Major Markets Letter #6
16th January 2026

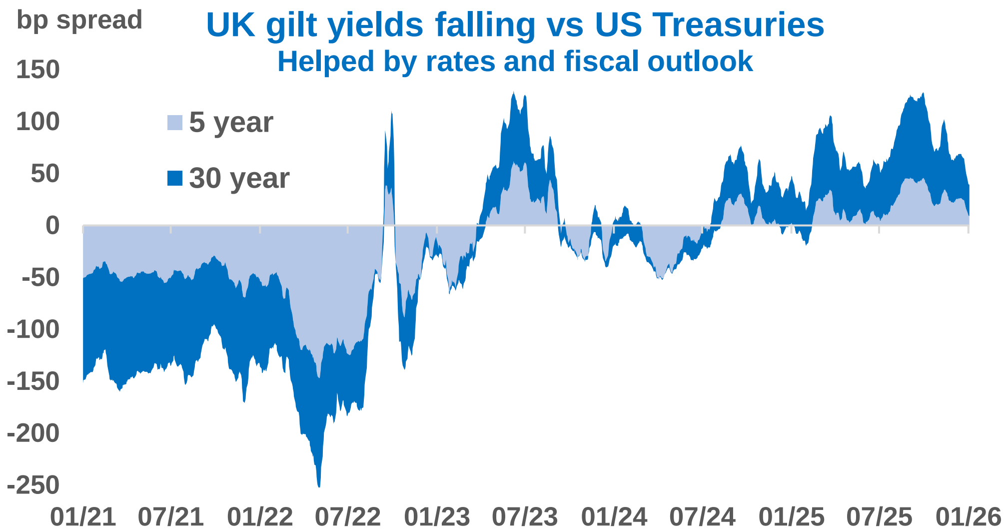
steven.major@tradition.com
+971 5017 18007

The case for the UK

Investors like trends that work in their favour, and UK gilts have started the year with momentum firmly on their side. Yields have fallen across the curve, offering welcome relief after the bruising experience of last year, when yields reached multi-decade highs.

Over the past three months, the 30-year gilt has outperformed the equivalent US Treasury by around 60bp. But through the last 30 years, the average spread between UK and US long-dated yields has been around -30bp, meaning gilts have typically yielded less than Treasuries. Our chart shows today's spread of roughly +28bp only appears "normal" if one's reference point is recent times.

That residual premium reflects an additional risk embedded in gilts. We can politely describe this as the legacy of past policy missteps, though others have used stronger language. Gilt investors still recall the Truss government's fiscal experiment of October 2022, and whilst it now appears as just a spike on our chart, it left a lasting impression. Then there was the more sustained rise in yields during 2023 and 2024, which reflected the Bank of England's forceful response to inflation: aggressive rate hikes alongside active gilt sales as quantitative tightening accelerated.



Source: Bloomberg

So what has changed?

In our view, the direction of central bank policy and a relative improvement in the UK's fiscal outlook now outweigh the remaining risks.

Central banks: lower, not higher, rates

Money markets are currently pricing two additional 25bp rate cuts this year, taking Bank Rate to 3.25%. If delivered, this would amount to 100bp of easing through 2025, 150bp from the peak.

The economic backdrop supports the view that rates will fall. Growth is cooling and most importantly for the Bank of England, the labour market is weakening. While the Fed operates under a dual mandate of price stability and maximum employment, the Bank's primary focus is inflation - albeit with a close watch on jobs. With inflation gradually falling towards target, a deteriorating labour market materially strengthens the case for further easing.

Institutional credibility also matters. The Bank of England's independence is not in question. By contrast, the unprecedented public attacks on the Fed Chair, and speculation that the next Chair may be explicitly "dovish", complicate the outlook for US rates. That uncertainty feeds risk premia and keeps the US curve steeper than it otherwise might be.

Say it quietly, but by comparison the UK looks like a haven of stability.

For UK gilt investors, the key point is simple: *rate hikes* look highly improbable - at a time where there are some forecasters looking for Fed rate hikes next year - while the risk of deeper-than-expected cuts remains underappreciated.

Where do rates ultimately trough in the UK and US? If the longer-run neutral sits below policy rate levels, as we suspect it might be, the trough is potentially below what is implied by forwards. Over time, policy rates reflect not just the cycle but deeper structural forces: demographics, technology, geopolitics and debt dynamics.

Supply dynamics and the UK's "twistability"

Neither the UK nor the US has a pristine fiscal position. Debt-to-GDP ratios are projected at around 101% for the UK and 124% for the US (IMF, 2025). But it's not just the level, the key difference lies in direction of travel. The UK is one of the few large developed economies committed to fiscal tightening, in part as a response to the earlier policy errors that created today's yield premium. The US, by contrast, remains firmly expansionary, with further fiscal stimulus under active discussion.

Debt servicing costs depend not just on the size of the debt stock but also on its maturity profile. Here, the UK stands out. The gilt curve has what might be called "twistability". Over the past four years, the average maturity of outstanding gilts has fallen from around 15 years to just under 13. Even after that decline, it remains roughly double the US equivalent.

Short-dated issuance is also far smaller in the UK. Treasury bills account for only about 3% of the UK debt stock, compared with just over 20% in the US. This structure has pros and cons. Locking-in long-term funding at ultra-low rates was advantageous for the taxpayer when yields were near zero. The drawback today is a large stock of debt that generates a big interest bill, hence the emphasis on finding opportunities to finance at a lower rate.

There is scope for change. The UK bill market is relatively small, at around £100bn. Expanding it would lower the average cost of funding for the UK government, given bills yield more than 100bp less than 30-year gilts. It would also broaden the investor base, offering retail investors an alternative to bank deposits.

Risks: politics and sterling

For overseas investors, gilts cannot be assessed in isolation from sterling. The dollar remains the world's dominant reserve currency, and FX considerations matter. That said, falling short-term rates would help - particularly if UK rates were to move below US rates, improving the economics of currency hedging.

The UK has generated its own political risk premia in recent years. But, as with currencies, it's the relatives that matter. Against a backdrop of heightened uncertainty elsewhere, UK assets currently look more predictable than the market may be pricing and offer a diversification opportunity for those holding US Treasuries.

Returning to valuations, gilts still offer a yield advantage over Treasuries. Five- and 30-year spreads stand at approximately +9bp and +30bp respectively. Those spreads have already compressed, but if the current trajectory persists, and we return to the levels of a few years ago, there is room for them to fall much further.

For investors seeking duration with improving fundamentals, UK gilts deserve renewed attention.