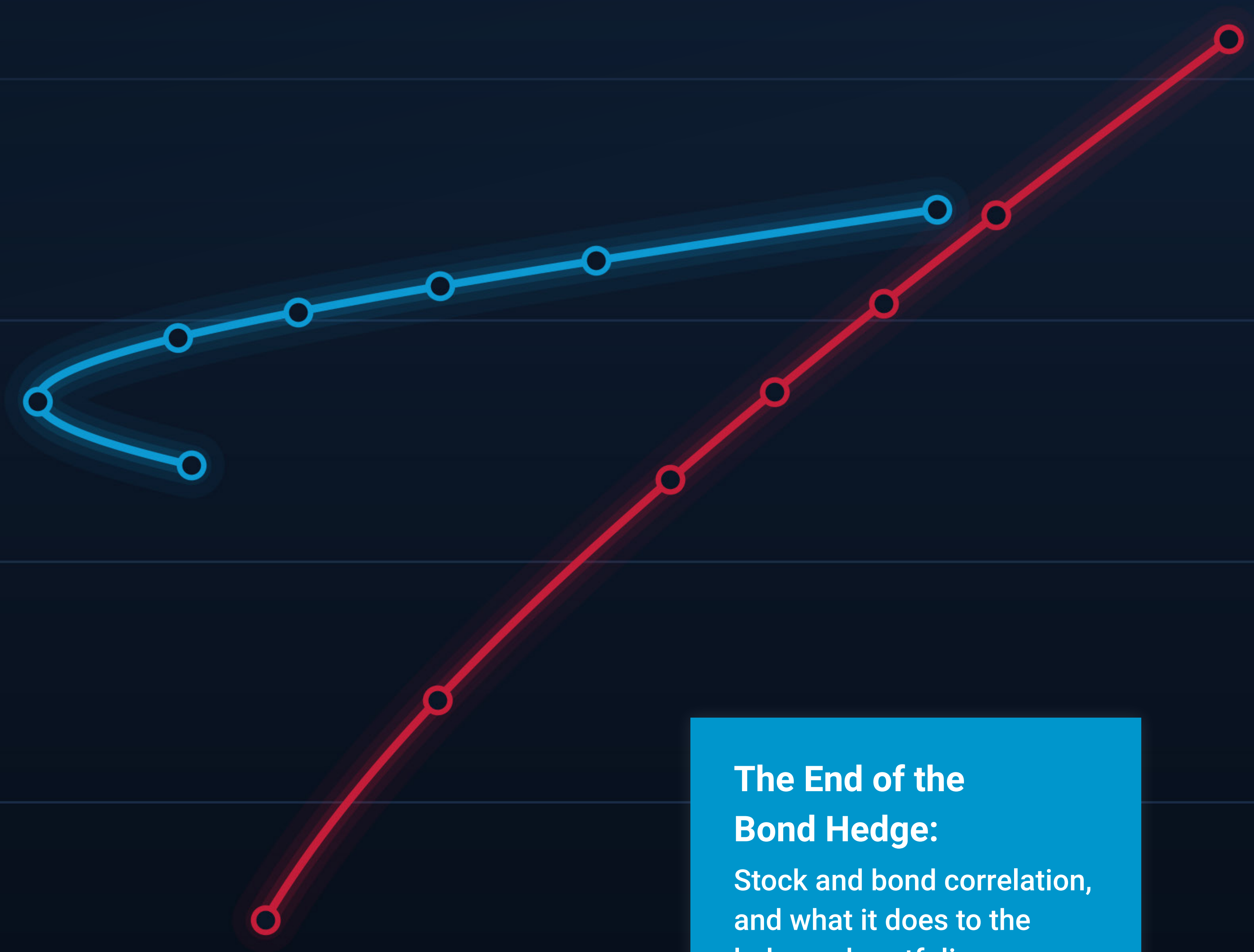
OMNIGENCE
ASSET MANAGEMENT



The End of the Bond Hedge:

Stock and bond correlation, and what it does to the balanced portfolio

September 2026

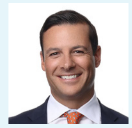
EXECUTIVE SUMMARY:

Between 1986 and 2020 the correlation between annual S&P 500 total returns and annual returns on the 10-year US Treasury was negative 0.11. Between 2021 and 2025 it was positive 0.77. A single change in that one parameter removes the property on which the balanced portfolio has depended for four decades.

The consequence is visible in the shape of the risk and return frontier. Under the earlier regime the least volatile portfolio available was not an all-bond portfolio. It was a mix of roughly 26 percent stocks and 74 percent bonds, carrying 7.6 percent annualised volatility against 9.1 percent for bonds held alone. Adding a volatile asset reduced total portfolio risk, a benefit worth approximately 1.5 percentage points of volatility.

In the 2021 to 2025 period that benefit is absent. The minimum variance portfolio is an all-bond portfolio, and every incremental allocation to equities raises risk in close to a straight line. Bonds over this window returned negative 2.4 percent a year while carrying 9.8 percent volatility.

