

Choppy equity and bond markets reflect heightened US military tension across three continents



Quarter in brief

The US and Israel launched a combined attack on Iran which sent oil prices soaring

Major central banks held borrowing costs steady amid concerns over the return of high inflation

Long dated gilt yields stepped up to their highest level since the 90s

Global tensions and AI concerns wipe out equity market gains made earlier in the quarter

Aggregate UK DB pension scheme funding improved marginally over the quarter

This was a quarter of two halves. Aggressive US foreign policy – first in Venezuela and then in Iran – was one of the key themes of the first quarter. Markets performed surprisingly strongly amidst volatility in the first two months, with March then reflecting a realisation of the extent of possible challenges that lie ahead in relation to geopolitical tensions around the globe. Central banks have paused rate reductions in anticipation of rising prices.

The first quarter of 2026 began with the US military operation in Venezuela to remove President Nicolas Maduro. The focus then quickly shifted to Greenland as President Donald Trump advocated for US ownership of the island on the basis of international security. Having originally refused to rule out a military takeover, Trump's threats later tempered to tariff impositions on all NATO countries that opposed him before he removed economic and military threats altogether. By late February, Iran was subjected to joint US and Israeli air strikes that resulted in the death of Supreme Leader Khamenei after almost four decades in power. The conflict in the Middle East widened amidst a barrage of retaliatory strikes by Iran against US assets in neighbouring countries.

Oil supplies have been squeezed by the closure of one of the key shipping lanes in the region – the Strait of Hormuz. As a result, the price of Brent Crude surged 59% in March, surpassing its previous record monthly gain of 46% almost three decades ago. Major economies are now bracing for the knock-on impact of rising inflation driven by higher energy costs impacting food supplies in particular. In their latest forecast, the OECD has estimated that US inflation will climb to 4.2% this year, the highest rate in the G7 group. Meanwhile, Eurozone inflation rose to 2.5% in March – up 0.6% on February's figure – and now sits above the European Central Bank's (ECB) long-term target of 2%.

After a unanimous vote to hold the bank rate at 3.75% in March, the Bank of England (BOE) signalled that it was ready to act as necessary to get inflation down to its 2.0% CPI target. The market is pricing in two quarter-point rate hikes this year from the BOE, a reversal from rate cuts that had been priced in before conflict in the Middle East escalated. Lending rates have also been held constant by the ECB and the Federal Reserve over the quarter, suggesting that the major western central banks are bracing for the inflationary impact of the conflict.



Loui Quelcutti
Senior Investment Consultant



**Click to watch
Loui's video.**

The cost of US and UK government borrowing has also risen after a sell-off in bond markets. Foreign central banks have cut their holdings of US Treasuries to the lowest level since 2012, in a bid to prop up their own economies. Yields on shorter term US Treasuries have risen whilst Eurozone borrowing costs have also climbed with countries such as France, Spain and Italy reaching recent highs. In the UK, gilt yields have risen sharply, although only modestly exceeding the recent trading range. Whilst there has been some speculation of this presenting challenges to pension schemes, the Liability Driven Investment (LDI) fund management industry has sailed through volatility because of the considerable buffers now employed. Short dated gilt yields increased the most. The 10-year gilt reached just over 4.9%, its highest since 2008, with 20-year yields rising above 5.6%. The weakened economic backdrop has fuelled fears of stagflation in the UK economy which the BOE must balance as it uses monetary policy to try and negate the impact of inflationary pressures.

Equity markets had started 2026 in good form but the S&P 500, FTSE 100 and European Stoxx 600 have all suffered significant downturns since late February. UK equities still managed to post a positive return over the quarter on the whole, but global and emerging markets in particular were pared back by growing concerns over bloated AI-related stock valuations. Emerging markets have been particularly badly hit by the shortage of oil and gas.

Despite being considered a safe haven asset, gold has not been immune from market volatility over the first quarter. Prices tumbled just over 15% from the start of the Iranian conflict to the end of the quarter, putting an end to the precious metal's record rush.

