



The Tatton Weekly

Challenged optimism

20 March 2026

This week's topics:

Escalation precedes de-escalation

China projects stability

Structural weakness in UK government debt

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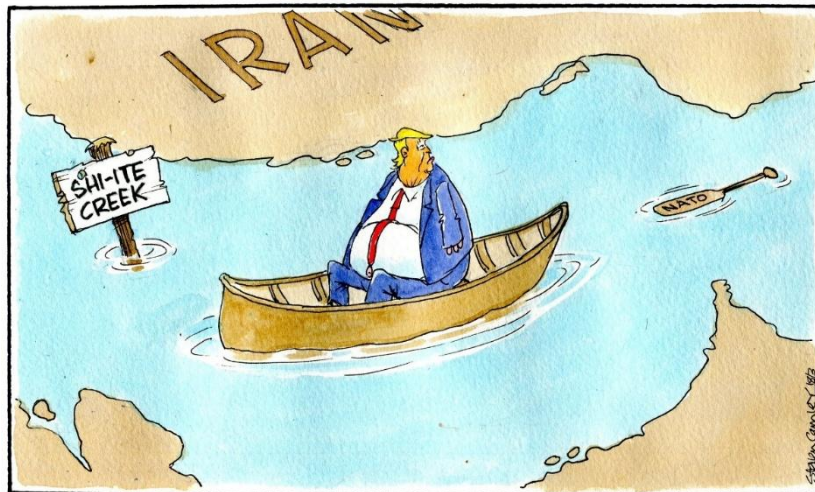
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Difficult manoeuvring, Steven Camley, 17 March 2026

Escalation precedes de-escalation

The Iran War keeps dragging down markets. Israel's strike on Iran's South Pars gas facility, followed by Iran's strike on a Qatari liquified natural gas facility – the largest in the world – saw crude oil spike above \$115 per barrel and European natural gas prices surge. The FTSE 100 dropped 2.3% on Thursday, and European stocks similarly fell. Escalation has forced markets to reconsider their optimistic view on the extent of the war. At the same time, though, we suspect these events have made de-escalation more likely.

The events have worsened market liquidity as geared investors had honour margin calls - which could become its own issue. As we write, energy prices are down from Wednesday's highs, but both equity and bond markets are struggling.

Israel isolating itself and Trump looking for an 'off-ramp'?

We wrote last week that, despite choking short-term oil supply, neither side of the war looked likely to destroy long-term oil and gas production. Cue the US attacking military targets on Kharg Island – through which 90% of Iran's oil exports flow. Tit-for-tat gas site attacks this week marked a more disruptive phase of the war for long-term global growth. Further escalation in this direction will panic markets even more.

President Trump threatened to "blow up" the South Pars gas field if Iran continued striking Qatari sites, but the subtext was that he disapproved of Israel's initial South Pars attack. Regardless of Israel claims that it coordinated the strike with the US, Trump clearly does not want Israel to attack energy infrastructure in a way that hurts the US' other Middle Eastern allies.

This backs up the narrative that Washington is looking for a way out of what they started. It is increasingly clear that Israel has its own objectives, which might conflict with the US, and with the Arab nations with which Israel had improved relations in recent years.

The US already has an incentive to de-escalate, and it might try to create an Israeli incentive to do the same. But incentives do not always turn into actions. This is a nervous phase for markets. Everyday without a resolution looks like a bigger threat to the world economy, rather than just a short term energy price push.

