# What we got right... and where we missed

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## Rates & cash

**2025 delivered on the big calls: rates fell, inflation eased but stayed sticky, and central banks continued cutting. Yet, the pace of disinflation lagged expectations, exposing the resilience of global demand and the willingness of consumers to absorb higher costs. This stickiness now limits how far central banks can go – a critical question for 2026.**

Issuance dynamics are shifting. After a surge in long-dated supply early in the year, the fourth quarter saw a sharp pullback as governments acknowledged the unsustainable cost of locking in high yields. You can now expect a glut of short to medium-dated issuance ahead, with curve flattening likely as long supply remains constrained.

Looking forward, we think inflation should grind lower, but growth risks loom. Central banks are nearing the end of their easing cycles, and any uptick in unemployment or wage weakness could unsettle risk assets. For investors, the environment demands flexibility: global diversification, active curve positioning, and inflation hedges will be key. Opportunities lie in global sovereign strategies and index linked bonds – not just to weather volatility, but to exploit it.

## Did we get it right?

We began 2025 expecting policy rates to fall and inflation to ease but stay sticky – and that broad call held. Major central banks moved further into their easing phases, while inflation moderated from its peaks without returning to pre pandemic norms.

Where we misjudged was the pace of disinflation in the second half. The global economy proved more resilient than consensus, with wage dynamics and protectionist trade policies slowing the descent of core inflation. The International Monetary Fund's July update framed the growth backdrop as "tenuous resilience" with inflation drifting down but still above target in key economies, particularly the US.

This stickiness matters: as long as underlying inflation hovers above neutral, policy space for deep cuts is limited. That's why 2025's easing moves by the US Federal Reserve, European Central Bank and Bank of England came with heavy caveats about the path ahead. The Fed delivered back-to-back 25bps cuts in September and October but explicitly pushed back on the idea that December easing was "a foregone conclusion," and it announced quantitative tightening (QT) would stop, a liquidity signal as much as a policy one.

The question for 2026 is whether inflation proves mostly transitory from here or evolves into a structural issue driven by tariffs, fiscal looseness and supply-side frictions. That debate will define rates, term premia and cross market relative value next year.

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## Issuance: the elephant in the room

Sovereign borrowing remained enormous through 2025, pushing debt to GDP ratios higher and increasing the share of budgets devoted to interest costs. The OECD's Global Debt Report flagged record sovereign issuance and a marked rise in interest to GDP across much of the OECD. When supply is heavy and inflation uncertain, term premia re-price as investors demand more compensation to hold the long end. We saw that drama play out most clearly in the UK, where the Debt Management Office (DMO) executed an "important shift" away from long-dated issuance in March and April, cutting the long bucket to its lowest share in about 35 years and redirecting supply toward the front end and UK treasury bills.

Markets welcomed the signal that selling 15-year and longer duration at yields above likely nominal growth is not a sustainable funding strategy. By the fourth quarter, that stance was even more visible in primary calendars. The DMO's revised 2025/26 remit kept overall gilt sales near £299bn but trimmed long-dated supply and boosted short and unallocated buckets to maintain flexibility – a clear attempt to flatten curves at the margin by easing long end supply pressure.

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## More of the same, or a turning point?

Lower inflation and more rate cuts are likely in 2026, but the path won't be smooth. The Fed cut 50bps across September and October, bringing the target range to 3.75–4.00%, and halted QT from 1 December; a liquidity pivot that matters for term funding. The ECB held steady in the fourth quarter after earlier cuts, citing "broadly unchanged" inflation risks, while the BoE eased twice but warned on sticky services inflation.

The first US hurdle into winter is the aftermath of the shutdown. The Senate backed deal to end the record long shutdown reaffirms back pay for federal workers and unwinds reductions in force (RIFs); once the House vote and presidential signature complete the process, back pay should flow "at the earliest date possible" under the 2019 law. Whether households spend or save those lump sums will matter for consumption momentum.

Meanwhile, labour dynamics bear watching. If unemployment ticks up and wage growth cools while tariffs keep goods prices sticky, we could face a tricky mix of softer growth and persistent inflation, forcing slower, stop start easing cycles and renewed dispersion across countries.

## Yields on the move: Where do investors go?

Government bond yields fell from their mid year peaks as the market priced a slower growth glide path and the end of QT, but moves were uneven across the curve and regions. In the US, the curve oscillated between 'bull flattening' (front end leading on cuts) and 'bear steepening' (long end leading yield increases) driven by term premium rebuild, fiscal supply and tariff risks. Strategists highlighted that in cutting cycles the curve often steepens, but today's mix of policy, fiscal and trade uncertainty makes the path jagged.

In the UK, long yields briefly traded at levels last seen in the late 1990s before retreating as the DMO curtailed long supply. The DMO's pivot, plus the BoE's measured easing, has nudged investors to re assess duration and the balance between short strategies and all maturity exposures.

In our view, the message is straightforward: you should look to diversify interest rate risk. Concentrated single country funds leave you exposed to one macro call, whether it is the US term premium or UK issuance, and to local policy pivots. A global, active approach can rotate across curves, regions and relative value expressions, targeting disparate sources of alpha.

