HYMANS ROBERTSON

# Capital Markets Update

April 2026

**The outlook deteriorated in Q1. Escalating conflict in the Middle East and disrupted energy supplies raised the risk of higher inflation and weaker growth.**

**Global equities fell 2.4% over the quarter, while credit spreads widened. Sovereign bonds failed to diversify portfolios; yields rose sharply, particularly at the front end, as markets moved to price in a series of interest-rate rises.**

## Global themes

Conflict in the Middle East and higher energy prices have added uncertainty and downside risk to what had been a solid, if unspectacular, growth outlook supported by AI investment, fiscal support and prior monetary easing. While geopolitical shocks often fade, major energy-supply disruptions (such as in the mid-1970s or 2022) have tended to leave more lasting macroeconomic and market scars.

Sharp rises in oil, gas and fertiliser prices are likely to prompt downward revisions to growth forecasts, particularly for energy-importing economies, and could derail the nascent recovery in global manufacturing. The scale of any stagflationary shock will depend on the duration and severity of supply disruptions: the longer they persist, the greater the drag on growth and the upward pressure on inflation.

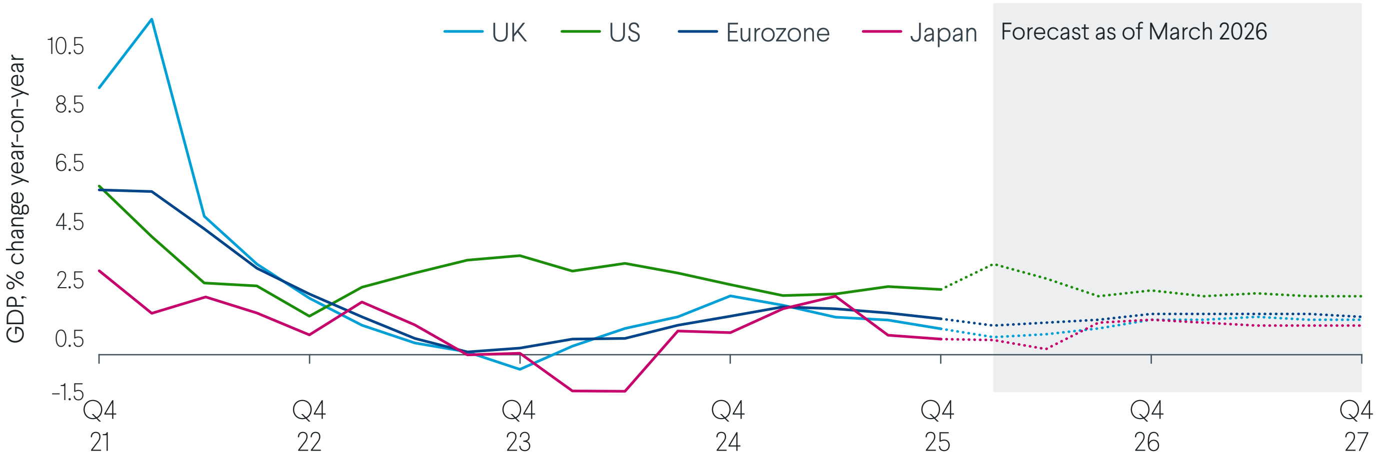
Even if tensions ease, rising energy prices are likely to push headline CPI inflation close to 4% year on year in many advanced economies in the second half of 2026. While the US is still likely to experience a sharp rise in fuel prices (given the closer relationship between US fuel and oil prices), the persistence of energy-driven inflation is likely to be lower, given the US is a net exporter of oil & gas. However, the UK, eurozone, Japan and many other East Asian economies are more exposed, particularly to gas prices, which have risen dramatically.

Chris Arcari
Partner and Head of Capital Markets

Monetary policy has limited the scope to offset supply-side shocks, while higher energy prices will also weigh on growth through demand destruction. At the same time, the risks of second-round effects and unanchored inflation expectations are likely to keep central banks cautious in the near term, particularly given the experience in 2022.

