Gilts and pounds

A no confidence vote on the economy.

By James Mashiter, CFA – Fixed Income Portfolio Manager

The new government announced its mini-budget

Bond and currency markets were not impressed

A country's currency and bond markets are typically the most telling barometers of economic health. On these measures, investors are giving the UK an unequivocal vote of no confidence.

Rising yields, falling bond prices, weak currency, and huge volatility

- The upward march in gilt yields sharply accelerated after 23 September following the release of the Government's mini-budget. Moves in yields that are more typically associated with an entire calendar year occurred over just a few days.
- As of close on business on 27 September, the rapid rise in yields had translated into an eye-watering loss on the ICE BofA UK Gilts All Stocks Index of -30.2% (bond prices fall as yields rise), making the UK the worst-performing developed bond market according to Bloomberg data. The 10-year gilt yield rose above 4.5% for the first time since 2008, taking it higher than the equivalent US Treasury note, something that has not happened since 2014. The magnitude and speed of recent price declines in UK government debt has been reminiscent of moves more typically seen in emerging markets.
- At the time of writing, the Bank of England (BoE) has just pledged unlimited purchases of long-dated bonds, along with the postponement of its planned start to quantitative tightening. This move is in response to fears that frantic de-risking across liability-driven portfolios triggered by a tsunami of collateral calls could risk an imminent crash in the gilt market. The BoE's announcement has led to a huge retracement in gilt yields, the moves of which are the largest in living memory. The question is whether yields can stabilise around this lower level, in spite of the UK's deteriorating fiscal position.
- Sterling remains the weakest performing major currency year to date according to Bloomberg data, and has reached an all-time low against the US dollar.

Rising government debt fosters inflation

The catalyst for the latest sell-off in UK assets was the announcement of the mini-budget. The market reacted unfavourably to the large fiscal stimulus package, which investors clearly view as an unfunded borrowing splurge that risks an unsustainable debt trajectory and makes the Bank of England's (BoE) job of taming inflation all the more difficult. Markets are now pricing in a significantly higher terminal Bank Rate (5.9% vs. 4.4% at the start of the month). The implication is that the BoE will need to increase interest rates even more aggressively to combat the inflationary impact of the budget announcement, although the messaging is now further complicated following today's announcement on asset purchases.

Higher interest rates will be needed to attract foreign capital in order to fund the widening current account deficit. This, in turn, puts the housing market at risk as many fixed-rate mortgages are on relatively short 2-year or 5-year terms. The government's hope is that tax cuts will pay for themselves through higher future economic growth. For this to happen, the UK needs to address the long-term headwind of anaemic productivity growth.

Weak currency is good for exporters, bad for everyone else

Sterling has fallen significantly this year versus the US dollar, and is approaching half its value (vs the greenback) of 2007. Market onlookers have begun to speculate that it may reach parity, a scenario once viewed

© 2022 SEI

as implausible. Although the weakness in the currency may give a competitive boost to domestic firms that export to overseas markets, it exacerbates the inflationary pressures on imports. Focusing on the UK, the three-month moving average of non-EU import prices have soared nearly 30% over the year ended July according to the Office for National Statistics (with sterling weakening further since then). By contrast, import prices on goods from the European Union have climbed “only” 10.5%. One piece of good news for the UK: Import-price inflation from the EU might be peaking. The bad news: Even if import price inflation begins to subside, overall consumer price inflation will likely stay uncomfortably high well into 2023.

SEI’s view: Care and caution are the hallmarks of good planning

For brave investors with cash to invest, current depressed prices may represent an attractive entry point. Prices have fallen and yields have risen, presenting an income-generating opportunity. For existing investors, the declines are quite unsettling. Nowhere more so than in the Institutional space where the rapid rise in rates has triggered a wave of collateral calls on liability-driven investment vehicles, which often has to be funded by selling down growth assets. Forced de-risking puts further upward pressure on yields, which is the reason for the BoE’s latest intervention.