Elsewhere, investors should consider global index linked exposure. With sticky services inflation and tariff uncertainty, short to intermediate linkers have outperformed at points this year as inflation accruals and high real yields did the heavy lifting. Allocations to linkers can hedge upside inflation surprises while adding diversified duration.

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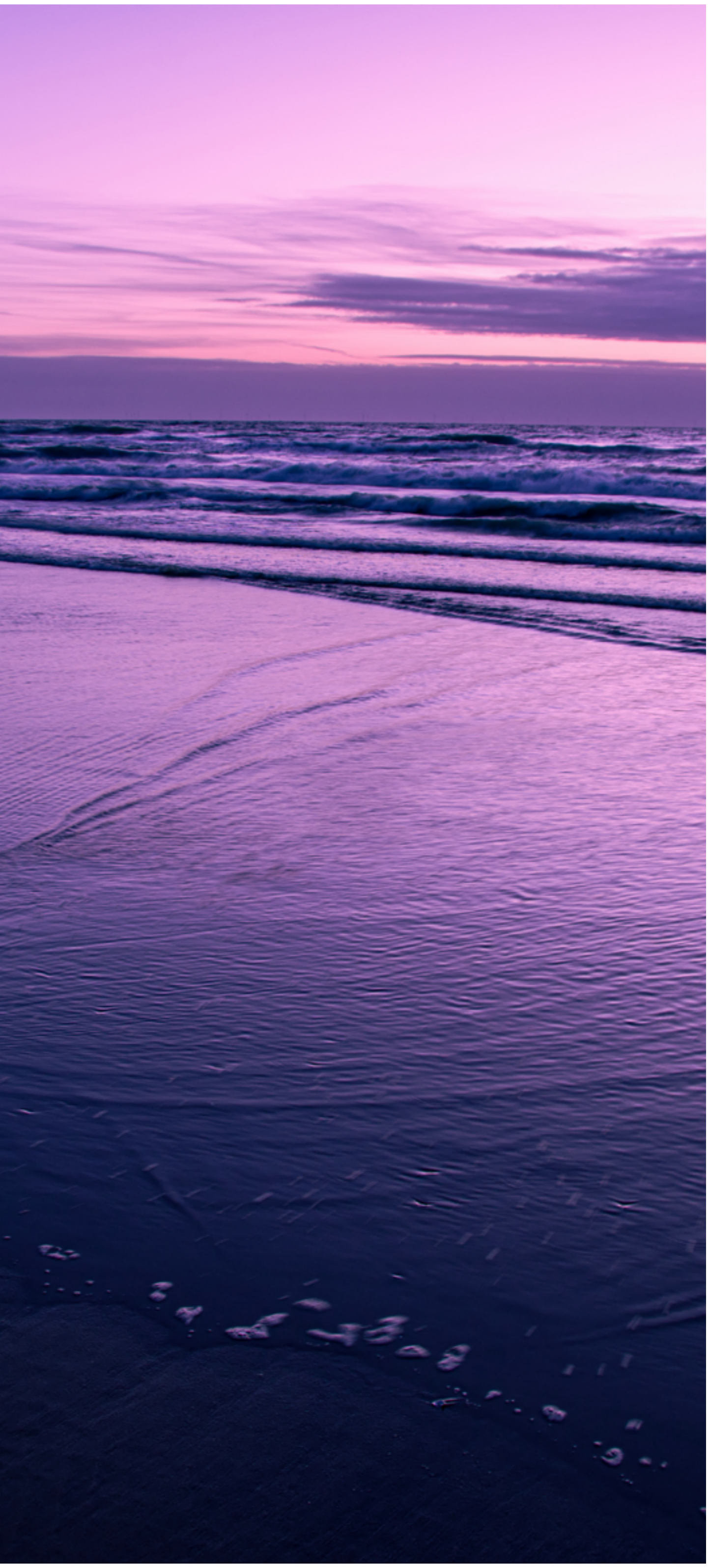

## What we're watching into 2026

Simple, the labour market. The uptick in the unemployment rate will be of concern to the UK and US. If this begins to break the 5% level materially, we could see some more urgency on rate cuts.

There is inflation's 'last mile' to watch. The IMF and private sector forecasts see headline inflation drifting down, but core (especially services) and tariff pass through keep risks two sided. Whether the stickiness proves cyclical or structural will determine the depth and pace of further cuts.

The issue of fiscal issuance and discipline will also need to be monitored. Where treasuries emphasise short end over long end supply and communicate consistent frameworks, curves should flatten and volatility should moderate, with the UK offering a real time case study.

And finally, geopolitical posturing is worth watching. European budget concerns in France, continuing tariff tensions and trade talks in the US, as well as underlying global conflicts will continue to create volatility for both risk assets and sovereign bonds.

## One thing Is certain

The next 12 months will not be quiet. Investors who embrace flexibility, global diversification, and active management across curves and instruments should be best placed to navigate, and capitalise on, volatility across rates, inflation, and policy regimes. In our view, the right mix is a globally diversified government bond core, selective index linked exposure, and the ability to lean into relative value when issuance, policy and liquidity regimes create dislocations.

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