



8th May 2015

the technical analyst

AWARDS 2011

F I N A L I S T

Multi-Asset Update:

UPDATE
Technical
Fundamental

The UK Gilt – is it vulnerable?

Mark Sturdy
John Lewis

[Full performance of
our Key Trades
recommendations
2006-15 here](#)



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Weekly iShares ETF Gilt chart

The market is poised on very powerful support from the prior Highs in 2012 and 2013.

Note well that the market has bounced powerfully from this level before- earlier this year.

There is no compelling long or medium-term bear case until the band of support 12.25-21 is closed beneath in convincing fashion.



Weekly Sept 15 Long Gilt Futures chart

This is slightly more bearish short-term.

Note the small gap that arose on pushing down beneath the Prior low.

The market has tried to cover that gap - not quite achieved – it remains (with the Prior Low at 116.73) as good resistance...

The short-term bears would be further emboldened by a break beneath the diagonal (neatly coinciding with a Fibonacci support) and they would begin to sell again.

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FUNDAMENTALS:

As 2015 began and the UK General election began to loom large, as opinion polls consistently pointed to a hung Parliament or a Labour government propped up by the SNP, the Gilt entered a wide trading range.

Although political risk was a factor weighing on the Gilt, the UK economic fundamentals were still too good to warrant a bear market in UK government Bonds:

- Inflation was low and set to fall further on the then collapsing oil price,
- Growth was holding up well,
- The coalition government remained committed to fixing the public finances
- Interest rates were still at historic lows and looked set to remain there.

Fast-forward 5 months to the present and what has changed?

The UK General election delivered a surprise overall majority for the Conservative party. So the job of reducing the budget deficit and debt to GDP ratio continues.

Inflation has for the first time in decades turned negative: deflation.

The Government is achieving its goal of reducing the budget deficit as evidenced by today's PSNCR and PSNB data.

And interest rates look set to remain at current low levels until at least the middle of next year and longer if the Bank of England's latest forecast turns out to be wrong and deflation lasts longer than predicted

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The UK Gilt – is it vulnerable?

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FUNDAMENTALS: CONTINUED

So where are the negatives that could see the Bears take control of this market and send it on a relentless journey lower?

Over recent months the oil price has rebounded from the lows. What initially looked like a correction could develop into something more durable. The ISIS group that has conquered vast swathes of Syria and Iraq are in control of roughly half of Iraq. If they gain control of Iraq's oil resources causing a net loss to the oil market, that would support the Oil price.

Since last years sell-off in oil was a major factor in crushing UK and global inflation, a sustained rally would reverse what is a clear economic benefit to consumers and send inflation higher.

Additionally, if the US economy finally emerges from its winter torpor and leads the Fed to begin hiking rates in the near future, global Bond markets would react negatively, including the Gilt.

So, although the conditions are not yet right to call a bear market in the Gilt, those conditions could quickly and easily fall into place.

On the other hand, there is one offset on the near horizon that could further support the low inflation environment. That is if Iran and the major powers reach an accord over Iran's nuclear program. This would lift sanctions and allow Iran's vast oil reserves back into the market.

There are many factors at work in the government bond markets. The net effect is of them is far from clear. The least predictable of these, as ever, is the price of oil and the politics of the Middle East. They could yet be the decisive factor once again.



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