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Quick Take: Neglected History— A Shift in Bond-Stock Diversification

July 2022

In 2022, Bonds have Not Delivered Familiar Protection

- In recent decades, asset owners grew accustomed to diversification benefits from sovereign bonds. During market shocks, their negative correlation with stocks lent significant protection to 60/40 portfolios (top chart).
- But during the 2022 sell-off, 60/40 allocations have exhibited less of a defensive character than in past selloffs.
- In contrast, low beta equities (light blue bars) have provided material downside protection* this year, in fact outperforming the canonical balanced allocation.

An Interesting Shift in Stock-Bond Comovement

- The lack of diversification from bonds reflects the nature of the 2022 selloff. Bonds and broad equity indexes have struggled alike as rising commodity prices and supply shocks have simultaneously generated inflation and threatened growth.
- Within equities, however, low volatility portfolios have benefited from typical cross-sectional performance patterns. While higher vol sectors geared to growth have performed poorly, including IT, consumer discretionary, and communications, lower vol sectors, including utilities and consumer staples, have fared better.
- An interesting result is that in this rising-rate selloff, sectors that for years have been anticorrelated with bonds have behaved like bond proxies. Meanwhile, high-yielding sectors commonly thought of as proxies for bonds have helped to diversify them and, in the process, reduced portfolio risk (middle chart)
- While atypical of more recent history, the positive comovement between stocks and bonds should not come as a surprise. For decades prior to 2000, it was the norm (bottom chart).

Deliberation in Risk Reduction

- Recent 60/40 performance is a reminder not to assume that bonds will diversify stocks as they have over the past 20 years. Allocators should consider other forms of portfolio risk reduction, including low vol equities and strategies deliberately constructed to reduce correlation with both equities and bonds.

* See Managed Volatility in the Pandemic for discussion of historical downside protection

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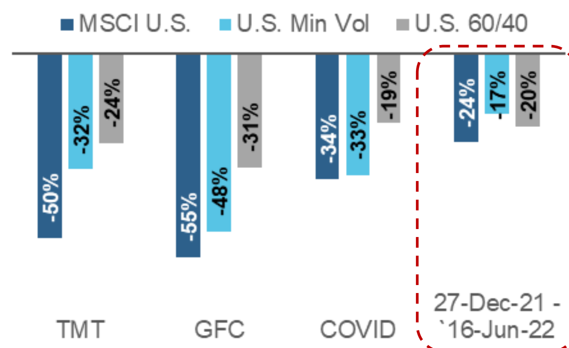
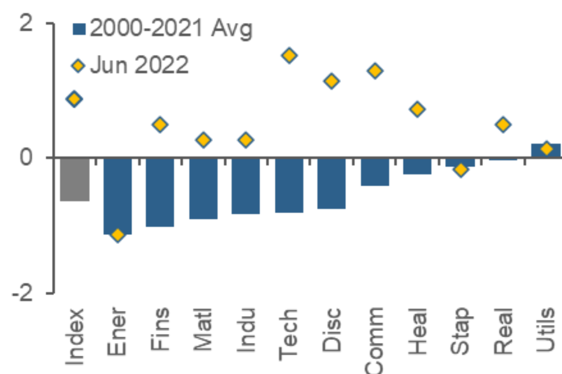
Drawdowns: Cap-weighted, low vol, and 60/40

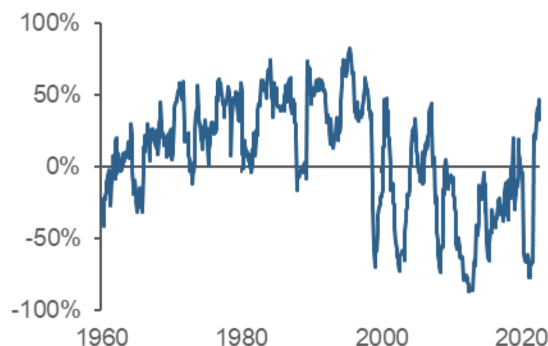


Drawdowns based on MSCI US Index peak to trough.

Bond Betas to U.S. 10y Treasuries (trailing 18M)



Long-term Stock-Bond Correlations (rolling 18M)



Sources: Acadian Analysis, Equity Index Source (top two charts): MSCI Copyright MSCI 2022. All Rights Reserved. Unpublished. PROPRIETARY TO MSCI. Long-term S&P Composite Index total returns (bottom chart), U.S. 10y Treasury Index and 3m Treasury Bill Index Source: S&P Copyright (c) 2022, Standard & Poor's Financial Services LLC. All rights reserved. For illustrative purposes only. For illustrative purposes only. Investors have the opportunity for losses as well as profits. Past performance is no guarantee of future returns.

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