For professional advisers only

The alternative to cash?

UK Gilts

Investing in gilts now allows you to provide your clients with an alternative to holding significant sums of cash in deposit accounts where banks have been slow to pass on the interest rate rises to their customers.

What is a gilt?

Government bonds in the UK are known as gilts and are issued by HM Treasury. A gilt is like a loan to the UK government, with ongoing 'coupon' payments in the form of interest, usually twice a year. Gilts can be traded at prices above or below 'par'. 'Par' is the amount that will be repaid at the agreed maturity or redemption date.

They are very liquid instruments that can easily be bought and sold at the quoted price throughout the trading day without delay. They can trade in little amounts.

The total returns of gilts are made up of two things:

1. Income (interest received) - Income is taxed at the holder's marginal rate of income tax.
2. Capital gain - Capital gains are tax-exempt (depending on your tax status and residence).

What will be held in a typical BMI gilt portfolio?

Typically, we will hold gilts with varying maturities with the longest being no more than around three years in length. These gilts will be specifically selected based on the most tax efficient outcome for the client (i.e. where the majority of the total return is from the uplift in capital from the purchase price and par or maturity value) and held in an investment account.

Maturing gilts will be reinvested into other short-dated gilts that offer similar characteristics.

Why should I look at gilts now?

As a result of the ultra-low interest rate environment we had for the last decade, and the speed of interest rate rises in recent months, the gilt market is currently offering a very compelling, short-term opportunity. Gilts are, in most cases, trading at prices below 'par', or the amount they will be repaid at. The majority of the return to an investor may therefore be the gain in the capital value or 'pull to par', which is exempt from capital gains tax (depending on your tax status and residence). This applies to both individuals and companies.

If held to maturity, investors will get back the full-face value amount (subject to the UK government not defaulting on its repayments). However, the added benefit of buying gilts at a discount is that currently, for Channel Islands and Isle of Man taxpayers, no tax is levied on the capital gain of the bond. This means, for certain bonds that trade at a discount to their issue price, the majority of the return to investors is free of capital gains tax (depending on your tax status and residence).

The overall net return depends on the investor's underlying rate of tax.

Can the capital value in a gilt decrease?

Between the time a gilt is bought and the maturity date, the value of the gilt can fluctuate and so your capital is at risk if you don't hold them until maturity. However, at the maturity date the par value is paid.

BROOKS MACDONALD

Illustrative £1,000,0000 portfolio

Security	Weight	Amount Invested	Nominal/ Capital Maturity Value	Annualised Capital Return	Running Yield	Expected Coupons
UK Gilt 0.125% 31/01/2024	24.90%	£249,000	£254,793	4.78%	0.13%	£159
UK Gilt 0.25% 31/01/2025	24.90%	£249,000	£266,893	4.75%	0.27%	£1,001
UK Gilt 0.625% 07/06/2025	24.90%	£249,000	£268,791	4.30%	0.68%	£3,360
UK Gilt 0.125% 30/01/2026	24.90%	£249,000	£278,590	4.61%	0.14%	£871
Cash (GBP)	0.40%	£4,000				
Total	**100.00%**	**£1,000,000**				

Source: Bloomberg. Data accessed 4 August 2023.

Example of a gilt maturing at £100 in 1 year's time, currently trading at £96.00 and paying a 1% coupon. Assuming a 20% income tax rate.

£96 purchase price | £100 maturity price

£4 capital gain

£4 / £96

4.17% tax free return

£1.00 / £96

1.04% coupon return

1.04% + 4.17%

5.21% gross return

1.04% x 20%

0.21% tax on coupon returns

5.21% - 0.21%

5% return after tax

Source: Bloomberg. Data accessed 4 August 2023.

If you have any other questions, contact your Brooks Macdonald representative for more information.

Important information

More information about the Brooks Macdonald Group can be found at www.brooksmacdonald.com.

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