Stephen Johnston
Director
sjohnston@omnigenceam.com



Matt Barr
Director
mbarr@omnigenceam.com

Barclay Laughland
Director
blaughland@omnigenceam.com

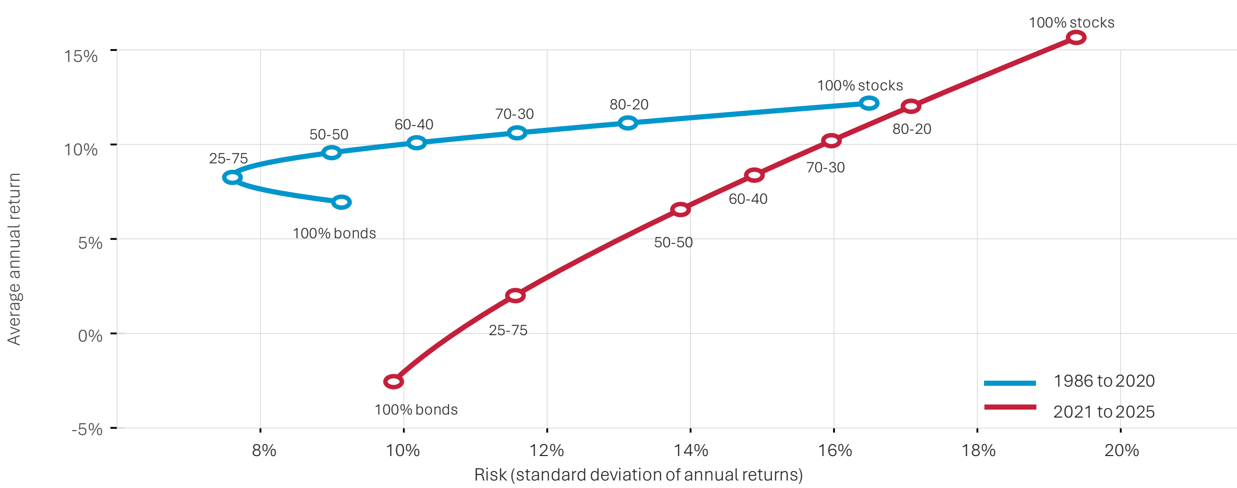
THE EVOLUTION OF THE FRONTIER:

Table 1. Average annual return and standard deviation of annual returns, by portfolio mix, percent

	1986 to 2020		2021 to 2025	
	Return	Risk	Return	Risk
100% bonds	6.99	9.10	-2.44	9.83
25 stocks / 75 bonds	8.31	7.58	2.13	11.53
50 / 50	9.64	8.96	6.69	13.83
60 / 40	10.17	10.15	8.52	14.86
70 / 30	10.70	11.55	10.35	15.93
80 / 20	11.23	13.10	12.18	17.04
100% stocks	12.29	16.46	15.83	19.35

Source: Annual S&P 500 total returns and 10-year US Treasury returns, Aswath Damodaran, NYU Stern, January 2026 update. Omnigence calculations.

Chart 1: Stock/Bond Frontiers 1986-2020 and 2021 to 2025



The two curves differ in level, which is unsurprising given the interest rate cycle, but the material difference is in shape. The earlier curve bends backwards at its left end. That hook is the entire mechanical case for holding bonds alongside equities: over that period the two assets frequently moved in opposite directions, so the variance of the blend was lower than the variance of either component in the region near the minimum. The later curve has no hook. It is monotonic in risk, which means no combination of the two assets was less volatile than the least volatile asset held alone.

THE MECHANISM:

Equity and bond prices respond to a common discount rate but to different underlying shocks. When the dominant shock is to growth, the two assets diverge: weaker growth depresses earnings expectations and lowers policy rates, so equities fall while bonds rally. When the dominant shock is to inflation, the two assets converge: higher inflation raises the discount rate applied to both, and both fall together.

The 1986 to 2020 window was characterised by disinflation and by growth shocks that were met with monetary easing. The negative correlation observed over that period was therefore a property of the macroeconomic regime rather than an intrinsic property of government bonds. The 2021 to 2025 window has been characterised by an inflation shock and by monetary tightening in response, and the correlation has behaved accordingly. Investors who treated the negative correlation as structural were extrapolating a regime.

CONSEQUENCES FOR PORTFOLIO CONSTRUCTION:

A 60 percent equity and 40 percent bond portfolio earned an average 10.2 percent annually at 10.2 percent volatility under the earlier regime. From 2021 to 2025 the same allocation earned 8.5 percent at 14.9 percent volatility. If the correlation remains positive, the diversification that the balanced portfolio was designed to deliver may need to be sourced elsewhere. The relevant test for any candidate allocation is not whether it is described as an alternative asset, but whether its return is driven by something other than the discount rate that now moves stocks and bonds together.

OMNIGENCE
ASSET MANAGEMENT

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:
3 Place Ville Marie, Suite 3190
Montréal, QC H3B 2E3

www.omnigenceam.com