

Testing the Waters: Sterling Credit Remains Anchored Despite Political Waves

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A consequential shift in the UK political backdrop defined the British Summer, as Andy Burnham succeeded Keir Starmer as Prime Minister on 20 July, pledging a “circuit breaker for Britain.” Burnham’s agenda of reindustrialisation and putting “life’s essentials back under stronger public control” has reset the risk calculus for regulated sectors, particularly the water sector, where Burnham has openly favoured public ownership. Yet the market reaction landed almost entirely in gilts, not in credit.

Market review

The gilt market has been highly sensitive to political risk and bore the brunt of the recent headlines. Thirty-year yields pushed higher to 5.91% as of 11 September, while the 10-year sits near 5.34% and the two-year at 4.81%. The drivers remain fiscal and technical (a restored term premium, elevated issuance of roughly £275–300bn annually and recurring political catalysts) rather than anything to do with corporate fundamentals. This is a rates story, and it continues to be a volatile one.

Sterling credit has told a different story. The combination of strong corporate fundamentals, reasonable valuations and supportive technicals has kept credit resilient in the face of political and geopolitical risk. The Bloomberg Sterling Aggregate Corporate index posted an option-adjusted spread (OAS) of 88 basis points (bps) as of 11 September, only five bps wider than where we started the year, while the 10-year gilt moved 87 bps higher. Over the trailing twelve months, realised gilt-yield volatility has run roughly five times that of sterling investment-grade (IG) spreads (Exhibit 1). Credit technicals have provided remarkable support as relentless demand from buy-and-maintain/fixed maturity mandates, insurer bulk-annuity flows and LDI real-money continues to anchor spreads.

AUTHORS



SHANE MCNAMARA
Associate
Portfolio Manager



DIPEN PATEL
Portfolio Manager

Viewed over the full cycle (Exhibit 2), the contrast is stark. Spreads have compressed from the ~260 bps peak during the autumn 2022 mini-budget/LDI crisis (peak 13 Oct 2022) to today's 88 bps, absorbing successive gilt sell offs with only a handful of short-lived widenings. Crucially, credit was flat-to-tighter even as gilts sold off into the leadership change. We expect this resilience to persist and believe the forces driving gilt volatility, including fiscal supply and term premium, differ largely from the technical and fundamental factors anchoring credit spreads.

There are idiosyncratic risks in the credit market, however. The clearest risk sits in UK water. Thames Water continues its restructuring saga as the senior-creditor rescue plan would write off roughly £9.4bn of debt and inject

approximately £3.35bn of new equity, with a "golden share" now proposed to government. But the company has warned it could exhaust liquidity by November without a deal, leaving the Special Administration Regime (temporary nationalisation) a possible outcome. Burnham's stated preference for public ownership increases that tail risk. We view this as an idiosyncratic and highly dispersed problem, specific to Thames and to stressed capital structures. However, the sentiment around UK water remains negative, and recent headlines about a legally binding gearing cap of 55% have deepened feelings.

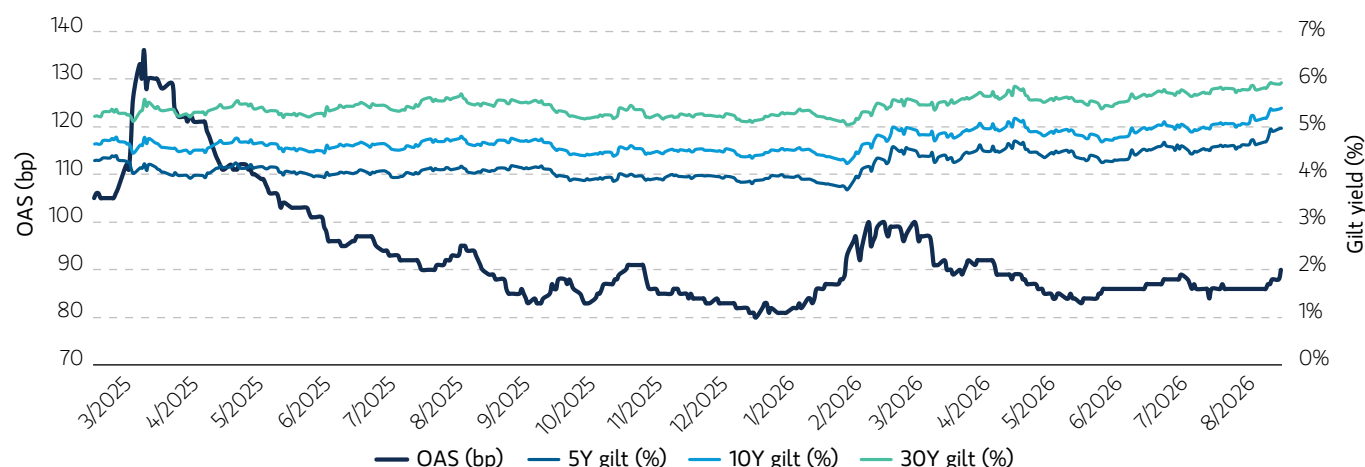
Sterling credit offers a compelling investment opportunity: strong fundamentals, high starting yields and resilience that gilts have not shown.

