



**Stock Bond Correlation  
Inversions:** How Stocks  
and Bonds Rise and Fall  
Together (or not) In Various  
Inflation Regimes

September 2025

**EXECUTIVE SUMMARY:**

Sustained inflation disrupts one of the central assumptions of modern portfolio theory – that stocks and bonds move in opposite directions, providing reliable diversification. While this relationship holds true in stable or disinflationary environments, high-inflation regimes often reverse it, leading both equities and bonds to decline simultaneously. This white paper explores the structural reasons behind these shifts and categorizes inflation regimes and their effects on stock–bond dynamics.

**INTRODUCTION:**

For decades, investors have relied on the negative correlation between equities and bonds to anchor diversified portfolios, particularly the classic 60/40 allocation. However, inflation fundamentally alters these dynamics. When inflation rises above threshold levels, equities and bonds become more positively correlated. Bondholders suffer directly as rising yields erode the value of fixed cash flows, while equities face margin compression, valuation headwinds, and lower real earnings growth. In such regimes, the correlation between stocks and bonds flips positive, undermining diversification precisely when it is most needed.



**Stephen Johnston**  
*Director*  
 sjohnston@omnigenceam.com



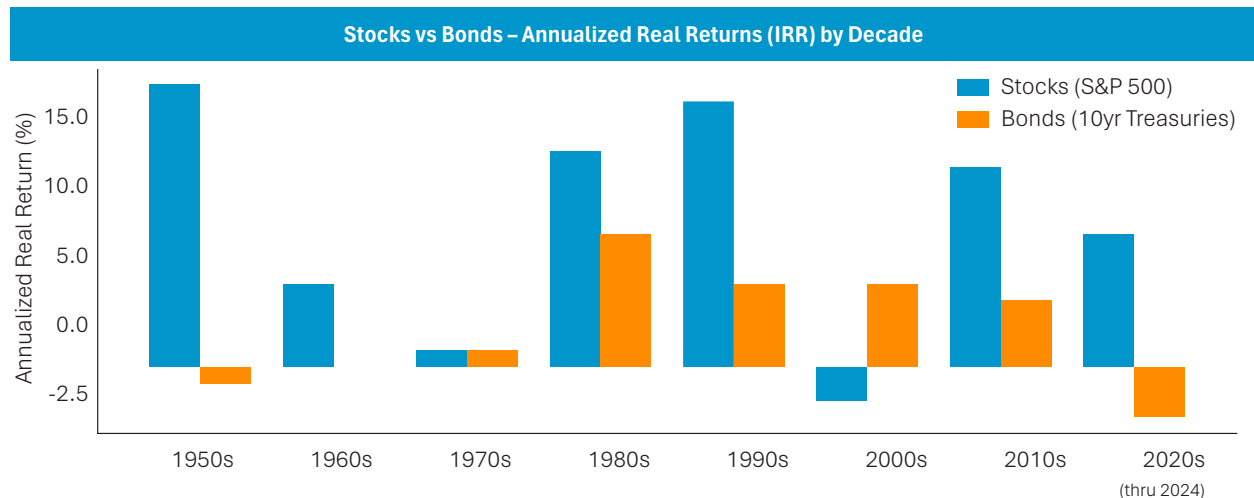
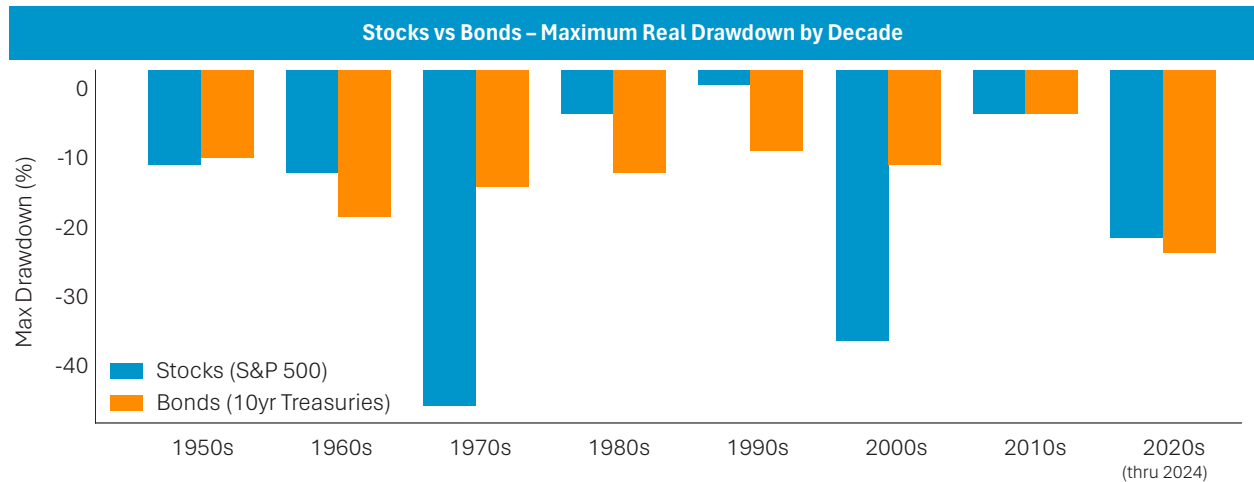
**Matt Barr**  
*Director*  
 mbarr@omnigenceam.com