War hurts markets in unexpected ways

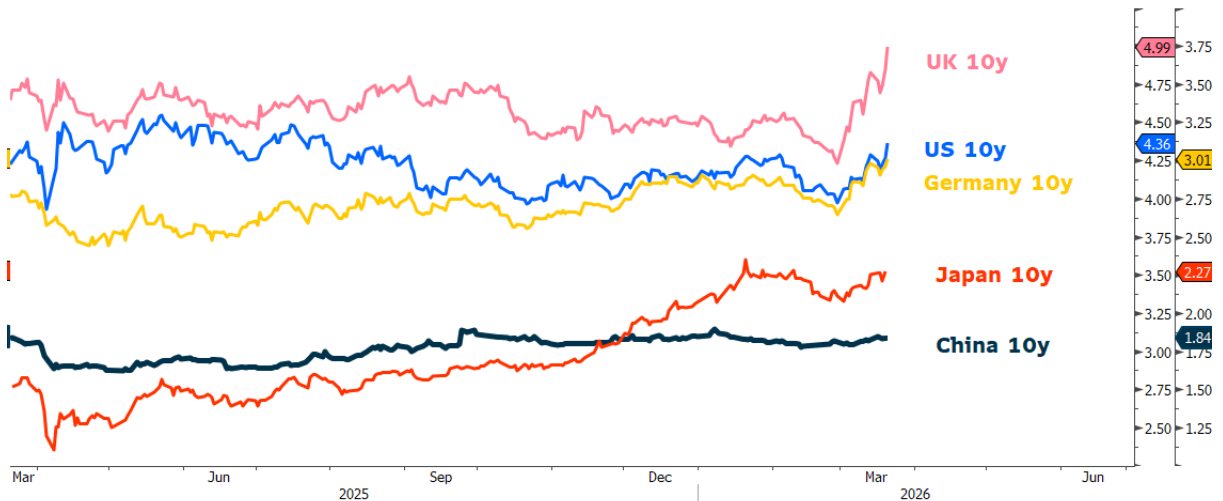
The fear factor is having strange effects on markets. Russia – one of the few clear winners from the oil shock – saw its currency drop this week. Energy import-dependent China saw its currency fall too, but similarly dependent Japan saw the yen rise.

Strangest of all was the significant fall in gold prices. Gold is the stereotypical ‘safe haven’, but prices have dropped more than 10% since the war started. Counterintuitively, this could be a signal of a need for liquidity. Central banks are signalling tighter monetary policy and people need cash right now. Gold may not appear currently to be functioning as a safe haven, and speculative traders who have put on leveraged positions will be wondering what is going on. However, many participants bought gold in the past months and years for just these periods of geopolitical shock. When they happen, the safe haven is there to provide cash liquidity – by selling it.

The bond market reaction has been understandable in some ways but perplexing in others. Government bond yields are rising to new highs – as you might in an inflation spike, but against what you would expect in a growth scare. The chart below shows the main 10-year government bond yields over the past year:

10-year yields

Japan simple yield, compound elsewhere



Source: Tatton IM, Bloomberg: G 2524
 .91282CPZ Govt (T 4 02/15/36) Global yield 10y 2axis Daily 20MAR2025-20JUN2026
 Copyright© 2026 Bloomberg Finance L.P. 20-Mar-2026 14:11:50

If investors were really worried about global growth, you would expect higher credit spreads (the difference between corporate and government bond yields), as private sector defaults become more likely. And yet, while US high-yield (non-investment grade) credit spreads are ending the

week towards recent highs, they are not wider than last week. European credits have widened more, consistent with worries that European growth will be harder hit.

Nevertheless, credit markets were under pressure before the beginning of March. Some of the weaker holders (generally those that are more leveraged) seem to have been squeezed out ahead of the shock.

Central banks signal tighter policy, less liquidity

The war overshadowed some important central bank meetings. There were no interest rate changes from the Federal Reserve, the Bank of England (BoE) or the European Central Bank (ECB), but all issued inflation warnings about energy prices. The BoE's committee voted unanimously to keep rates steady, and even talked about potentially raising them. But we suspect this messaging is more about managing inflation expectations than signalling future policy.

The BoE will have welcomed February's labour market report. Wages are rising marginally, with little sign of a wage-price spiral. Unfortunately, the oil shock makes past data basically irrelevant.

The same is true in the US. February's producer price inflation showed a surprising increase in the services sector, suggesting that, even before the war, the US economy was more inflationary than expected. The Fed's dots plot (monetary policymakers' rate expectations over the next few years) suggests one rate cut this year – just about – but its inflation forecast moved up. Chairman Powell is signalling that, since the Fed does not know what will happen with the war, the best he can do is project stability.

