

What on earth just happened?

For stock market geeks like me, yesterday will likely go down in history as a memorable moment in the UK, akin to that of a 2008 crash moment - one which people will be talking about for decades to come.

What happened? It has all spun off Kwasi Kwarteng's "Mini Budget" which has proven akin to a fiscal hand grenade thrown into the UK bond market. UK Government bonds, under the triple threat of a massive increase in UK bond issuance to fund the energy price cap, further interest rate rises and quantitative tightening (that's the Bank of England selling back all of the bonds they have been buying off the government for the past 13 years [started in 2009, I think]) the UK Government debt market has tanked quite spectacularly (hence the hand grenade reference). To put the selloff in perspective, in the history of the UK Government bond market, the largest single sell off was -9%. September's sell off, as of Wednesday morning, from the highest point to the lowest, was down a touch over -30%. To call that a new record doesn't quite do the situation justice and it's chiefly why I have chosen to write a note explaining what's going on.

As almost everyone knows, the backbone of the UK's behemoth pension industry is UK government

bonds and on Wednesday morning it looked like there were some very large pensions funds about to tip into insolvency from the losses being inflicted on portfolios. This is what prompted the BoE to intervene.

Shortly after the market opened on Wednesday the Bank of England got wind of the potential implosion in UK pensions and stepped in swiftly to prop up the market and essentially save a large number of UK pension savers. This came in the form of the central bank halting quantitative tightening (selling the bonds they have been buying for the last 13 years) and recommitting to buying £65 billion worth of UK government bonds at £5 billion a day for 13 days. Essentially the BoE turned from quantitative tightening into quantitative easing in a matter of minutes to save the UK pension industry. This had the desired effect. The mainstream UK bond market bounced up over 7% with long maturity bonds rallying over 18%. The positivity spread over into the US with government debt rallying over 1% and US stocks also rallying nearly 2% on the news. Great for investor portfolios.

So how exposed were TAM's clients to this blockbuster volatility? TAM is a UK investor by nature and as such we have a natural exposure to the UK bond market but TAM clients remain nowhere near the fear which gripped the UK pension industry. It's worth reminding our clients that TAM is a cautious investor by nature which steps away from volatile markets. Befitting this approach, TAM's exposure in 2022 to UK bonds has been cut to some of the lowest levels we have ever owned - which is both a boon to our performance and a boon to protecting client portfolios during this volatility saga in which TAM was more of a spectator than a participant. TAM's exposure to UK government debt resides almost exclusively in longer maturity bonds the likes of which the BoE started buying yesterday and as a result our clients were able to enjoy being invested into that 18% rally we saw yesterday.

The intervention we saw yesterday was welcome but doesn't change our thinking when it comes to UK bonds and the UK economy. Economically it doesn't make sense to be pumping money into the bond market at the same time as you are fighting inflation. They are opposing forces which will further clobber the pound and create unwelcome volatility - which will then need more aggressive interest rate hikes to tame. It's a scenario which is simultaneously destroying the credibility of this government and of central bank at exactly the time as the UK population needs to be able to trust their leaders.

TAM has resisted the temptation to buy into the bond rally yesterday which many others started to. Chiefly because the uncertain backdrop in the UK doesn't warrant us investing clients capital into it at this time. As with all scenarios before this and the many still to come, its worth remembering that its darkest before the dawn and there will absolutely come a time for the UK to shine on both the bond and equity front and at this juncture TAM know what to invest into and in what size to capture the best value from the UK but we still see further uncertainty from here for UK inc.

If you would like to chat to us about anything in this note, or our discretionary investment management services in general, please get in touch with us today.

This document is not intended in isolation as an offer or solicitation or recommendation to use or invest in any of the services or products mentioned herein. Investors should be aware that the value of the portfolio and the income from it can go down as well as up so you may get back less than you invested. Past performance is not necessarily a guide to future returns. The value of investments denominated in foreign currency may fall as a result of exchange rate movements. The investments and services referred to in this document may not be suitable for all investors and, if in doubt, you should seek qualified independent financial advice. Any opinions, expectations and projections within this note are those of TAM Asset Management International Limited, represent only one possible outcome and do not constitute investment advice.

TAM Asset Management International Limited is regulated by the Financial Services Commission of Mauritius and is an authorised Financial Services Provider regulated by the South African Financial Service Conduct Authority.