Late summer's golden glow

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Summer is over, the weeks of quiet repose lie in the past and, with a final wistful glance over a holidaymaker's shoulder, the sun has set, bringing the curtain down on a long, hot couple of months across Europe.

While the month's astronomical highlight proved to be a solar eclipse that, for once, was highly visible in the evening sky, the ascendency of a golden globe across financial markets has been equally plain to see. Admittedly, it has not been all one-way traffic for the gold price (or precious metals more generally) over 2026. After hitting an all-time high (in US dollar terms) in late January, the price pulled back to year-to-date lows in late July before accelerating powerfully higher over August. According to the World Gold Council global central banks never lost the faith and purchased a record 289 tonnes over the second quarter. For households, too, the yellow metal has never lost its enduring lustre. But gold's recent resurgence owes much to the return of professional speculators to the market, adding a further layer of demand for geopolitical and macroeconomic uncertainty hedging.

The conflict in the Middle East has entered a new phase. US Treasury Secretary Scott Bessent has formally announced "Operation Economic Outcast", a campaign to sever Iran's remaining technological and financial lifelines from elsewhere. The plan may be centred on Iran, but the US administration has more than half an eye on China given Beijing's long-standing relationship with Tehran. Whether the plan works or what Iran's response might be are, as yet, unknown. But what is known is that the level of uncertainty remains high even if the worst of the fighting may now be over. The US has claimed control over the Strait of Hormuz and, if maritime specialist reporting is to

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(THE STROLL / SUMMER IS OVER)

be believed, shipping transiting the dangerous chokepoint has increased. But while the oil price has held fairly steady (Brent crude at around $90 per barrel), stresses in refined products markets, including diesel where demand far outstrips available supply, remain apparent.

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The Iran war has concluded its sixth month and whilst the shape of the conflict is constantly evolving it cannot, alone, account for the major highlight across financial markets over the past month; a surge in long-dated government borrowing costs exemplified by yields on 30-year bonds across many developed economy sovereign markets rising to their highest levels since 2007 (and in Japan's case 1996). True, the inflation outlook is as uncertain as at any time in almost twenty years and equally true that the Middle East conflict is another reminder that the world is more prone than ever to stagflationary economic shocks. But adding to the mix, the biggest increases in long-dated bond yields are taking place in economies where the pressure on public finances and by extension associated fiscal risks are deemed greatest. The US is a stand-out as its debt mountain has crossed $40 trillion for the first time, but the UK, France, Italy and Japan carry their own idiosyncratic risks too.

The pricing adjustment across these government bond markets is a reflection of investor reluctance to hold long-dated government debt without additional compensation. The justification for this reticence lies in the material deterioration in fiscal positions across much of the developed world, with little apparent sign of any political appetite to return public finances to a more sustainable position.

But nothing of the above is new to all-seeing financial markets. Despite the uncertainties in and around the Persian Gulf there have been no obvious economic or market-based triggers lying behind the timing of the sell-off. Indeed, global developed stock markets have made further upside progress buoyed without question by the exceptional strength of the corporate sector through the summer reporting season. Importantly, from an economic perspective, the spike in government bond yields has been concentrated in longer duration issues which have relatively less influence on household and company borrowing costs than 10-year benchmark equivalents. Furthermore, although the political outlook is uncertain; US Congressional mid-term elections in November, the UK Budget due on 28th October and French Presidential Elections in late April / early May next year, politicians provided no obvious trigger either.

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Two additional factors have, however, played a more pivotal role. In the United States the recently installed Federal Reserve Chair Kevin Warsh has pushed to reduce "forward guidance" regarding the central bank's decision-making, which has added to pre-existing uncertainties relating to the outlook for monetary policy, interest rates and the communication strategy surrounding such key decisions. Meanwhile the US Treasury's interventions, firstly in support of the ailing Japanese yen and more latterly in the US Treasury bond market, aimed at heading off disorderly conditions, had a hint of panic about them which markets were quick to pick up on. In response, the dollar has come under pressure again.

Not to be overlooked, and clearly a factor at the margin, is the extent to which AI-related corporate debt issuance has added to long-dated supply, as that cutting-edge industry transforms from cash generation and utilisation to debt financing in support of its ambitious investment plans. Whilst not directly impacting on the UK gilt-edged market, domestic bond pricing adjustments continue to reflect the impact of regulatory changes following the autumn 2022 crisis which forced long-term institutional holders of government debt to shorten duration and add to liquidity safety buffers. New buyers, including those from overseas, have proved much more price sensitive, demanding higher long-term yields to tempt them into the domestic market.

Financial markets used to be a quiet place over the summer, trading volumes light as investors and market practitioners took a couple of weeks of well-deserved rest. Not anymore! If developments in the government bond market tell us anything, it is that the world has become a riskier place, inflation is less predictable, developed nations are becoming increasingly indebted, and the political will from weak governments to forcefully address such structural problems is apparent by its absence. While part of the surge in long-dated borrowing costs may unwind over the autumn the unavoidable truth remains, the old world has sunk like the setting sun and it's not coming back. Little wonder, then, that the oldest intrinsically valuable investment of all is proving so popular again.

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