**Barclay Laughland**  
*Director*  
 blaughland@omnigenceam.com

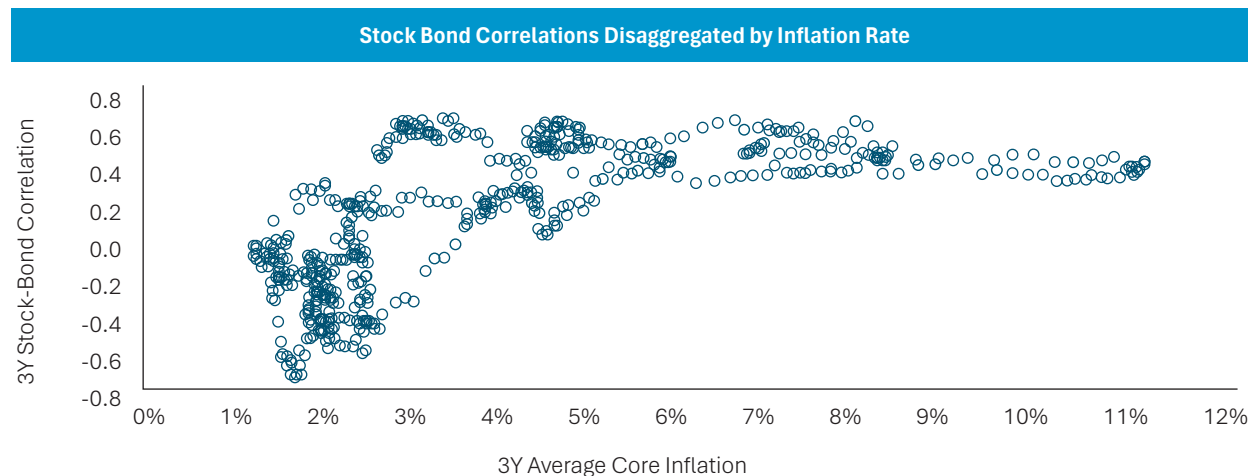


**Kerri Furlong**  
*Director*  
 kfurlong@omnigenceam.com



## OVERVIEW OF INFLATION REGIMES AND STOCK BOND CORRELATIONS:

The relationship between equities and bonds is regime-dependent rather than constant.



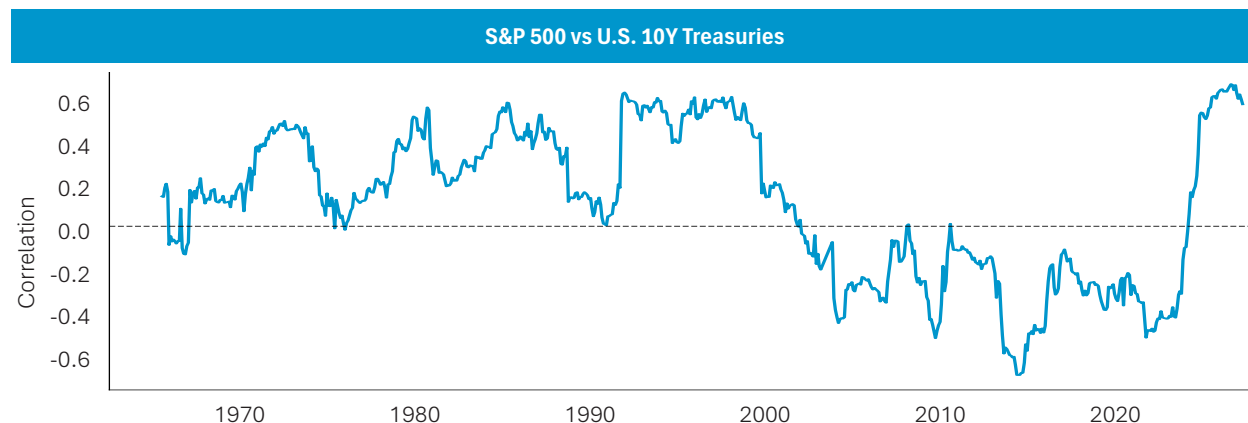
Summarized by Inflation Regime:

