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ASSET MANAGEMENT
Unlocking Returns in the Undervalued and the Novel

September 9, 2025

Stock-Bond Correlation Inversions

For decades, investors relied on the negative correlation between stocks and bonds as the anchor of diversified portfolios. History shows this relationship is not constant. In periods of high inflation or stagflation, stocks and bonds move together – falling at the same time – leaving portfolios exposed.

Decade	Stocks (Real IRR)	Bonds (Real IRR)	Stocks Max Drawdown	Bonds Max Drawdown	Narrative
1950s	+17%	-1%	-13%	-12%	Postwar boom fuels equities; bonds lose to inflation
1970s	+1%	+1%	-46%	-16%	Stagflation erodes both
1990s	+16%	+5%	-2%	-11%	Tech boom, low inflation — both thrive
2020s (thru '24)	+8%	-3%	-23%	-25%	Post-COVID inflation & rate hikes hit both

Note: Adapted from historical data on S&P 500 and 10-year Treasuries

Key Highlights

Inflation Disrupts Diversification:

- In stable or low-inflation environments, stocks and bonds tend to move in opposite directions.
- But once inflation exceeds ~5%, correlations turn positive, eliminating the hedge.

Historical Evidence:

- 1970s stagflation and 2021–2023 inflation spike both saw stocks and bonds lose value together.
- 2008 crisis proved the opposite: bonds rallied while stocks fell.

Portfolio Risks:

- Traditional 60/40 allocations are highly vulnerable in inflationary and stagflationary regimes.
- Historical examples of simultaneous drawdowns of 20–40%.

Core Conclusions:

- The assumption that bonds always hedge equity risk is not reliable.
- Investors must adapt strategies in inflationary and stagflationary conditions.

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