High time to worry?

With UK gilt yields hitting a 28-year high, memories of the 2022 bond crisis are resurfacing. Sandra Haurant explores what's driving the latest market shifts, whether pension schemes should be worried, and what higher yields mean for the future of pension investment strategies

Summary

- Pensions and gilts have a symbiotic relationship that dates back over a century.
- At the start of October, gilt yields rose to the highest levels since 1998.
- Commentators warned that a repeat of the 2022 gilt crisis could be on its way, while the opposition leader called on the Prime Minister to ensure that this was averted.
- Some experts argue that the high prices are not evidence of volatility but instead are proof that gilts have moved into a new, higher-yield phase after historic lows in the 2010s.
- The role of gilts remains in many ways unchanged for pensions, but in a context of greater political uncertainty there is an argument for shorter dated types, in place of 30-year bonds.



In early October 2026, yields on British 30-year gilts reached a 28-year high, pushing past 6 per cent and sending shockwaves around the city. Some commentators have warned that we may see something akin to the 2022 bond crisis play out all over again, while others say today's context does not carry the same risks, and a more robust market should help the markets weather any coming storm. So, what has been happening to this traditionally stable asset class, and how does this affect pensions?

Government bonds have been around since the 17th century, when the Bank of England issued them to raise funds to fight the French. Effectively a loan to the government, the bonds began to be known as 'gilts' in the 19th century, a name that came from the gilded edges of the certificates that were issued to investors.

Pension schemes have been investing in gilts for more than 100 years, and while they are no longer the biggest buyers of the asset, it is nonetheless a relationship that could be described as co-dependent. Certainly, as with all relationships, there have been a few ups and downs over the years, with perhaps the biggest bump in the road that previously mentioned 2022 crisis. Few will need to be reminded of Liz Truss and Kwasi Kwarteng's mini Budget, with its proposal for billions in unfunded tax cuts, which triggered the gilt crisis that shook the pension sector. The recent surge in yields has prompted concerns that there may be another drama on its way.

A long-term relationship

Pensions have traditionally depended on gilts and other government bonds as a kind of stabiliser for their portfolios. Today, defined benefit (DB) and defined contribution (DC) pension schemes both use gilts, with slightly different goals in mind. Russell Investments' associate director, EMEA, Aqib Merchant, explains: "For DB schemes, the primary use of gilts is to match and hedge liabilities across schemes. They use gilt exposure either directly, through buying gilts, particularly for larger schemes, or by using pooled funds, which is more common for smaller to medium schemes." Using gilts in this way is particularly effective when interest rate and inflation expectations change, Merchant says.

For DC, the principle is similar, he says, but the timeframe is different. "Gilts start to appear as members edge closer to retirement," says Merchant. "So, if you think of someone saving from age 20-something, most default strategies will not have gilts in them on day one. At that stage, it will be about how you can get maximum returns over the next couple of decades through equities, through multi asset investments. But as you get towards retirement, the last five to 10 years, potentially even 15 years in some instances, default strategies start to pivot towards small allocations of gilts or

bonds, and particularly gilts, [with this element] growing as they get closer and closer to retirement."

Unfinished business?

Of course, the drama of 2022 is still fresh in the minds of pensions professionals, so it's no wonder that investors get nervous at the prospect of another like it happening today. Climbing fuel and energy prices and an expectation that high levels of inflation are here to stay pushed up yields to the highest levels in decades in September. Headlines shouted about the risks of a new crash, and *The Daily Telegraph* wrote of "Truss warnings" coming from Bank of England, while opposition leader, Kemi Badenoch, called on Andy Burnham not to repeat the errors of her predecessor.

The movements in the government bond market over recent months have indeed been sizeable, and not just in the UK. Marsh People and Investments UK chief investment officer, James Lewis, says: "Global government bond yields have risen materially through 2026. For example, the US 10Y yield has risen by over 100 basis points year to date." The reasons for this are multiple, but can be summarised as "higher oil prices, strong real GDP growth, sustained fiscal deficits, global bond supply and shifting demand for government bonds," he says.

Importantly, for Lewis, this is not purely and simply about a volatile market – instead, higher yields are a sign that things have shifted more substantially. "We think that bond yields have moved to a new regime since the pandemic to a range more in line with the pre-global financial crisis period and neutral rates may have moved higher in recent years," says Lewis.

A new normal

Indeed, Merchant, argues, today's situation is very different from that experienced in the 2022 crisis. "The difference [then] was that, because [yields] grew really rapidly, everyone was concerned, and there was a sort of systemic risk," he says. "But now, they've been increasing gradually over the past couple of years, so while it's true to say that yields have been high, I don't think they've been too volatile. They've just been high."

He continues: "We now must accept that we have left that low gilt yield environment that we saw in the 2010s. We're no longer in that. I think it's that acceptance that, even if inflation is to come down, even if some of the political uncertainty starts to reduce, yields will remain at higher levels than in the past that we've seen in 2010, I think that's the key. It's a new normal world that we live in; these yields might settle down to a lower level, but not as low as what we were seeing in 2010."

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Lewis agrees: "What we have seen is a significant repricing of rates and bonds after an extended period of unusually low yields. That is not the same as a systemic breakdown. The more relevant issue for pension investors is whether portfolios are robust enough to withstand continued volatility and whether they are positioned to take advantage of the new rate environment," he says.

That does not mean today's steep yield increases will not affect pensions, of course, but there may be positives as well as negatives. Lewis says: "The impact depends on the investment strategy being pursued. For mature corporate DB plans who are typically fully hedged on interest and inflation risk the movement in yields has simply reduced the size of the balance sheet. For schemes in surplus who have hedged the liabilities rather than limiting hedging up to the level of assets they are seeing funding level gains as a result. For other schemes who decided not to fully hedge they will see funding/leverage improvements, all things being equal, when gilt yields rise."

Indeed, there are notable advantages to be found here, Lewis says: "Over the past four to five years, for many pension schemes, higher gilt yields, allied to strong performance of growth assets, have created opportunities to hedge, to lock in gains, derisk further, or reconsider the balance between matching assets and return-seeking assets. But it also raises the stakes around liquidity, collateral, and portfolio resilience, which is where strong governance and active oversight really matter."

The next phase

Today, even in an environment of high yields and shifting geopolitical sands, gilts remain a key part of pension portfolios. But the way in which they are used may be changing. Keyridge Asset Management head of fixed income, John Thornton, says: "We know yields are high, and that should mean good returns going forward from here; volatility may be a bit higher than we feel comfortable with. So that probably means that you end up wanting to invest in shorter date government bonds, maybe under 10 years, or five-year bonds, because our visibility of the world in 20 and 30 years is perhaps more challenged today than in the past."

This is, despite all the dramas, an enduring relationship. As Thornton says: "I think the political world is more complex now, probably, than at any time in living memory. That might change how gilts might perform an investment market, but it doesn't change the core fundamental role that they have in a portfolio."

Written by Sandra Haurant, a freelance journalist