Is There a **Better Way to Diversify** Equity Risk than Fixed Income?

By LoCorr Research Team | March 2025

"Insanity is doing the same thing over and over again and expecting different results."

This quote is often associated with Albert Einstein and mystery novelist Rita Mae Brown, addressing the need for change in the face of failure. Many have found the applicability of this quote in life's challenges, including in their golf game. The expectation to score low and hit every shot without intense practice or dissection of the fundamentals could be considered insane. Is this rational? More often than not, it isn't. It is often easier to just hope for the best or make surface level changes like buying new golf clubs or simply blaming the density of sand in the bunkers some are frequenting. However, do these quick fixes or blaming really help the golfer's game in the future?

All the quick fixes, blaming, and repetitions without addressing the root cause draws parallels to investing. We are fortunate to speak to a wide range of investors, from institutional sector specialists studying commodity market supply and demand structure to financial advisors looking to solve multi-generational wealth transfers.

For this short article, we want to focus on institutional allocators, financial advisors, and retail clients and challenge "the way things have been done," with respect to asset allocation, meaning repeatedly using bonds to diversify stocks.

Key Takeaways

- The correlation between equity and fixed income market indices has been steadily rising.
- As bond correlation to stocks has increased, managed futures correlation has decreased
- Analyzing correlation among positions in portfolio construction and the asset allocation process must be paramount.

Since 1986 until recently, bonds have been in a structural bull market, as represented by the Bloomberg U.S. Aggregate Bond Index. For a multitude of reasons, interest rates fell from the 1970's until 2020, creating a substantial tailwind for bonds. But even more interesting and, in our view, detrimental to the way many allocate today, bonds became rooted in human psychology as the "safe pick" or "no brainer". Amongst a whole host of reasons, the perceived benefits of bonds largely fall into two broad categories: return (via income or price appreciation) and diversification.

As of 12/31/2024, the U.S. 10-Year Treasury yielded 4.39%, not a bad pre-tax/pre-inflation adjusted income level for something backed by the full faith and credit of the U.S. Government. By using yield as a rough proxy for forward return expectations and assuming all else constant (low inflation, no movement in rates, and continued all-time tight credit spreads), you are hoping the future is brighter than the last 5 to 10 years.

Performance Summary | As of 12/31/24

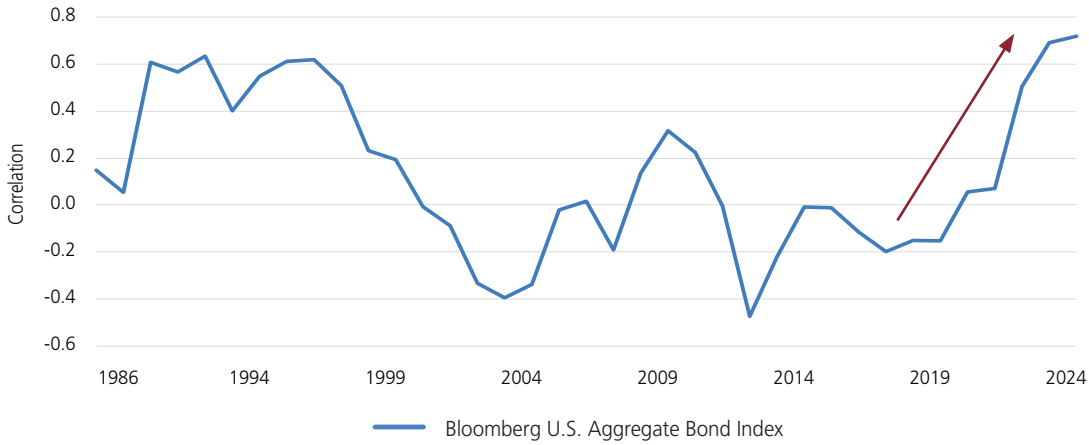
	YTD	1-Year	3-Years	5-Years	10-Years	15-Years	20-Years
Bloomberg U.S. Aggregate Bond Index	1.25%	1.25%	-2.41%	-0.33%	1.35%	2.37%	3.01%
S&P 500 Index	25.02%	25.02%	8.94%	14.53%	13.10%	13.88%	10.35%

Source: FRED, Economic Research Division.

