

ECONOMIC RESEARCH – DECEMBER 2025

INVESTMENT INSIGHT

UK

- ✓ **Bond market offers attractive yields**
- ✓ **Changing expectations for sterling**
- ✓ **Real estate favored by upcoming rate cuts**
- ✓ **Moderate outlook for FTSE100 in Q1 2026**

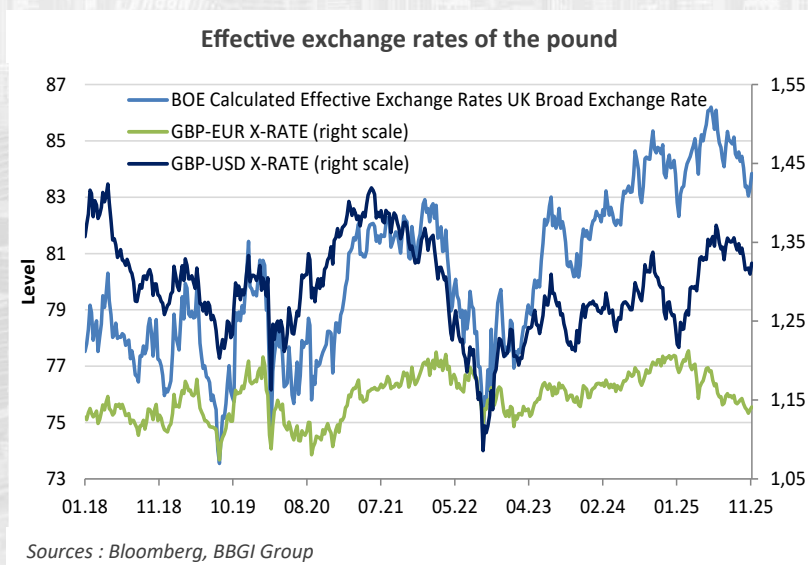
THE BOE WILL LOWER ITS KEY INTEREST RATES SOONER THAN EXPECTED

Gilt market value proposition and real yield potential

In the current decelerating environment, UK Gilts offer a compelling value proposition. With nominal 10-year yields around 4.5% and real yields near 100 basis points, there is significant potential for capital appreciation as the economy slows and the Bank of England nears a pivot. The nearly 200 basis point spread over German Bunds provides a robust risk premium and diversification for global portfolios seeking stable, inflation-protected income.

Sterling realignment and growth prospect devaluation

The British Pound has undergone a notable correction over the past eight weeks, reflecting a rational market readjustment to the UK's evolving fiscal reality. The primary catalyst was the late-October budget, which introduced a substantial increase in business costs through National Insurance contributions. Unlike the 2022 liquidity crisis, this volatility stems from a "fear of stagnation" rather than insolvency. Markets have effectively devalued sterling's growth prospects, concluding that the new tax burden will act as a structural drag on GDP. This sentiment is exacerbated by shifting BoE expectations, as investors anticipate more aggressive rate cuts to support the flagging domestic economy.



Favorable currency differentials against the Swiss Franc

While the pound has struggled against the dollar, we anticipate a period of relative outperformance against the Swiss Franc. Despite the carry trade favoring the pound with a massive 400 basis point interest rate differential, the franc's safe-haven status maintained its strength through mid-November. However, with Switzerland facing its own growth shocks and the imminent introduction of negative interest rates, the yield advantage of the pound is becoming too significant to ignore. We believe sterling is poised to appreciate against the franc as investors rotate back toward the UK's superior yield profile in an environment of global monetary easing.

Securitized real estate and the net asset value discount

The UK residential and commercial property markets are currently characterized by a "cautious wait-and-see" approach. While housing values rose by +1.8% year-on-year in November, mortgage approvals have dipped, reflecting high borrowing costs. However, this environment has created a unique entry point in Real Estate Investment Trusts (REITs). The EPRA UK index is trading at a significant 33% discount to Net Asset Value (NAV), with a price-to-asset ratio of 67%. This deep discount, paired with net dividend yields exceeding 5%, offers exceptional medium-term appreciation potential as financing conditions improve and the BoE begins lowering the cost of capital.

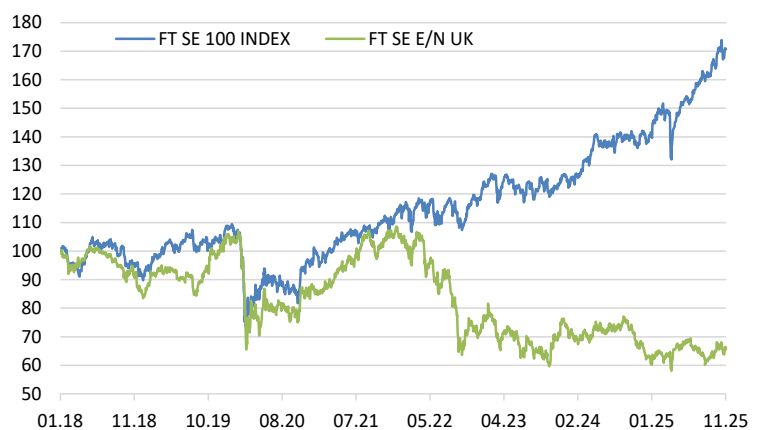
FTSE 100 valuation support and defensive resilience

Despite the specter of persistent inflation and sluggish organic growth, the FTSE 100 remains supported by its defensive characteristics and attractive valuation metrics. Trading at a price-to-earnings (P/E) ratio of 14.5x—significantly lower than the Euro Stoxx 50 (17x) or the S&P 500 (22x)—the index provides a high margin of safety. An average dividend yield of 3.17% reinforces this resilience. While the lack of earnings growth prevents aggressive multiple expansion, the anticipated BoE pivot in early 2026 should spark tactical interest in yield-sensitive sectors, making the UK equity market a preferred destination for risk-averse capital.

Strategic outlook for Q1 2026 and sectoral rotation

As we approach the first quarter of 2026, our scenario favors a moderately bullish but selective outlook for UK equities. Performance will likely be driven by dividend distributions and a slight revaluation of multiples rather than a surge in price growth. The index's lower risk profile compared to international counterparts makes it an ideal vehicle for navigating current stagflationary risks. We recommend a focus on sectors capable of benefiting from falling long-term rates, as the transition from high-interest-rate protection to growth-supportive liquidity will define the winners of the upcoming quarter.

UK equities and securitized real estate



Sources : Bloomberg, BBGI Group

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