DISPLAY 1

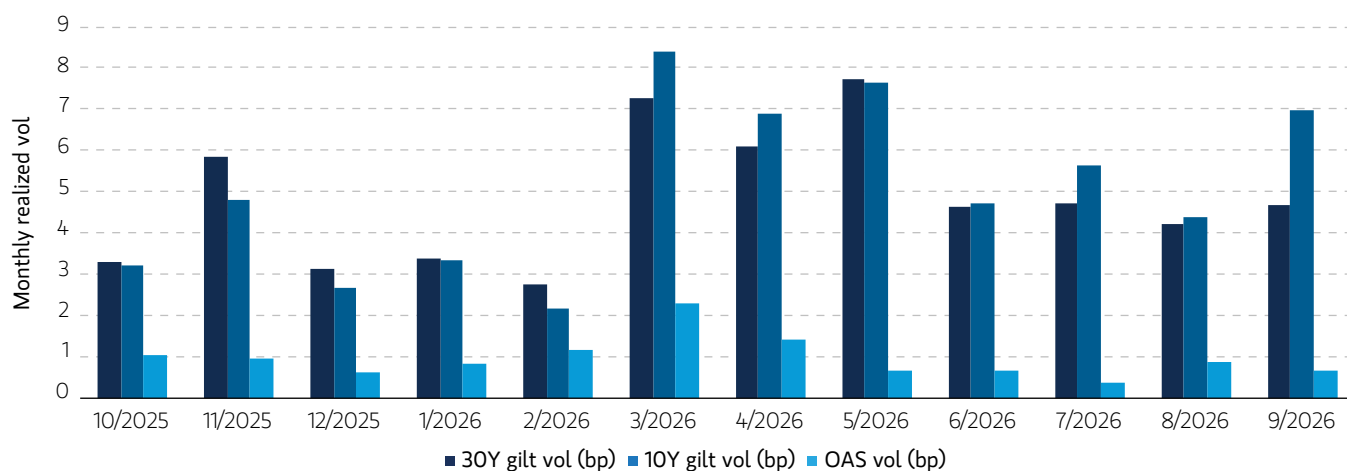
Rate vs. spread volatility—spreads range-bound as gilts whipsaw