The risks have increased, and both near-term supply and demand have weakened. At the same time, central banks are not signalling any monetary accommodation – the opposite, in fact. That effectively means that short-term liquidity is being squeezed. Even if the geopolitical outlook improves, the liquidity squeeze alone will make things difficult for markets into the quarter-end.

However, the underlying global growth picture gives reasons to be hopeful for what comes after the shock. Despite the hits on energy infrastructure, the world's potential energy production is not yet significantly impaired. Should that remain the case after this conflict passes, supply will resume while most regions will want to invest in closer (and probably renewable) energy sources. That could well reverse the current stagflationary dynamic from the war: more growth potential and less inflation risk – a hopeful outcome from a difficult situation.

China projects stability

China's grand policy showpiece ended earlier this month. This year's National People's Congress (NPC) unveiled the first official unveiling of the 15th Five-Year Plan, guiding economic policy until 2030. The headline news was a lowering of China's growth target from "around 5%" to 4.5%-5%, its lowest level since 1991. That is a recognition of weakness in the world's second-largest

economy – but it is also part of Beijing’s shifting strategy. As China matures, economically and politically, it increasingly presents itself as a stable global partner. That seems to be working.

Beijing wants consumer spending and tech dominance

The 4.5%-5% range basically means China will target 4.5% GDP growth for the next five years. That is significantly below previous growth targets, but 4.5% growth in the world’s second-largest economy is still a very substantial expansion. If China reaches that target despite its declining population and plateauing urbanisation (one of its historic growth motors) policymakers will rightly consider it a success. Premier Li Qiang was unusually upfront about the country’s “deep-seated structural problems”, acknowledging “domestic difficulties and tough policy choices,”

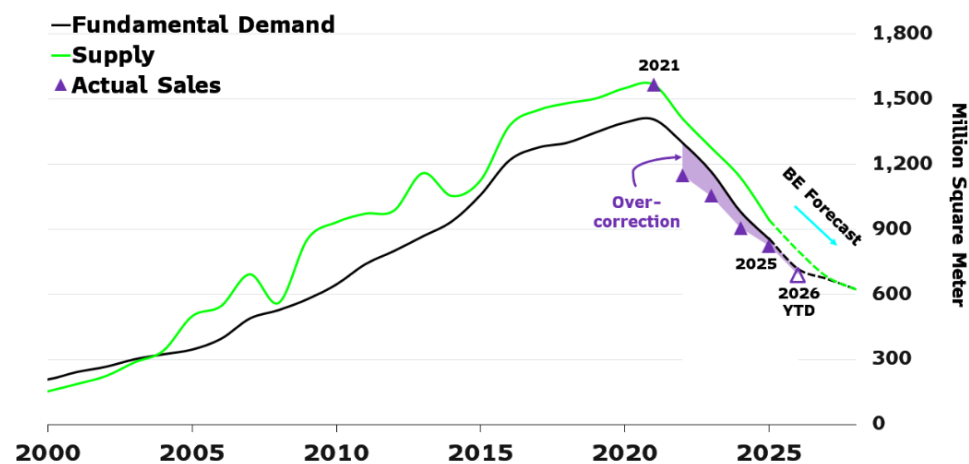
There was a recognition from policymakers at the NPC that the government needs to better stimulate domestic demand, encouraging consumers to spend more and save less. A ¥100 billion “fiscal-financial coordination fund” will be set up to boost demand through loan interest subsidies, guarantees and risk compensation. That is despite keeping the national budget deficit capped at 4% of GDP. Monetary policy will be kept “appropriately accommodative”, which most assume means interest rate and reserve-requirement-ratio cuts are coming.

Along with supporting consumer demand, the next five-year plan doubles down on China’s technological development. The NPC committed to growing research and development spending by over 7% annually, outpacing the 4.5% overall growth target. Beijing is pushing hard to integrate AI systems into every section of its economy, from manufacturing, logistics, healthcare and education, as part of its “AI+” initiative.