However, going back even further, say 20 years an allocation to bonds for return has not been anything to write home about. The above table may be shocking; the "safe pick" or "sure bet" has only returned 3.01% over the past 20 years? However, the more shocking point is the second benefit of bonds, or current lack thereof, diversification.

The correlation between equity and fixed income market indices has been steadily rising, reaching a level not seen since the inception of the Bloomberg U.S. Aggregate Bond Index in 1986. With a correlation nearing +0.7, the diversification "free lunch" as described by the Nobel prize winner Harry Markowitz, is now looking for payment.

Correlation of Bloomberg U.S. Aggregate Bond Index vs. S&P 500 Index - 1986-2024



Source: LoCorr Fund Management and Morningstar Direct. Time period is 1/1/1986-12/31/24. **Past performance does not guarantee future results.**

Since the start of 2020, when stock & bond correlation started to move meaningfully positive, there have been 12 pullbacks in the S&P 500 of -5% or more with bonds being positive in only 3 of these instances.

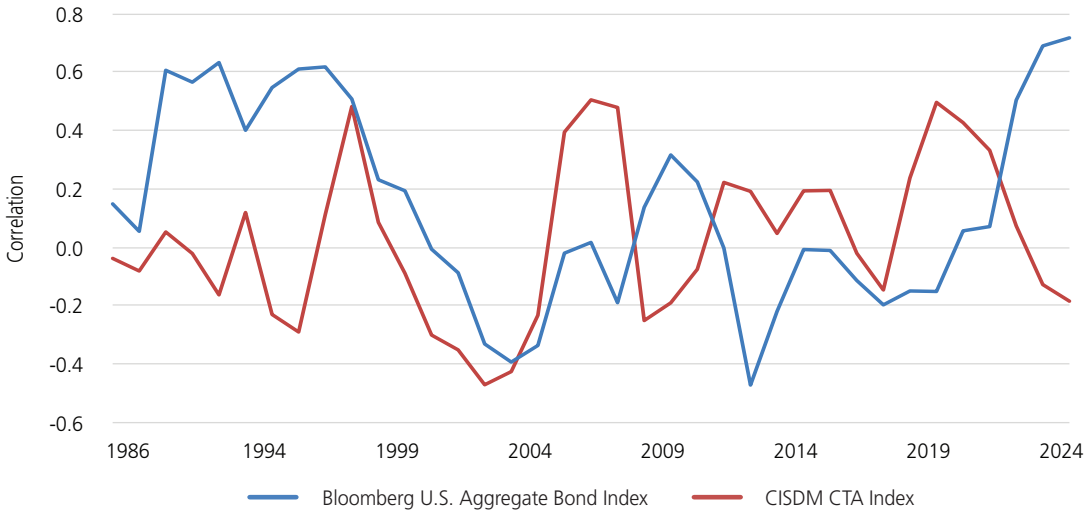
Performance Summary | As of 12/31/24

	2/20/20-3/23/20	3/27/20-4/1/20	6/9/20-6/11/20	9/3/20-9/23/20	10/13/20-10/30/20	9/3/21-10/4/21	1/4/22-10/12/22	12/1/22-12/28/22	2/2/23-3/13/23	8/1/23-10/27/23	3/29/24-4/19/24	7/17/24-8/5/24
Bloomberg U.S. Aggregate Bond Index	-0.94	1.01	0.70	-0.33	-0.22	-0.78	-14.38	-0.60	-1.46	-4.41	-2.36	2.21
S&P 500 Index	-33.79	-6.04	-7.11	-9.52	-7.43	-5.12	-24.49	-7.16	-6.16	-9.94	-5.40	-8.45

This brings us back to the insanity quote; is there a better way to balance equity risk than with bonds? Or should we hope correlation falls back into negative territory and the next 20 years are better than the last? Is hope a strategy when historically, stock and bond correlation has gone decades in positive territory? Should we search for short-term band-aid fixes like finding the next 10 bagger stock or attributing this market environment as completely different, too hard, and full of imperfect sand quality?