We anticipate further market volatility as the BoE and other central banks across the globe must navigate an increasingly complicated economic and geopolitical environment. In the past, central banks have been successful in supressing market volatility; today the reverse may be true. In market conditions such as these, we believe patience and caution are warranted. Short-term markets conditions are not typically a good reason to make changes to a sound long-term investment plan.

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events or a guarantee of future results. Positioning and holdings are subject to change. All information as of the date indicated. There are risks involved with investing, including possible loss of principal. This information should not be relied upon by the reader as research or investment advice, (unless you have otherwise separately entered into a written agreement with SEI for the provision of investment advice) nor should it be construed as a recommendation to purchase or sell a security. The reader should consult with their financial professional for more information.

Statements that are not factual in nature, including opinions, projections and estimates, assume certain economic conditions and industry developments and constitute only current opinions that are subject to change without notice. Nothing herein is intended to be a forecast of future events, or a guarantee of future results.

Certain economic and market information contained herein has been obtained from published sources prepared by other parties, which in certain cases have not been updated through the date hereof. While such sources are believed to be reliable, neither SEI nor its affiliates assumes any responsibility for the accuracy or completeness of such information and such information has not been independently verified by SEI.

There are risks involved with investing, including loss of principal. The value of an investment and any income from it can go down as well as up. Investors may get back less than the original amount invested. Returns may increase or decrease as a result of currency fluctuations. Past performance is not a reliable indicator of future results. Investment may not be suitable for everyone.

This material is not directed to any persons where (by reason of that person's nationality, residence or otherwise) the publication or availability of this material is prohibited. Persons in respect of whom such prohibitions apply must not rely on this information in any respect whatsoever.

The information contained herein is for general and educational information purposes only and is not intended to constitute legal, tax, accounting, securities, research or investment advice regarding the strategies or any

security in particular, nor an opinion regarding the appropriateness of any investment. This information should not be construed as a recommendation to purchase or sell a security, derivative or futures contract. You should not act or rely on the information contained herein without obtaining specific legal, tax, accounting and investment advice from an investment professional.

Information issued in the UK by SEI Investments (Europe) Limited, 1st Floor, Alphabeta, 14-18 Finsbury Square, London EC2A 1BR which is authorised and regulated by.

The offer or invitation to subscribe for or purchase shares of the Sub-Funds (the “Shares), which is the subject of this Information Memorandum, is an exempt offer made only: (i) to "institutional investors" pursuant to Section 304 of the Securities and Futures Act, Chapter 289 of Singapore (the “Act”), (ii) to "relevant persons" pursuant to Section 305(1) of the Act, (iii) to persons who meet the requirements of an offer made pursuant to Section 305(2) of the Act, or (iv) pursuant to, and in accordance with the conditions of, other applicable exemption provisions of the Act.

SIEL has appointed SEI Investments (Asia) Limited (SEIAL) of Suite 904, The Hong Kong Club Building, 3 Jackson Road, Central, Hong Kong as the sub-distributor of the SEI UCITS funds. SEIAL is licensed for Type 4 and 9 regulated activities under the Securities and Futures Commission ("SFC")
This information is being made available in Hong Kong by SEIAL. The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

This information is made available in Latin America and the Middle East FOR PROFESSIONAL (non-retail) USE ONLY by SIEL.

SIEL is not licensed under Israel’s Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the “Advice Law”) and does not carry insurance pursuant to the Advice Law. No action has been or will be taken in Israel that would permit a public offering or distribution of the SEI Funds mentioned in this email to the public in Israel.

Any questions you may have in relation to its contents should solely be directed to your Distributor. If you do not know who your Distributor is, then you cannot rely on any part of this document in any respect whatsoever.

Issued in South Africa by SEI Investments (South Africa) (Pty) Limited FSP No. 13186 which is a financial services provider authorised and regulated by the Financial Sector Conduct Authority (FSCA). Registered office: 3 Melrose Boulevard, 1st Floor, Melrose Arch 2196, Johannesburg, South Africa.