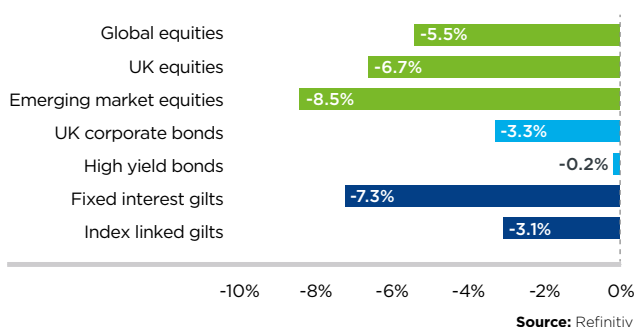
Private credit has also come under the spotlight recently, following concerns last year around poor underwriting standards. During the quarter there have been two particular areas of concern: Retail investors rushing to exit publicly traded Business Development Companies (BDCs) – a type of investment structure providing exposure to private credit – leading them to trade at a material discount to net asset value, along with a number of retail focused semi-liquid private credit funds gating redemption requests to protect remaining investors. Institutional investors like pension schemes do not typically access private credit through BDCs and, in our view, the structural benefits of investing in private credit remain intact.

Investment grade credit spreads and high yield credit have widened marginally over the quarter but remain tight. Fixed interest gilts underperformed their index-linked counterparts over the quarter owing to a material rise in future inflation expectations. Whilst rising long-term gilt yields will have generally been positive for schemes that do not hedge their liabilities in full, negative returns from a basket of growth assets is expected to have dampened the impact on the funding position for aggregate UK DB pension schemes on a low-risk basis over the first quarter.

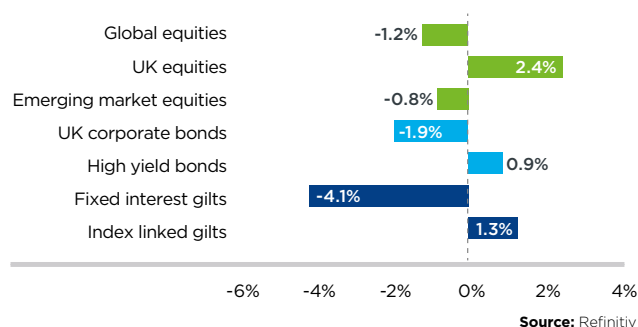
Market returns

UK equities posted positive returns despite global volatility

1 month to 31 March 2026



3 months to 31 March 2026



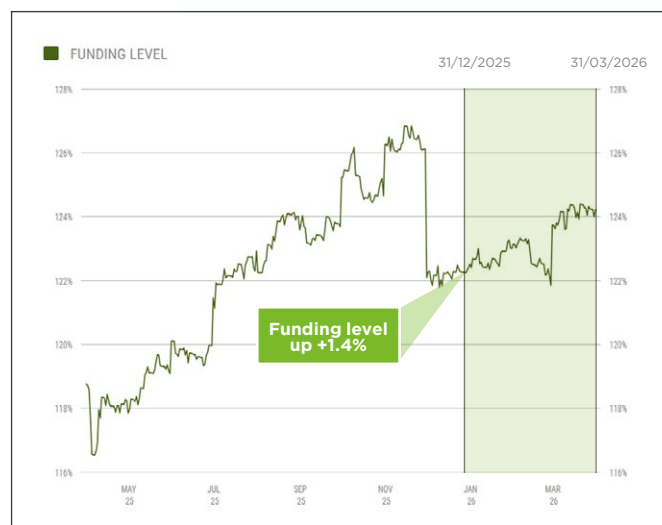
The market is pricing in two quarter-point rate hikes this year from the BOE, a reversal from rate cuts that had been priced in before conflict in the Middle East escalated.

Simeon Willis
Chief Investment Officer

Asset and liability progression for the DB:UK universe



Funding level progression for the DB:UK universe



Source: XPS DB:UK | www.xpsgroup.com/services/xps-pensions/xps-dbuk-funding-watch

The charts above are based on data from The Pensions Regulator, the PPF 7800 Index and the XPS data pool. The assumptions used in the UK:DB long-term target basis include a discount interest rate of gilt yields plus 0.5%. The assumed asset allocation is 15.5% equities, 24.4% credit, 4.5% multi-asset, 5.9% property and 49.7% in liability driven investment (LDI) with the LDI overlay providing an 85% hedge on inflation and interest rates.

XPS Investment asset class views

Asset class	Favourable	Neutral	Unfavourable	Movement
UK Equity		●		
Developed Market Equity		●		
Emerging Market Equity	●			
Investment Grade Credit			●	
High Yield Credit			●	
Senior Secured Direct Lending		●		
Balanced Property	●			
Long Lease Property			●	
Private Equity		●		
Infrastructure		●		
Equity Protection Strategies	●			↑
Buy-in	●			
Cash		●		

Find out more

To discuss any of the issues covered in this edition, please get in touch with **Simeon Willis** or **Loui Quelcutti**. Alternatively, please speak to your usual XPS contact.

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