Spreads have stayed range-bound while rate volatility has run roughly 5x higher

SPREADS GROUND TIGHTER WHILE GILT YIELDS WHIPSAWED HIGHER



RATE VOLATILITY HAS DWARFED SPREAD VOLATILITY EVERY MONTH

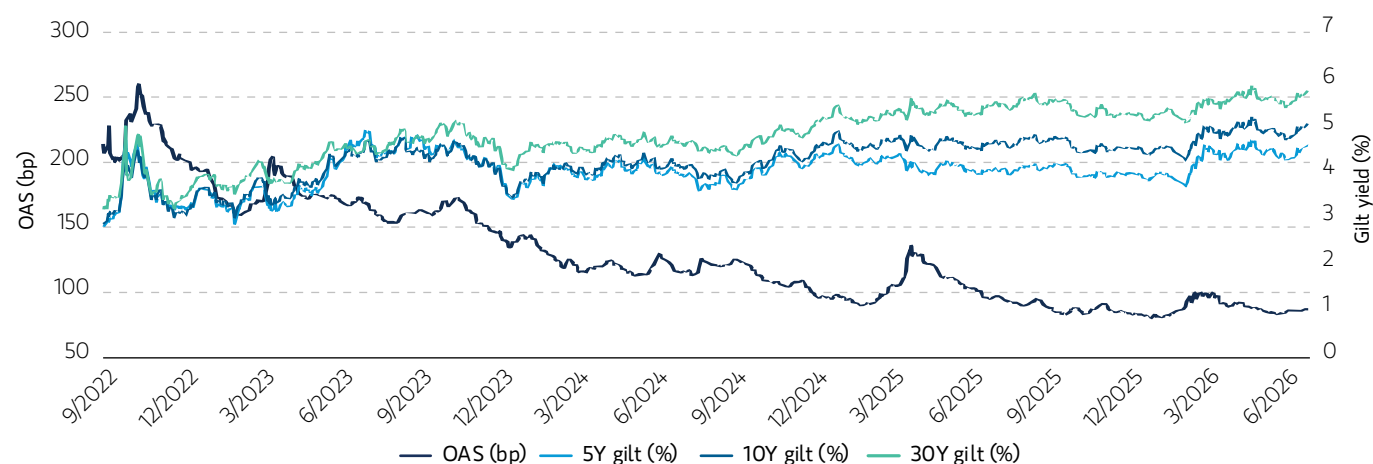


Source: Bloomberg as of September 2026. Monthly volatility = standard deviation of daily changes within each calendar month, in bps. Trailing-12m average: rate volatility $\approx$ 5x spread volatility. **Past performance is no guarantee of future results.**

DISPLAY 2

Sterling credit OAS vs. gilt yields

Credit spreads have ground tighter through every gilt sell-off since 2022



Source: Bloomberg (Sep 2022 – 11 Sep 2026). Credit OAS on left axis (bps); 5/10/30y gilt yields on right axis (%). **Past performance is no guarantee of future results.**

Sterling credit: positioning and outlook

STERLING INVESTMENT-GRADE CREDIT (CONSTRUCTIVE ON SPREADS)

We remain constructive on sterling IG spreads, as strong technical demand and robust corporate fundamentals underpin them. Financials and large, regulated utilities (ex-water) remain our preferred sectors to invest in with a preference for subordinated risk (tier 2s and corporate hybrids). We are highly selective on industrials as we see late-cycle, shareholder-friendly behaviour increasing (M&A, large capex, buybacks and dividends). We like heavy assets, low obsolescence (HALO) sectors including telecommunications, transportation and energy while remaining alert to AI-disruption risk to identify unfairly punished companies. We are also cautious on the hyperscaler and related space given the amount of capex they plan to finance over the next few years as the AI arms race heats up.

Looking forward, we expect returns to come from carry. We are underweight to spread duration as we view the opportunity for further spread compression to be limited. Given the strong fundamentals in corporates, we are long-credit risk measured by duration-times-spread.

UK WATER (UNDERWEIGHT, SELECTIVE VALUE IN HIGHER-QUALITY NAMES)

We remain underweight on the water sector overall, reflecting elevated political and regulatory tail risk and ongoing Thames headline risk. Within that underweight, we see value in the higher-quality, better-capitalised names with lower leverage and strong operational performance. We prefer taking risk at the operating-company level and avoiding stressed, complex or highly-levered structures such as Thames.

Regulatory pressure on balance sheets is also building at the sector level. The government is drawing up plans for legally binding debt limits, framing a company's gearing (net debt as a percentage of its Ofwat-determined regulatory capital value) against the notional approximately 55% assumption used in PR24. A legally binding limit may disincentivise additional equity injections at a time when large capex programmes need equity support. Sentiment around the water sector remains negative overall, and we remain highly selective.

REGULATED UTILITIES EX-WATER (SMALL OVERWEIGHT, WATCHING POLITICAL RISK PREMIUM)

While Burnham's "essentials under public control" rhetoric argues for a higher political-risk premium across the broader regulated utility complex, we expect the focus to remain on water in the near-term. The non-water utilities also operate well and have strong balance sheets. We are a small overweight for now given the attractive valuations in the space but alert to negative read-across should intervention rhetoric turn into policy.

FINANCIALS (OVERWEIGHT, STRONG FUNDAMENTALS AND ATTRACTIVE VALUATIONS)

Financials are the largest sector in the sterling index, and strong capital, benign asset quality and resilient net interest margins support them. We are overweight, with a preference for national-champion banks across senior and tier 2. The key tail risk to monitor is a windfall bank levy or tax from the government seeking to fund cost-of-living measures.