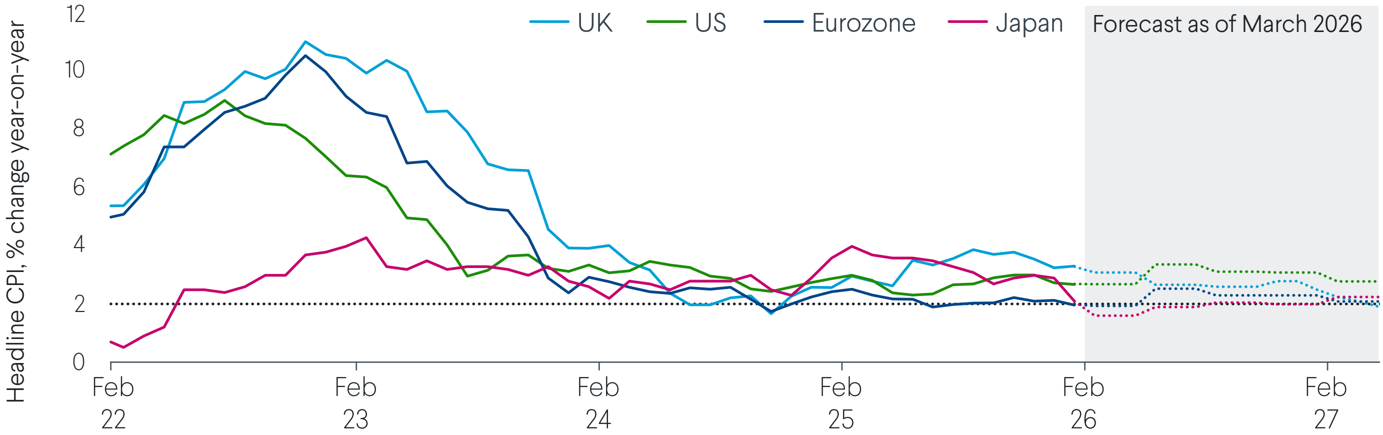
That said, key differences suggest the inflationary impact should be more muted this time. In 2022, growth and inflation were stronger (Charts 1 and 2), post-pandemic demand collided with acute supply constraints, and labour markets were exceptionally tight. Today, conditions are looser: UK unemployment is at a four-year high (5.2%), wage growth is easing, inflation was trending lower and interest rates are starting from much higher levels.

**Chart 1: Growth had been forecast to expand at a decent, but unremarkable, pace prior to the recent shock**




*Source: Bloomberg*

**Chart 2: Inflation was trending lower before the start of conflict in the Middle East**




*Source: Bloomberg*

## Looking ahead

While a swift resolution could materially improve the outlook, the balance of risks has shifted towards weaker growth, higher inflation and less accommodative monetary policy.

In the UK, the inflation shock is more likely to keep the Bank of England (BoE) on hold than to force cuts. However, market pricing of aggressive rate hikes appears to place too much weight on near-term inflation pressures and too little on weak real growth and unemployment – now at a post-pandemic high of 5.2%.

The sharp repricing in front-end bond yields has already embedded a reasonable inflation risk premium, improving their attractiveness – particularly if growth slows and inflation ultimately moderates. Nonetheless, with elevated inflation and fiscal risks and downward-sloping long dated forward curves, maintaining exposure to short to-medium-dated sovereign bonds remains sensible, given their lower duration risk and sensitivity to further upside inflation risks.

Credit spreads have started to widen, particularly in speculative grade markets. Although yields are becoming more appealing, spreads remain tight and volatility is likely to stay elevated, suggesting better entry points may emerge.

Equity valuations have eased somewhat, but higher yields, rising costs and weaker demand continue to pose risks to valuations and earnings, respectively.

Against this backdrop, leaning into attractive front-end yields while maintaining caution on equities and speculative-grade credit appears prudent, given still-elevated equity valuations and relatively thin credit-risk premia.

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# Government bonds

Q4 data confirmed tepid UK growth in 2025 of 1.3% year on year, while forecasts for 2026 and 2027 have edged lower to 0.9% and 1.3%, respectively. Inflation had been easing, but recent energy-price rises are likely to push headline CPI higher again. Forecasts suggest UK headline CPI will average above target over the next two years.

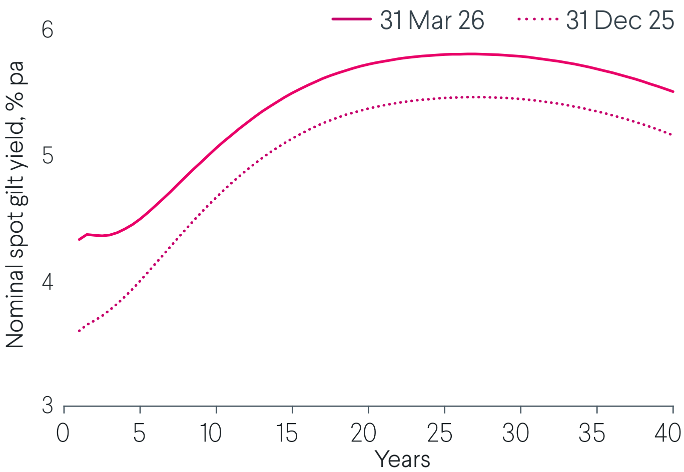
Gilt yields have risen across maturities as markets price in an energy-driven shock following disruptions in the Middle East (Chart 3). Yields on short-dated bonds (which are sensitive to monetary policy) have increased more sharply on fears that higher inflation would prevent the BoE from cutting rates; investors now expect several rate hikes. Although higher inflation will mean a more cautious BoE, aggressive rate hikes are unlikely amid weak real growth and unemployment at post-pandemic highs.

