

US government shut down and rising government borrowing costs, but still pension funding soars



Quarter in brief

US government shutdown following funding shortfall

The Bank of England and Federal Reserve cut borrowing costs despite inflationary pressures

Long dated UK gilt yields rise to highest level this century

Gold pulls off an extraordinary rally to new high as the US Dollar weakens

Pension scheme funding stronger than ever

The quarter end was abruptly followed by US government going into shut down following the lack of agreement on funding measures into the new US fiscal year which started on 1 October. This follows a quarter where the cost of government borrowing and above target inflation remain key challenges for major global economies.

Paradoxically, this market dynamic is serving pension schemes very well.

The quarter ended with significant political and macroeconomic tension in the US especially. For the first time in nearly seven years, the US government has shut down. The shut down was put in motion when the Republicans and Democrats failed to come to an agreement on how to fund the federal government in the new fiscal year. The closure is expected to put around 750,000 workers in an effective furlough scheme as well as costing the US economy dearly in lost output. In a shut down, the federal government ceases all non-essential functions, while those whose jobs are deemed essential are often expected to carry on without pay. The equity and debt markets initially seemed unconcerned with the potential detriment this could cause to US GDP.

Long-term UK government bond yields rose during the quarter reaching record highs this century in August as global sovereign borrowing costs have generally risen and demand for UK gilts is showing the strains of reduced pension scheme demand. The sell-off has piled the pressure on Chancellor Rachel Reeves as she grapples with her pledge to fill a fiscal spending gap without increasing mainstream taxes. The issue has come into greater focus as the Autumn Budget approaches, but the UK is not alone in tackling bond market volatility. Political discontent in France has sent borrowing costs close to their highest level since the Eurozone debt crisis a little over a decade ago, although still well below the UK's current borrowing costs. The rating agency Fitch has since downgraded France's credit status.

UK inflation rose to 3.8% in July with prices rising in the UK much faster than in the Eurozone. The Bank of England has continued to tread the

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line of trying to bring inflation back down to target, whilst being supportive of the economy. It cut rates by 0.25% in August with rates being held at 4% in the September meeting. The gilts market has largely ignored these short end factors, with long dated yields rising to a new high this century towards the end of August. However, the longest dated gilts are still priced at a premium reflecting pension demand and scope for reduced future ultra-long gilt issuance.

The US economy fared better than forecasts had predicted, growing at an annualised rate of 3.8% in the second quarter versus estimates of 3.3%. Inflation is in a better place than the UK, at almost 1% lower and consumer spending was also higher than expected so the Federal Reserve has been able to cut rates for the first time this year to a range of 4% to 4.25%. Meanwhile the European Central Bank (ECB) kept rates steady throughout the third quarter of the year. Eurozone inflation rose to 2.2% in September, above the 2% target for the first time since April. This has signalled to markets that the ECB has neared the end of their rate cutting cycle and are likely to hold rates in its end of October meeting.

Gold has experienced another rally over the third quarter with prices surging by just short of \$400 per troy ounce over September to \$3,800 by quarter end.

The increase marks a 45% rise in the Bullion this year alone. Deemed by many a safe haven asset, the price rise was largely driven by the looming threat of a US government shutdown and the Fed's bulk purchasing of gold as the central bank seeks to diversify their holdings away from a weakening US Dollar.

In major equity markets, performance was strong as the S&P 500, FTSE 100 and Stoxx 600 delivered strong positive returns. Emerging market stocks have outperformed the global market year-to-date, showing signs of investors' increased appetite for risk premiums.

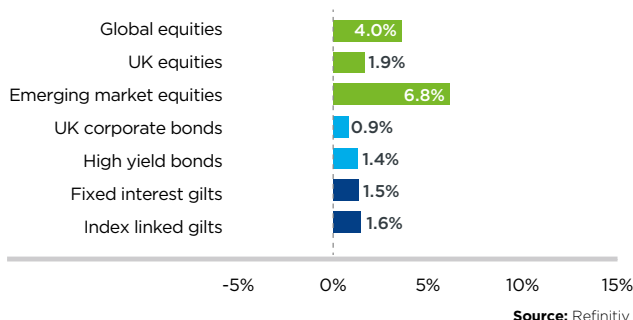
UK credit spreads widened in July before tightening as the quarter progressed. Spreads have reverted to exceptionally tight levels as the premium for lending to corporates is vanishingly small. Thames Water's debt holders may be close to a deal where they can expect to receive only 75p in the pound for their debt as part of a market led restructuring. Long-term inflation expectations were much more stable and finished broadly where they started the quarter.

The combination of rising long term gilt yields and positive returns for major growth assets has bolstered an already strong position for aggregate UK DB pension scheme funding on a low-risk basis.

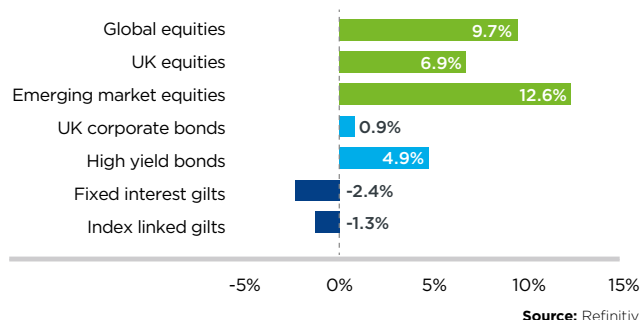
Market returns

Emerging market equities outperformed the global market over the quarter.

1 month to 30 September 2025



3 months to 30 September 2025



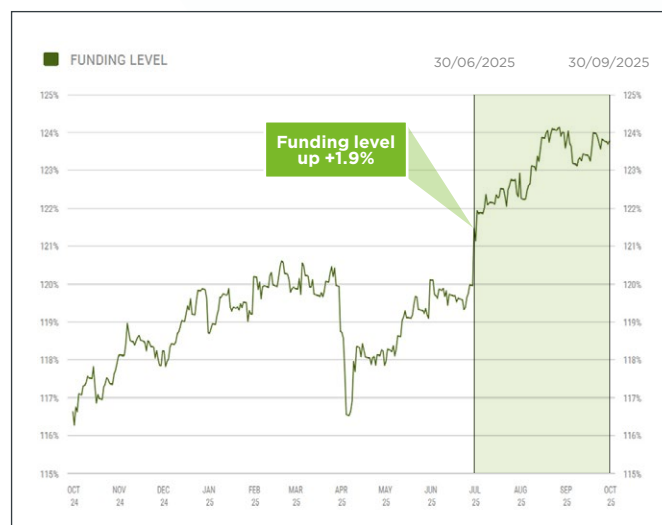
Long-term UK government bond yields rose during the quarter reaching record highs this century in August as global sovereign borrowing costs have generally risen and demand for UK gilts is showing the strains of reduced pension scheme demand.

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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 **Scott Millward**. Alternatively, please speak to your usual XPS contact.



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