From FIRE to FOMO: Why duration fears are misplaced

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September 2026 | Marketing Communication

Investors have spent the past few years fearing inflation and avoiding duration. Persisting with that approach could mean missing out on significant opportunities, argues David Roberts.

In recent years, focusing on the short end of the curve in fixed income made sense. 'Fear inflation rises evermore,' or FIRE, kept investors in cash and short-duration funds while central banks raised rates and bond prices fell. Anyone skewed to long duration through that period risked capital losses, and anyone who avoided it looked smart for having done so.

The trouble with good calls is that investors keep making them even when the world has moved on. Yields are at their highest levels in twenty years. Curves have steepened, with the opportunity to generate decent returns appreciably higher at the long end. Despite this, positioning has barely changed. FIRE persists even when the fire looks to be burning itself out.

Short or long?

For investors fearful of adding duration, some simple bond maths may help. A short-duration fund is locked into whatever income the front end of the curve offers, currently around 4%. A more flexible strategy with duration of around 6 years is currently earning closer to 5.5%, simply from higher yields further out.

Investors, quite reasonably, want to know what happens if rates move. If yields rise another half a point, the short-duration fund loses roughly a point of capital with the total return netting out at around 3%. The flexible strategy loses more in capital terms, but the higher starting income leaves it close behind in total return terms, at around 2.5%.

However, if yields fall by half a point, the return of the short-duration fund will be around 5%. The flexible strategy, benefiting from higher income *and* price appreciation, will see returns of 8.5%. This is not to claim a fall in yields is likely, but investors are now being paid enough for the risk that a similar-sized move in either direction leaves the downside comparable and considerably better upside. And that's just beta – returns could be higher for managers who can add alpha on top.

Illustrative returns under different yield scenarios

Market move	Short duration (2 years)			Flexible strategy (6 years)		
	Income	Capital	Total return	Income	Capital	Total return
No change to market rates	4%	–	**4%**	5.5%	–	**5.5%**
Rates rise 50bp (to 5.7%)	4%	-1%	**3%**	5.5%	-3%	**2.5%**
Rates fall 50bp (to 4.7%)	4%	1%	**5%**	5.5%	3%	**8.5%**
Return range (beta only)			**3–5%**			**2.5–8.5%**
Alpha opportunity	Narrow			Broad		

Source: Nedgroup Investments, September 2026. For illustrative purposes only.

Returns without undue risk

Importantly, the potential upside from taking on more duration does not require moving further down the risk spectrum. It will come from income and active management of interest rate exposure in liquid, public markets.

The opportunity is not confined to UK gilts either. Interest rate cycles across the G7 are no longer moving in lockstep. Japan's rate structure has shifted enough this year to generate meaningful gains from a market that a UK-only mandate cannot touch. New Zealand's central bank raised rates in September but was explicit that the move was calibrated to limit how much further it would need to go, flagging the toll higher energy costs are taking on growth. A short-duration, UK-focused fund cannot capture either move. A global, flexible mandate can go where the opportunity is forming.

Furthermore, the opportunity does not rest on rate cuts. Markets are currently pricing in three or four more hikes across most of the G7 over the coming year. If that turns out to be correct, funds with longer duration should hold their own against short-duration ones through income alone. But pricing is not fixed. If the market starts to expect fewer hikes than are currently priced in, yields will fall and bond prices will rise.

Comments from a member of the Bank of England's Monetary Policy Committee suggesting one rather than three hikes might be enough to dampen inflationary pressures were enough to send gilts rallying sharply. Investors waiting for confirmation that the tightening cycle has ended are, by definition, waiting to buy after that repricing has already happened.

FOMO vs FIRE

The case for money market or short duration strategies was compelling when inflation spiked, and central banks tightened monetary policy aggressively in response. It is less compelling after one of the largest bond-market repricings in decades. At today's yields, investors can earn more income by adding duration, with considerably greater upside if expectations for interest rates shift.

That does not mean buying the longest bonds available and hoping that rates fall. It means having the flexibility to take duration where the potential return justifies the risk and to adjust that exposure as conditions change. Investors who continue to wait for confirmation that rates have peaked may miss out on a sizable rally by the time they enter the fray.

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