in the government bond market, speaking to one of our advisers before making any rash decisions is essential. We can provide you with better context on positioning, how well diversified the portfolio is, and indeed if there are any opportunities to buy new investments at a lower relative prices.