How much demand can the party actually bring?

Since Beijing signalled fiscal stimulus in September 2024, we have often doubted the communist party’s commitment to genuinely boosting Chinese consumer demand – possibly due to Xi

Housing Likely to “Halt the Declines” By 2027



Source: NBS, United Nations World Population Prospects, Bloomberg Economics

Jinping's personal aversion. We no longer doubt that commitment, but there are still big question marks around policymakers' *ability* to truly stimulate demand. Beijing's classic growth response is to push industrial production, but that has only worsened the oversupply. Pumping R&D spending could have the same result, if the government does not address the underlying problem of excessive savings curtailing consumer spending.

Consumers should at least be helped by the fact that the property market overhang (properties paid for but unbuilt) is finally clearing up. Prices are still falling due to previous overinvestment in construction and resulting oversupply, but Bloomberg estimates that the adjustment could be finished by next year.

There could also be a silver-lining for consumer demand: years of property market stagnation have lessened the sense that property is the best vehicle for savings – which, strangely, could result in less saving and more consumer spending.

There are also slow improvements for company pricing power, after years of overproduction. That has led to a pickup in industrial profits, which should feed back into wages and spending. Beijing's fiscal support is a welcome addition to this mix, but we should be careful not to overstate it. There has been an increase in central government debt and spending, but much of this seems to be local governments offloading their 'shadow loans' onto the central government. Capital Economics labelled Beijing's additional fiscal support "timid".

Strength through stability

The overarching feeling we get from China's new five-year plan is stability. Beijing wants to support its weak economy and ailing consumers, but there is no sign of the 'bazooka' support of previous eras. Policymakers want to keep monetary policy supportive, but they do not want a repeat of the 2010s credit bubble, and so will not encourage a massive expansion of debt.

That fits nicely with the way Beijing is presenting itself on the international stage – as a stable and reliable trade and diplomatic partner, compared to an increasingly erratic US – the 'only adult in the room' amongst the superpowers. The communist party keeps talking up threats against Taiwan, but there is no sign that it will use the Iran War as an opportunity to invade the island.

Part of this stability is the strength of the renminbi. We wrote recently that Beijing has guided its currency stronger against the dollar over the last year as a way to increase political status, rather than boost its economy. That is still true to an extent, but it is now becoming increasingly clear that the previous pressures on the renminbi to fall have gone away. Chinese citizens are no longer as concerned with moving their money abroad, and international capital appears to be flowing in.

Currency strength has helped Beijing's image rehabilitation. A stronger renminbi lessens deflationary pressures emanating from China, meaning fewer accusations of 'dumping' from the West. All of that helps China attract capital inflows, which support its markets in the medium-term. Beijing will want that positivity to continue.

Structural weakness in UK government debt

UK government bond yields have been hit hard by the Iran War. As of this Friday afternoon (20th March), the 10-year yield has moved above 5%. Sharply higher oil prices have pushed up global inflation expectations, pushing up bond yields everywhere. But UK bonds (gilts) have once again fared worse than most major markets, due to a perceived sensitivity to changes in inflation expectations. This perception means gilts often trade at a discount to other bonds, and hence the government has to pay more than its peers (bond prices being the inverse of yields). The reasons behind this are not as simple as prevailing commentary often suggests.

The gilt market has a term structure problem

The gilt market today is fragile. For years, it was dominated by large pension funds who, for historical regulatory reasons, tended to buy gilts with long maturities. In previous decades, this imbalance compressed yields on very long-term gilts (maturities of over 20 years) and, in response, the government issued much more long-term debt than short-term. Quantitative easing (QE) after the 2008 financial crisis – and again during the pandemic – added to that long-term issuance. That is why the UK has one of the highest weighted average maturities on its outstanding debt among advanced economies.