Inflation Regime	Period Examples	Average Correlation (approx)	Notes
Low Inflation (<3%)	2000–2020	Negative (-0.2 to -0.5)	Negative correlation dominant post-2000; bonds hedge equities well.
Moderate Inflation (3–5%)	Early 1990s; post-2023 easing	Near zero (0 to 0.3)	Transition phase; diversification still viable but weakening.
High Inflation (>5%, sustained)	1966–1970; 1977–1980; 2021–2024	Positive (0.3 to 0.5)	Correlation rises sharply; peaked above 0.5 in 2022–2024.
Stagflation	Late 1960s–1970s; potential 2025	Positive and volatile	Equities inversely correlated with inflation spikes; downside amplified.

Summarized by Decade:

	Monthly Correlation (Pearson)	Avg Rolling Correlation (36m)
1950s-1960s	0.186	0.099
1970s Stagflation	0.323	0.240
1980s	0.259	0.329
1990s	0.362	0.452
2000s	-0.156	-0.236
2010s	-0.449	-0.345
Post-COVID 2021-2023	0.616	0.616

Rolling 36 Month Correlation Summary:



Notes: SP 500 v 10-year Treasuries, GS10/\*TNX pre-2002, IEF post 2002

**HISTORICAL REAL RETURNS:**

While correlations illustrate the loss of diversification, return and max drawdown data reveals the extent of potential portfolio damage during high-inflation regimes. The table below shows average annualized real returns for U.S. equities and bonds with accompanying return narrative:

	Stocks ~Real IRR	Bonds ~Real IRR	Stocks Max Drawdown	Bonds Max Drawdown	Explanation for Stocks and Bonds Performance
1950s	17%	-1%	-13%	-12%	Stocks: Strong postwar economic growth and low inflation fueled robust returns. The S&P 500 benefited from a booming economy and stable dividends. Bonds: Rising interest rates and moderate inflation eroded real returns.
1960s	5%	0%	-14%	-20%	Stocks: Returns moderated due to rising inflation, Vietnam War spending, and economic uncertainty. Market volatility increased, but dividends provided some cushion. Bonds: Near-zero real returns as inflation began to accelerate.
1970s	1%	1%	-46%	-16%	Stocks: High inflation from OPEC oil shocks and stagflation led to poor real returns. The 1973–74 crash drove a -46% drawdown in real terms. Bonds: Severe inflation outpaced coupons, and rising yields caused bond price declines, with max losses of -16%.
1980s	13%	8%	-6%	-14%	Stocks: Recovery from 1970s stagflation, falling inflation, and strong economic growth drove gains. The 1987 crash was a temporary -6% setback in real terms. Bonds: Yields peaked early (15%+), then fell sharply, boosting bond prices and delivering strong capital gains alongside high coupons.
1990s	16%	5%	-2%	-11%	Stocks: The tech boom, dot-com growth, and strong economic expansion fueled exceptional returns. Low inflation and high productivity supported market gains. Bonds: Continued yield declines (to ~6%) drove price appreciation, and low inflation preserved coupon value, leading to solid real returns.

	Stocks ~Real IRR	Bonds ~Real IRR	Stocks Max Drawdown	Bonds Max Drawdown	Explanation for Stocks and Bonds Performance
2000s	-2%	5%	-37%	-13%	Stocks: The dot-com crash (2000–2002) and 2008 financial crisis led to a “lost decade” with flat-to-negative real returns. Bonds: Falling yields during crises (dot-com and 2008) boosted bond prices, and low inflation supported positive real returns, making bonds a safe haven.
2010s	12%	4%	-6%	-6%	Stocks: Post-2008 recovery, driven by tech giants and low interest rates, supported strong returns. The longest bull market in history began in 2009, with only shallow drawdowns. Bonds: Ultra-low yields limited upside, but safe-haven demand preserved modest real returns.
2020s (thru 2024)	8%	-3%	-23%	-25%	Stocks: Strong recovery post-COVID (2020) and tech sector growth (e.g., AI, NVIDIA) drove high returns. Bonds: Rate hikes in 2021–2022 caused sharp price declines, leading to a -25% real drawdown, despite partial recovery in 2023–2024 as inflation cooled.