Index-linked gilts outperformed their nominal counterparts. As a result, implied inflation has risen sharply, which may prompt some investors to rebalance between real and nominal bonds to capture some of this relative outperformance.

Nominal yields already embed a reasonable inflation risk premium. This strengthens our valuation case for nominal over index-linked gilts, particularly if growth slows and inflation ultimately moderates. However, with inflation risks high and forward yields declining beyond 15 years, we see the greatest value in the short- to medium-term part of the curve. We're more cautious on very long-dated bonds. This approach allows investors to obtain attractive income while managing their portfolio's interest-rate sensitivity.

Overall, we continue to see gilts as attractive and maintain a balanced view between nominal and index-linked bonds. While valuations now firmly favour nominal over real yields, the fundamental backdrop of subdued growth and above-target inflation arguably favours index-linked gilts.

**Chart 3: Gilt yields have risen as markets price in an energy-driven inflation shock**




*Source: Bank of England*

## Higher short-dated bond yields suggest that inflation risk is largely priced in.

Robert Kotlar
**Senior Investment Research Analyst**

# Credit

Fundamentals are softening as higher interest costs and leverage weigh on companies' ability to pay interest on outstanding debt. Geopolitical events pose additional risks to revenues, costs and earnings, which have been healthy until now. Hyperscalers have issued (and are expected to continue to issue) more debt to fund AI-related expenditure, but these corporates show solid starting fundamentals supplemented by sizeable cash balances. Q1 forecasts before the start of conflict in the Middle East suggested that defaults would fall across both the bond and loan market over 2026.

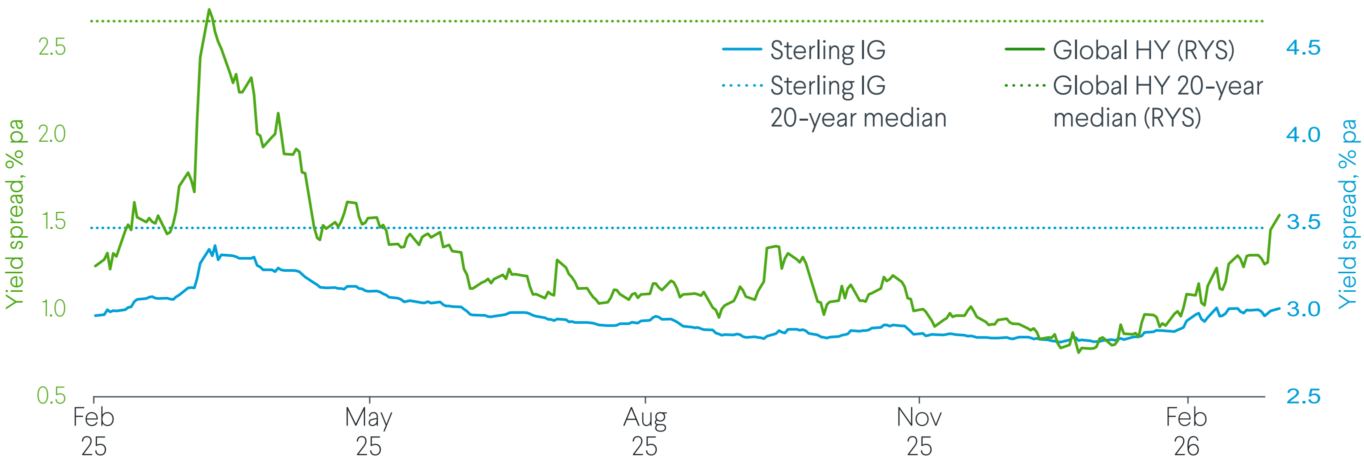
Bond issuance accelerated in January, with US and European investment-grade supply exceeding both January 2025 levels and the 2014–24 average. Expectations of further hyperscaler issuance may continue to put upward pressure on spreads over the year. Demand remains supported by high all-in yields.