Long-term gilts were particularly useful for defined-benefit pension schemes but, as they were gradually replaced by defined-contribution schemes, pension funds started reducing their stock of long-term gilts. That led to a shortfall of demand for long-term gilts which, along with the end of QE, set the scene for the infamous ‘Liz Truss Mini-Budget episode’ in 2022. The gap between gilt yields and other major markets shot up and never fully recovered after that, largely because the underlying imbalance still exists.

With a shortfall of demand for long-term debt, the government’s natural response was to issue more of its debt in short-term gilts, where demand was more in line with supply. But short-term debt needs to be refinanced more often, so a knock-on effect in recent years has been a greater refinancing risk for the government. That makes government finances more sensitive to short-term interest rates – and hence inflation. Markets recognise this, creating a circular accelerator to yields, as markets price in the UK’s double whammy.

How inflation-linked is an inflation-linker?

The other major reason why gilts are particularly sensitive to inflation is because so many of them are inflation-linked. The UK was one of the first developed countries to issue inflation-linked bonds, which pay a fixed coupon on a principal that increases in line with the retail price index (RPI). Inflation-linked gilts now account for around a quarter of all the UK’s outstanding debt – significantly more than other countries. More of our debt payments are inflation-linked (and specifically RPI-linked, which tends to be higher than CPI) so the UK is more sensitive to inflation.

That being said, the feed through from inflation to inflation-linked bonds is complicated. If for example, the oil shock pushes 2026 inflation up to 3%, when it was expected to be 2%, the future principal repayment of the bond will increase accordingly – and the amount the government pays in 2026 will be an inflation-linked percentage (usually 0.5%-0.8%) of that adjusted principal. In other words, the extra amount of cash the government pays in 2026 will be small, and the total increase in cash payments over the lifetime of the bond will be smoothed out.

However, the Office for Budget Responsibility (OBR) records the total increase in payments for life of the bond as an increase in debt interest payments in the year the inflation spike happens. So, an inflationary oil shock in 2026 would be recorded, in the OBR accounts, as a massive increase in UK debt repayments – even though only a fraction of those payments occur in 2026. That means that reported debt interest spending can be extremely volatile in response to inflation.

Volatile perceptions mean volatile gilts

That volatility increases the perception that UK finances are fragile, and that perception can make gilts vulnerable. The UK's actual debt-to-GDP and deficit-to-GDP metrics are not any worse than most major economies; in fact, the Institute for Fiscal Studies thinks the UK has relatively favourable underlying debt metrics.

Now, we deliberately have not mentioned any perceived flaws in government economic policy – but those flaws are usually what gilt pessimists use to justify gloomy predictions. It does seem like the risk factor for gilts (how reliable a borrower the UK government is) is more sensitive to inflation than in other countries. That might be because investors think the UK government will spend more than others – on social support or defence – in response to higher energy prices, for example.

That story makes sense in isolation, but less so when you compare likely UK policy to France or Japan – whose bond yields have had smaller swings lately. And in any case, Britain's tax revenues are also highly sensitive to inflation: higher goods prices means higher VAT revenues, and even a dreaded 'wage-price spiral' means higher income tax revenues.

All that to say, the underlying debt, growth and inflation dynamics would suggest that gilts are cheap, compared to similar bond markets. Before the Iran War, international investors were starting to agree, leading to a fall in gilt yields relative to the US and Europe. The oil shock has reversed that trend but, if things settle down, you would expect gilts to come more in line with US and European bonds in the medium-term. Undoubtedly, though, investors think gilts are fragile.

