

Always looking for long-term opportunities

It's fair to say that the first quarter of 2026 has been a volatile period for markets, but it's especially true for UK government bonds (or gilts).

In the opening weeks of the year, the market narrative was one of improving global growth and falling inflation; a benign and supportive backdrop for government bonds.

While this was the narrative for global markets, it was particularly applicable to the UK's economic backdrop. UK growth, or the lack thereof, was looking like it had troughed, and there were already embryonic signs of a developing recovery showing up in a raft of data sources, including economic activity surveys (not a major improvement, but a recovery nonetheless).

The UK gilt market was reacting positively to this; yields were falling (meaning that prices were rising), Rachel Reeves' fiscal headroom was building, and the market was expecting the Bank of England to cut interest rates twice more this year.

The Iranian escalation subsequently set this market narrative on its head. Along with oil, government bonds have been one of the most volatile asset classes ever since.

Why government bonds have been impacted by the Iran war

Commodity markets have been one of the chief theatres in which the Iran war has been played out. Prices here have spiked, especially for oil and gas given the current tensions in the Middle East have 'effectively' closed the Strait of Hormuz, through which circa 20% of the world's oil, liquefied natural gas and fertilisers usually pass.

This has understandably manifested as concerns around how much the closure will impact both global growth and the near-term trajectory for inflation, especially in regions like Europe and the UK. Our economy, like that of our European neighbours, has a much higher sensitivity to oil and gas prices than, say, the US. As we're far from being energy self-sufficient, we remain major importers of both oil and gas.



This has played out in bond markets with steeply rising market expectations for inflation alongside a complete reassessment of what path central banks are now likely to set interest rates upon in 2026.

In the case of the UK, interest-rate expectations have moved from pricing in two interest-rate cuts for this year to, at one point earlier this week, four potential interest-rate increases! By bond market standards, this is a seismic reassessment in such a short space of time. This has led to bond yields rising steeply (meaning their prices have retreated).

Between the onset of the Iran war on 28 February, and the time of writing (26 March 2026), the yield on two-year UK government bonds had risen by 84 'basis points' (meaning 0.84%), while the yield on 10-year gilts had climbed 54 basis points (0.54%), and the yield on 30-year gilts was up 43 basis points (0.43%).

These are large moves. To put this into context, the yield on 10-year gilts hasn't been this high since 2008 in the aftermath of the global financial crisis.



Source: Bloomberg as 26 March 2026.

As active portfolio managers, during periods of market volatility we're not just looking for ways to cushion our portfolios should the volatility persist, we're also looking for attractive opportunities.

How we've responded to this in our client portfolios

Given the size of the moves in government bond markets, especially in the UK, our multi asset class portfolios haven't been completely immune to this repricing. Naturally, the impact is most notable in our lower-risk portfolios, such as Defensive and Cautious, which have the highest weighting to bond markets.

However:

- Bonds are just one of numerous asset classes in which we invest; diversification remains a key strength of our investment proposition.
- Government bonds are only one aspect of our bond exposure. We also hold corporate bonds which are issued by companies. These exposures – often referred to as 'credit' holdings – have so far proven more resilient during this extended period of market volatility.
- Having held a long-standing overweight to gilts, compared to our long-term average, we trimmed our exposure back to 'neutral' in the early part of the year (meaning it was back in line with our long-term average). At the time, we were able to take advantage of falling yields (meaning we sold as prices were rising). Consequently, we were able to monetise some of the strong market performance seen earlier in the year.

As active portfolio managers and stewards of our clients' capital, during periods of market volatility we're not just looking for ways to cushion our portfolios should the volatility persist, we're also looking for attractive opportunities.

If you have questions about financial markets, or our investment services, please contact the Marketing team: marketing.hwam@handelsbanken.co.uk

We are firmly of the view that, while the evolving backdrop now means the Bank of England is unlikely to cut interest rates twice this year, we don't believe it will raise rates four times either, particularly given the negative impact that recent commodity prices will have on UK economic growth.

Our assessment is that UK government-bond valuations are beginning to look attractive once more through our long-term lens. **Whilst volatility may persist in the asset class in the near term**, we think yields at these levels represent a compelling medium to long term opportunity. Consequently, this week we bought gilts with a short to medium-dated maturity profile as we think that's where the best value has emerged in recent weeks.

This means that our portfolios have now gone from being 'neutral' on UK government bonds (in line with our long-term average) to being marginally overweight.

Important Information

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