Notes: 10 Year Treasury, S&P 500, deflator is CPI

### CASE STUDIES:

The 1970s stagflation era provides a textbook example of correlation breakdown. Inflation surged into double digits, monetary tightening failed to contain it, and oil shocks compounded economic strain. Equities suffered negative real returns, while bondholders endured a long bear market. The diversification premise collapsed.

By contrast, the 2008 financial crisis reflected a deflationary environment where bonds functioned as expected. Equities fell, but Treasuries rallied, reinforcing their role as a safe haven when inflation was not a threat.

Finally, the post-COVID surge in inflation between 2021 and 2023 mirrored the stagflationary pattern of the 1970s. Central banks tightened aggressively, equities and bonds both declined in real terms, and correlations turned positive. This episode was a clear reminder that diversification is inflation regime-dependent.

### IMPLICATIONS FOR PORTFOLIO CONSTRUCTION:

The evidence suggests that traditional 60/40 portfolios are vulnerable in inflationary or stagflationary regimes. Investors must adapt by expanding diversification into inflation- and stagflation-sensitive assets. Fixed income allocations should emphasize shorter duration exposures. Dynamic asset allocation is critical. Investors should monitor correlation structures, adjust exposures across regimes, and apply factor-based strategies in equities, favoring value and quality over long-duration growth assets. Stress-testing portfolios against inflationary scenarios ensures resilience when correlations shift unfavorably.

### CONCLUSION:

The notion that bonds always hedge equity risk is increasingly untenable. History shows that in high-inflation or stagflationary environments, equities and bonds can both deliver negative real returns as correlations flip positive, amplifying portfolio risk. Recognizing the cyclical nature of cross-asset dynamics, adopting inflation-resilient exposures, and actively managing allocations are essential steps toward building portfolios robust enough to withstand future inflationary/stagflationary shocks.

## REFERENCES & SOURCES:

- Ilmanen, Antti. *Expected Returns: An Investor's Guide to Harvesting Market Rewards*. Wiley Finance, 2011.
- Ang, Andrew, and Geert Bekaert. "Stock Return Predictability: Is It There?" *The Review of Financial Studies*, 2007.
- Dimson, Elroy; Marsh, Paul; and Staunton, Mike. *Credit Suisse Global Investment Returns Yearbook* (various editions).
- Campbell, John Y., and Luis M. Viceira. *Strategic Asset Allocation: Portfolio Choice for Long-Term Investors*. Oxford University Press, 2002.
- Board of Governors of the Federal Reserve System (FRED). Historical datasets on CPI, Treasury yields, and equity returns.
- International Monetary Fund (IMF). *World Economic Outlook* and historical inflation/market data.
- Bloomberg and Refinitiv Datastream. Time series on equity, bond, and inflation-linked returns.
- Research papers from the Federal Reserve Bank of San Francisco & St. Louis on stock–bond correlation dynamics under inflationary regimes.
- Max drawdown is peak to trough in the relevant decade
- Stock/bond real return table: Real returns reflect S&P 500 total returns (price appreciation + reinvested dividends) minus CPI inflation. Long-term real CAGR is ~7.75% from 1950–2025. Bonds: Real returns reflect 10-year Treasury total returns (coupon payments + price changes) minus CPI inflation. 2020–2025: Partial data up to August 31, 2025. Sources: Stock data from MacroTrends and Yahoo Finance (^GSPC); bond data from NYU Stern and FRED. Inflation assumed at ~2.7% for 2025 YTD.

