

## 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.

| Inflation Regime | Period Examples                  | Average Correlation | Diversification Impact                  |
|------------------|----------------------------------|---------------------|---|
| Low (<3%)        | 2000–2020                        | -0.2 to -0.5        | Bonds hedge equities well               |
| Moderate (3–5%)  | Early 1990s;<br>post-2023 easing | ~0 to 0.3           | Diversification weaker but still viable |
| High (>5%)       | 1966–70; 1977–80;<br>2021–24     | 0.3 to 0.5          | Both assets fall together               |
| Stagflation      | 1970s;<br>possible 2025          | Positive & volatile | Severe drawdowns across both            |

## Key Highlights

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### **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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