HYPERSCALERS AND AI-ADJACENT ISSUERS (UNDERWEIGHT, AI ARMS RACE WITH LOTS OF SUPPLY)

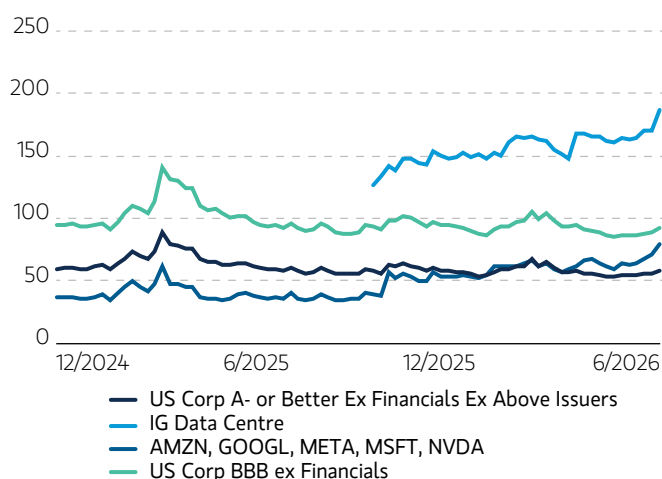
We are underweight the hyperscalers and AI-adjacent complex. As Exhibit 3 shows, public IG debt issuance from this cohort has stepped up sharply since 2025. Total volumes have risen from roughly \$20–48bn per year over 2020–24 to approximately \$135bn in 2025 and \$275bn in 2026, as data centre and large-technology financing drove the increase. We focus our concern on the volume and pace of supply. With AI- and infrastructure-related capital expenditure showing no sign of slowing, we expect these issuers to remain heavy, repeat borrowers across all major currency markets. What began as a predominantly U.S.-dollar phenomenon has broadened into EUR, GBP, JPY, CHF and CAD tranches.

DISPLAY 3

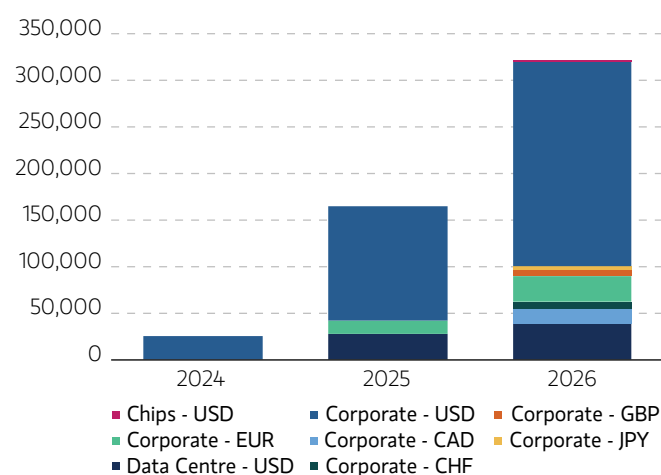
Public IG Debt Issuance & Spread Impacts

Hyperscalers and AI-adjacent issuers have driven a sharp increase in IG bond issuance since 2025

US IG - OPTION ADJUSTED SPREADS



PUBLIC IG DEBT ISSUANCE BY CURRENCY/TYPE



Source: Bloomberg; data as of 13 July 2026. Left: U.S. IG option-adjusted spreads, hyperscalers vs. broader A-or-better industrials. Right: IG bond issuance by currency / type (\$mn). This is for informational purposes only and does not constitute a recommendation to buy or sell any particular security. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**



What we are watching

The near-term risks to our constructive base case for spreads are:

- A prolonged conflict in the Middle East leading to higher oil prices and structurally higher inflation expectations
- The autumn budget and fiscal credibility under new Chancellor John Healey
- A disorderly Thames outcome or contagion into the wider water complex
- Explicit re-nationalisation signals across regulated utilities
- A windfall bank levy
- An increase in the size and pace of hyperscaler supply

In our view, sterling credit remains structurally more resilient and less volatile than the gilt market but requires an active approach to managing the risks listed above.

RISK CONSIDERATIONS

There is no assurance that any strategy will achieve its investment objective. Investing in companies in anticipation of a catalyst event, such as **AI adoption**, carries the risk that such catalysts may not occur, may be delayed, or that the market may react differently than expected. Companies focused on AI may have limited product lines, markets or financial resources, and their management and performance may be particularly impacted by events that adversely affect AI adoption, such as rapid changes in product technology cycles, product obsolescence, government regulation, cybersecurity concerns and competition. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Accordingly, you can lose money investing in a portfolio. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income.

Longer-term securities may be more sensitive to interest rate changes.

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