Global Equity Markets		20-Mar		Technical		Valuations			
Market	Level	% 1 Week	% 1 Week (GBP)	Short Medium		Div YLD %	LTM PE	NTM PE	10Y AVG NTM PE
UK FTSE 100	9939	-3.4	-3.4	↔	↔	3.2	14.5	13.1	12.8
UK FTSE 250	21313	-3.8	-3.8	→	→	4.1	12.5	11.1	13.4
UK FTSE All-Share	5322	-3.4	-3.4	↔	↔	3.3	14.2	12.9	12.7
FTSE Small x Inv_Tsts	6014	-4.3	-4.3	→	↔	4.6	18.8	10.4	10.0
EU STOXX ex UK	727	-3.9	-3.6	→	↔	3.1	16.8	15.0	15.1
France CAC 40	7689	-3.2	-2.9	→	→	3.4	16.8	14.6	14.1
Germany DAX 40	22443	-4.5	-4.2	→	→	2.6	16.8	14.5	13.3
US S&P 500	6548	-1.7	-2.4	↘	→	1.2	23.8	19.9	19.0
US NASDAQ comp	21816	-1.9	-2.6	↘	→	0.6	33.9	23.4	26.1
Japan Nikkei 225	53373	-0.8	-1.2	↗	↗	1.5	22.1	21.9	18.5
World Bloomberg	2285	-1.8	-2.5	→	→	1.7	20.7	17.3	16.6
China Bloomberg	1301	-2.8	-3.7	→	→	2.2	14.2	12.3	12.5
Emerging Bloomberg	1587	-1.0	-1.7	↗	↔	2.3	16.8	12.1	12.5

FTSE100 Top 6		S&P Global Top 6		(GBP terms)		Global Sectors		(GBP terms)	
Company	%	Company	%	Sector	%	Sector	%		
Diploma	+13.4	Equinor	+19.1	Tech	-1.4	Staples	-4.2		
BP	+5.7	Ciena	+14.4	Financials	-0.9	Energy	+3.1		
Shell	+2.2	Mitsui OSK Lines	+13.6	Health	-3.1	Materials	-5.9		
Hikma Pharmaceuticals	+2.2	Diploma	+13.4	Discretionary	-3.0	Utilities	-3.3		
Sage	+0.8	Aker BP	+12.0	Industrials	-2.6	Real_Estate	-3.3		
Hiscox	+0.7	APA	+12.0	Communicati	-2.4				

FTSE 100 Bottom 6		S&P Global Bottom 6		(GBP terms)		Fixed Income		
Company	%	Company (GBP terms)	%	Govt bond	%Yield	1 wk chg		
Fresnillo	-11.7	Super Micro Computer	-27.7	UK 5yr Gilt	4.62	+0.28		
Barratt Redrow	-10.9	Mosaic	-17.1	UK 10yr Gilt	5.02	+0.19		
Antofagasta	-10.6	Wheaton Precious Metals	-16.7	UK 15yr Gilt	5.37	+0.16		
National Grid	-9.9	Northern Star Resources	-14.9	US 10yr Treasury	4.39	+0.10		
Smiths	-9.9	Kinross Gold	-13.7	France 10yr OAT	3.75	+0.08		
Endeavour Mining	-9.7	Agnico Eagle Mines	-13.7	Germany 10yr Bund	3.03	+0.05		
				Japan 10yr JGB	2.27	+0.02		

Currencies			Commodities			UK Mortgage Rate Estimates		
Pair	last	%1W	Cmdty	last	%1W	Rates (LTV c.75%, no fee)	20-Mar	18-Feb
USD per GBP	1.331	+0.4	Oil Brent \$:bl	109.90	+9.3	UK BoE base rate	3.75	3.75
GBP per EUR	0.867	+0.3	Gold \$:oz	4565	-9.4	2yr fixed	4.30	3.91
USD per EUR	1.154	+0.7	Silver \$:oz	69.52	-13.8	3yr fixed	4.45	3.95
JPY per USD	159.12	-0.2	Copper \$:lb	537.3	-7.3	5yr fixed	4.42	3.95
CNY per USD	6.905	+0.1	Alumnm \$:mt	3290	-6.5	10yr fixed	4.90	4.52
USD per Bitcoin	69,732	-3.7	Agriculture BBG	57.04	+1.0	Standard variable	6.62	6.62

Prices taken levels at 14:45 where possible

LTM PE is the index price as a ratio of last 12 months earnings. NTM PE is next 12 months earnings.

Mortgage estimates are derived from sterling swaps markets and moneyfacts.co.uk

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Lothar Mentel