Spreads have widened but are still tight compared to long-term history in both investment- and speculative-grade bond markets. The spread levels provide a cushion to long-term expected losses, albeit a small one by historical standards. Leveraged loan spreads have widened to a greater extent and sit above long-term medians. The loan market has been subject to fundamental weakness and shifts in sentiment surrounding private credit defaults and the market's higher exposure to the software sector.

Within investment-grade credit, small spread moves could lead to underperformance relative to gilts of a similar duration for short-term investors. However, medium-term investors can still access reasonable all-in yields and risk-adjusted returns.

Attractive sovereign yields and modestly wider spreads mean speculative-grade bond yields are trending closer to, but still slightly below, neutral expectations. Nevertheless, we remain cautious on speculative-grade markets: spreads are still well below long-term averages and volatility is elevated, suggesting better entry points may yet emerge.

**Chart 4: Investment- and speculative-grade credit spreads have risen but remain below long-term averages**




*Source: Bloomberg*

Chiara Beaton
**Senior Investment Research Analyst**

Software sentiment, geopolitical events and hyperscaler issuance have put pressure on spreads in recent months. However, demand is strong. Medium-term investors can still earn reasonable all-in yields within credit markets.

# Equities

Global equities fell by 2.4% in Q1 as escalating conflict in the Middle East disrupted energy supplies, increasing the risk of higher inflation and weaker growth. The US underperformed as an initial rotation out of expensive US tech stocks outweighed later support from the region's relative energy independence. Growth stocks also significantly underperformed over the quarter. Despite its vulnerability to rising energy costs, Asia Pacific ex Japan led global markets in Q1. Gains were propelled by substantial AI capital expenditure and a strategic rotation by investors seeking value in the tech sector beyond expensive US stocks.

Despite the conflict in the Middle East and the global energy-supply disruption, earnings forecasts for this year and next have continued to rise. This points to a relatively supportive near-term fundamental backdrop for equity markets. Indeed, the ongoing surge in AI investment, fiscal support in the US and China, and defence spending in Europe lend support to these forecasts. However, the risks around this outlook have arguably increased. Higher energy and input costs (including financing costs) and demand destruction (owing to lower real incomes) have perhaps increased downside risks to earnings growth.

The March sell-off, alongside robust earnings growth, has reduced multiples based on recent earnings closer to longer-term averages (Chart 5). However, these trailing price-to-earnings ratios reflect earnings boosted by a period of strong growth. Cyclically adjusted price-to-earnings measures, which account for potential earnings reversion, remain elevated. While high valuations are a poor predictor of short-term equity returns, they continue to indicate a relatively subdued medium-term outlook for equity markets.

**Chart 5: Price declines, alongside strong earnings growth, have reduced trailing price-to-earnings ratios**


*Source: Bloomberg/Hymans Robertson*


Andrew McCollum
**Investment Research Analyst**


## The fundamental outlook remains strong, but downside risks have increased and valuations are still elevated.

# Property

UK property returned 6.9% (total return) over the 12 months to end-February, comprising modest capital appreciation and a 5.7% return from income. Real rents are increasing across the retail, office and industrial sectors, but the pace of rental growth slowed over the quarter. Industry surveys also indicate weakening occupational demand and softening rental expectations; in the industrial sector, data suggests the weakest tenant demand since 2012 (excluding one pandemic quarter). Vacancy rates across sectors are elevated relative to historic averages, particularly in offices – rates are close to double their long-term average, at 22%. However, retail sector vacancies have been falling and are now back to pre-pandemic levels.

The gross reversionary yield remained at 7.1% pa over the quarter, while the net initial yield expanded slightly to 5.3% pa, driven by office and industrial yields modestly edging out. The gap between the two indicates the potential for further rental growth. High-quality prime assets remain in demand. New energy-efficient offices are commanding the highest rents, attracting both investors and tenants.

There was a surge in investment volumes in Q4 2025, exceeding five- and 10-year averages, and the first three quarters of last year. The technical landscape remains challenging, with redemption pressures persisting across several core property funds, causing some to suspend or defer payout of redemptions. Amid ongoing selling pressure, value-add investors are seeking to capitalise on market weakness.

## Vacancies in the retail sector have been falling and are now back to pre-pandemic levels.

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## Contact us

**If you'd like to discuss what these market themes mean for your portfolio, please contact your usual Hymans Robertson consultant or any member of our capital markets team.**

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