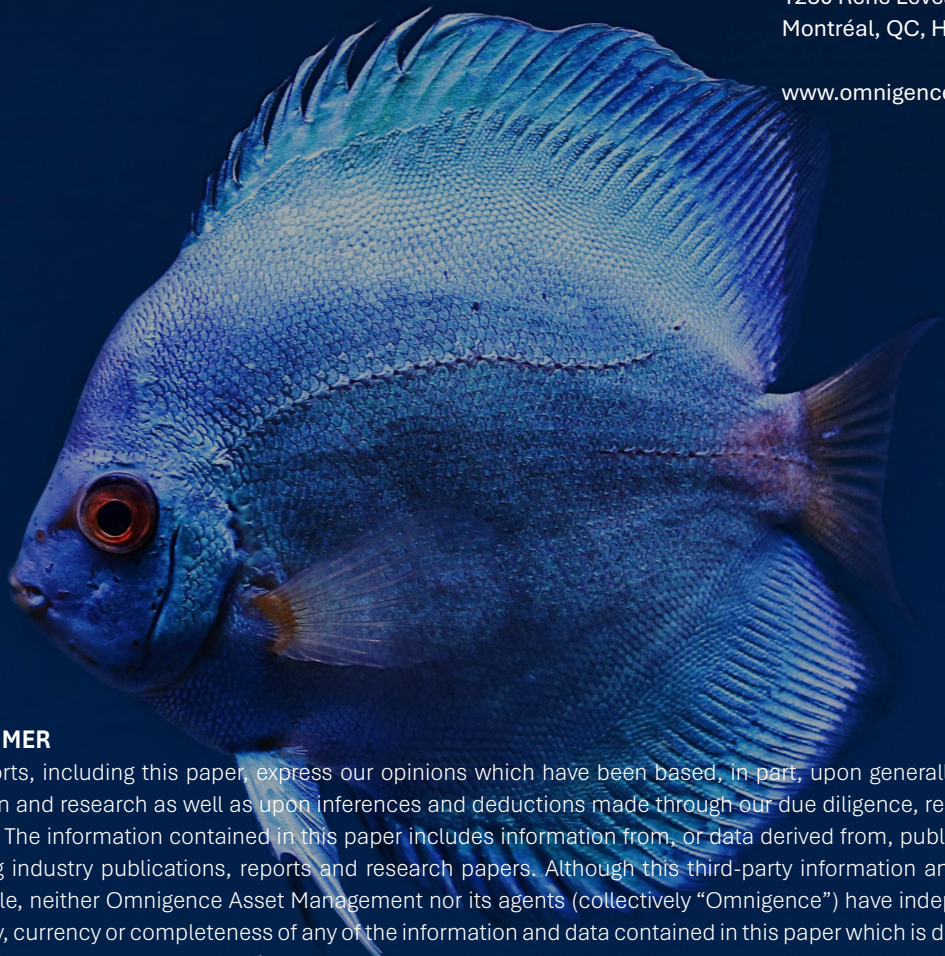


Toronto Office:  
TD Canada Trust Tower, 161 Bay St.  
27th Floor, P.O. Box 508  
Toronto, ON, M5J 2S1

Calgary Office:  
Suite 300, 4954 Richard Road SW  
Calgary, AB, T3E 6L1

Montréal Office:  
1250 Rene Levesque, 22nd Floor  
Montréal, QC, H3B 4W8

[www.omnigenceam.com](http://www.omnigenceam.com)



## DISCLAIMER

Our reports, including this paper, express our opinions which have been based, in part, upon generally available public information and research as well as upon inferences and deductions made through our due diligence, research and analytical process. The information contained in this paper includes information from, or data derived from, public third-party sources including industry publications, reports and research papers. Although this third-party information and data is believed to be reliable, neither Omnigence Asset Management nor its agents (collectively "Omnigence") have independently verified the accuracy, currency or completeness of any of the information and data contained in this paper which is derived from such third party sources and, therefore, there is no assurance or guarantee as to the accuracy or completeness of such included information and data. Omnigence and its agents hereby disclaim any liability whatsoever in respect of any third-party information or data, and the results derived from our utilization of that data in our analysis. While we have a good-faith belief in the accuracy of what we write, all such information is presented "as is," without warranty of any kind, whether express or implied. The use made of the information and conclusions set forth in this paper is solely at the risk of the user of this information. This paper is intended only as general information presented for the convenience of the reader and should not in any way be construed as investment or other advice whatsoever. Omnigence is not registered as an investment dealer or advisor in any jurisdiction and this report does not represent investment advice of any kind. The reader should seek the advice of relevant professionals (including a registered investment professional) before making any investment decisions. The opinions and views expressed in this paper are subject to change or modification without notice, and Omnigence does not undertake to update or supplement this or any other of its reports or papers as a result of a change in opinion stated herein or otherwise.