

# When nothing appears rational, anything can happen

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This is the chart for movements in the interest rate implicit from the price of UK 10-year government bonds yesterday:



This is the equivalent chart for US 10-year Treasury bonds at the close of trade there:



The upward trend in those charts seen early in the data yesterday should most definitely not have been happening.

If stock markets are in meltdown, and they were most of yesterday, investors should have been looking for safe assets in which to hold their funds. Traditionally, this role has been played by government bonds. In that case, if shares were being sold, then there should have been increased demand to buy bonds, both in the UK and USA.

It is important to remember that the interest rate and government bonds move inversely. That is because once a bond is in issue, the interest paid on it never changes. So, for example, if the rate at the time of issue was 10% (picked for the sake of convenience) and the current market interest rate on bonds is 5%, the market value of the bond in question is broadly speaking, double the issue price, although this equation is, of course, impacted by the time left until redemption takes place. As a result, the fixed interest payment reflects the current market rate on bonds.

Bearing this in mind, if the interest rate on both UK and US 10-year bonds went up yesterday, that must mean the price of these bonds fell. In other words, instead of investors buying bonds as anyone would reasonably expect, given what was happening on the stock exchanges for much of the day, where indices fell, bonds were, in fact, being sold, which is the mechanism that will result in the price falling and effective rates rising.

Logically, those falls in prices should not have taken place. So, why did this happen?

I am to be candid, unable to give a definitive answer to that question, because I doubt that anyone can. In such a confused market, irrational things can happen. I stress, that might be a sufficient explanation for this phenomenon. It is important to bear this in mind when noting the other suggestions I make below.

Alternatively, if there is to be some rationality to this, then that might be found in the US bond market. If Trump is, [as I noted yesterday](#), planning to tell the international owners of US treasury bonds to surrender their existing holdings in exchange for others of longer duration and lower nominal interest rates, in effect triggering a default on US bond obligations, which possibility seems to be quite real at present, then it is entirely rational for US bond market to increase their interest rate demand to reflect the increased risk inherent in US treasury bond holding. This might be sufficient explanation for what is happening in the US market.

That does not, however, explain why the same phenomenon was being seen in UK bond markets. After all, whatever Trump might wish to do, the likelihood that he will interfere directly in the UK bond market is low. So, is this movement simply a reflection of the dominance of the US markets, which the UK market is mimicking, quite illogically given the quite different risk profiles within the two?

Or is the commonality in the moves because both countries are believed to face substantial risks of increased inflation, and as a result, there is a real chance that both central banks are going to increase rates, even though Trump is demanding otherwise of the Federal Reserve?

Or is it that UK bond markets realise that Starmer and Reeves are headless chickens at this point in time, without a clue how to react to world events going on around them, and therefore believe that the risk premium on UK gilts or bonds needs to rise for that reason?

As I have noted, I have no certain answers to these questions because I do not believe that anyone knows precisely.

What I do know is that last night's change of heart on tariffs from Trump only confuses matters further.

What does, however, worry me is the sheer lack of logic in all this. When nothing appears rational, anything can happen, and that is the world that we are now living in.