# *ANOTHER* **VINTAGE YEAR** *FOR GILTS*

**Words** | Tom Croft

*Total returns from UK Government bonds, otherwise known as gilts, have continued to impress this year building on strong gains since the onset of the global financial crisis in the Autumn of 2008.*

While investor sentiment has constantly been undermined by events in the Eurozone and disappointing economic growth, those with an appetite for UK gilts have prospered outperforming most other asset classes during recent years. In fact, bonds in general have delivered remarkably good returns for a decade or more, outperforming equities in the UK by 2% per annum over the past 15 years, and with much lower volatility. This trend tracked a significant decline in the rate of inflation but slightly counter-intuitively also occurred at a time of huge increase in the supply of bonds as governments racked up ever greater long term liabilities.

More recently, a flight to safety coupled with a desire by Central Banks to keep long term interest rates below inflation have driven government bond yields to all time lows with 10-year gilts falling to just 1.41% in July. This return now appears unattractive when considering the strong reflation policies of western governments including strategies such as Quantitative Easing (QE) and 'Operation Twist' and this ultra accommodative monetary policy may encourage greater risk tolerance in the search for yield.

There has been extensive buying of corporate bonds which have much the same investment characteristics as government bonds although being issued by companies would suggest a greater risk of default. Corporate bonds will continue to look attractive in this low yield world although a lack of new issuance from higher quality issuers remains a drawback as does the prevalence of financial companies among short dated bonds. At times, active managers are better placed to spread risk across the bond markets (including high yield) and there are several reputable firms with strong performance records to choose from.

The very low returns now available from fixed interest stocks, including gilts, may lead to equity markets ultimately benefiting from a reallocation of assets seeking yield and long term real returns and in current market conditions global equities appear to be attractively valued. Many defensive sectors of the markets generate higher dividend yields than those currently available from the bond markets and it is perhaps informative that those stocks offering a store of value with a dividend stream are also providing market leadership suggesting investors are buying equities for the right reasons.

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