While the consideration of returns is often first analyzed, in the context of portfolio construction and asset allocation, correlation is paramount. And since 2020, as bond correlation has picked up, managed futures/global macro, as represented by the CISDM CTA Index has provided the diversification that bonds have not.

Correlation of Bloomberg U.S. Aggregate Bond Index vs. CISDM CTA Index - 1986-2024



Source: LoCorr Fund Management and Morningstar Direct. Time period is 1/1/1986-12/31/24. **Past performance does not guarantee future results.**

And over the long term, the correlation benefit has translated into better performance, or more money, +102% more money.

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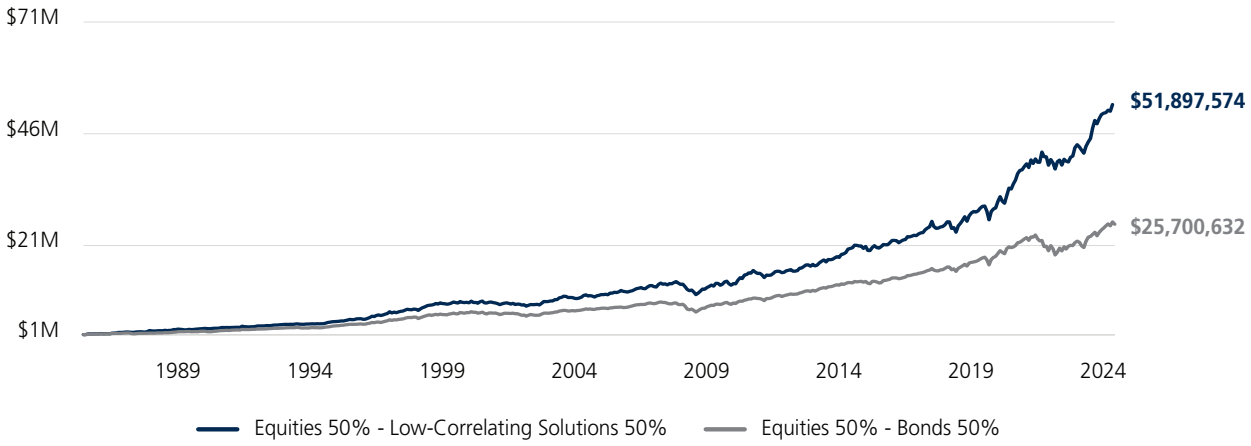

Source: LoCorr Fund Management and Morningstar Direct. Equities represented by the S&P 500 Index, Low-Correlating Solutions represented by the CISDM CTA Index, and Bonds represented by the Bloomberg U.S. Aggregate Bond Index. **Past performance does not guarantee future results.**

Asking what is at the root cause of our frustration, not short-term band-aid fixes, can often lead us to making changes for the better leading our insanity away from the markets and reserving the infuriation for the golf course.

To learn more about how LoCorr can help you reach your investment goals, contact us at **888-628-2887** or visit us at **www.LoCorrFunds.com**.

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Bloomberg U.S. Aggregate Bond Index is a broad-based bond index comprised of government, corporate, mortgage and asset-back issues rated investment grade or higher. **CISDM CTA Index** is designed to broadly represent the performance of all CTA programs in the Morningstar database that meet the inclusion requirements. **S&P 500 Index** is a capitalization weighted unmanaged benchmark index that includes the stocks of 500 large capitalization companies in major industries. This total return index includes net dividends and is calculated by adding an indexed dividend return to the index price change for a given period.

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