



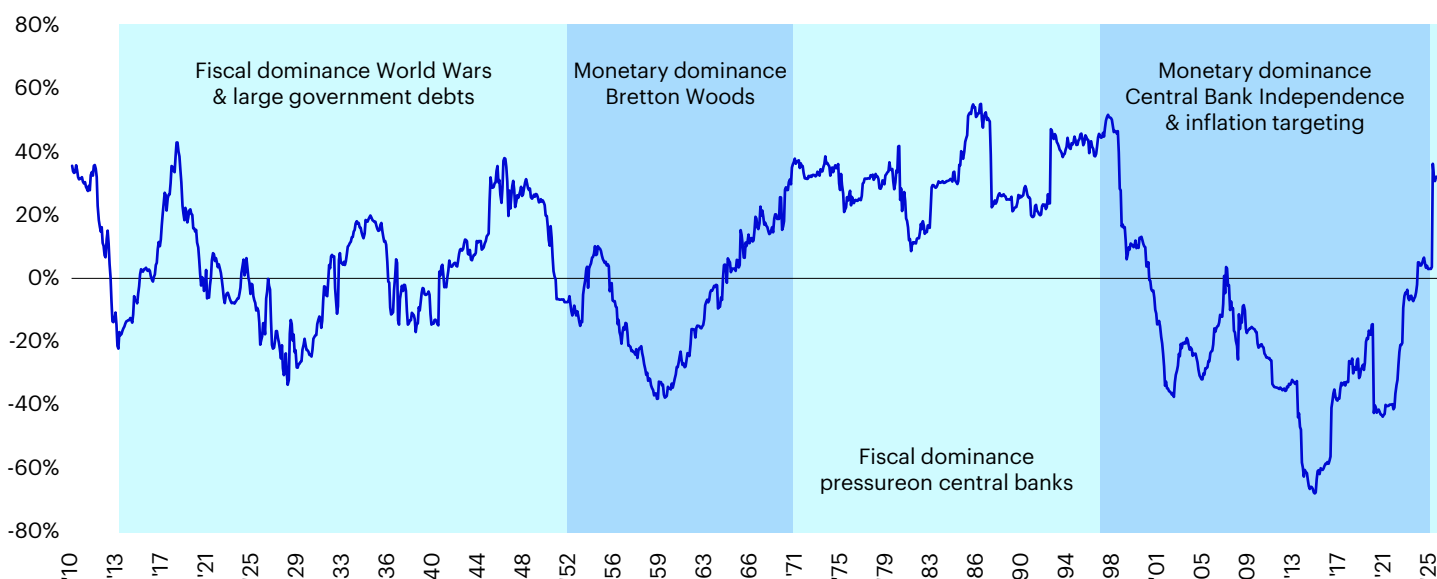
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Key takeaways

- Structural inflation may cause the correlation between stocks and bonds to become higher and more volatile, reducing the reliability of the traditional stock-bond diversification model.
- Resilience is therefore broader than bonds or portfolio defense. It requires investors to protect capital during economic stress, preserve purchasing power during inflationary environments, and diversify against risks shared by traditional assets.
- A total portfolio approach can bring defensive assets, inflation protection, and diversifying strategies into a common framework, evaluating each according to its contribution to overall portfolio resilience.

For much of the post-2000 period, portfolio resilience appeared relatively straightforward. Investors could combine equities for growth with high-quality government bonds for defense. When economic activity weakened and equity markets declined, inflation often moderated, interest rates fell, and bonds appreciated. This created a naturally complementary relationship between the two principal components of a traditional portfolio.

Figure 1 – 5-year bond / equity correlations using monthly returns



Source: Invesco, shillerdata.com, Bloomberg L.P. as of 31 March 2026. Based on monthly S&P500 and 10yr US bond return.

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It's important to note that the negative stock-bond correlation was really a historical exception, not the rule. However, the post-2000 relationship was so persistent that investors increasingly came to regard negative stock-bond correlation as a structural feature of markets. It was ultimately a feature of a particular economic regime: declining inflation, credible monetary policy, falling interest rates, and limited concern about fiscal sustainability. In that environment, growth shocks generally mattered more than inflation shocks. Weakening growth placed pressure on equities but usually supported bonds, allowing the two assets to offset one another.

Structural inflation can change that relationship. When inflation becomes the dominant source of uncertainty, rising prices can place simultaneous pressure on both equities and bonds. Bond prices may decline as interest rates rise, while equity valuations and profit margins can also come under pressure from higher discount rates and input costs. Rather than offsetting one another, the two largest components of a traditional portfolio can begin responding to the same underlying risk.

The challenge is not simply that the stock-bond correlation may become more positive. It may also become more volatile, moving between negative and positive regimes as markets alternate between concerns about growth and concerns about inflation. Bonds may still provide meaningful protection during a disinflationary recession, but they may offer substantially less protection during an inflation shock. Investors can therefore no longer assume that adding bonds automatically provides sufficient portfolio resilience.

This raises a central question: how can investors construct a portfolio for resilience when the relationship between stocks and bonds is itself dependent on the nature of the next shock?

Resilience has more than one function

In the first article in this series, we organized portfolios around three broad outcomes: growth, resilience, and total portfolio integration. Growth assets are responsible for long-term capital appreciation. Resilience is responsible for supporting the portfolio when the economic conditions underpinning that growth become less favorable. However, this function contains several distinct objectives.

The first is portfolio defense. High-quality bonds, cash, currencies, option-based strategies, and other defensive exposures may help protect capital when growth slows, market volatility rises, or investors seek liquidity. The second is inflation protection. Inflation-linked securities, commodities, infrastructure, real estate, and other real assets may help preserve purchasing power when inflation rises unexpectedly or remains elevated. The third is diversification. Strategies such as trend following, macro, market neutral, and multi-strategy investing may provide return streams that are less dependent on the direction of traditional equity and bond markets.

These exposures are often managed in separate asset class allocations, yet they contribute to the same portfolio outcome. Bonds, commodities, and option hedges may look very different as investments, but each can potentially improve resilience under different conditions. The relevant question is not whether they belong within fixed income, real assets, or alternatives. It is what risk they are intended to address and whether the overall portfolio possesses sufficient protection against that risk.

No single asset is always defensive

Traditional defensive assets have displayed materially different behavior across periods of market stress. Long-duration government bonds provided meaningful protection during the Global Financial Crisis and the COVID-19 shock, when falling growth and declining interest rates supported bond prices. They were substantially less effective in 2022, when inflation and monetary tightening placed simultaneous pressure on equities and fixed income. Gold, US dollar, and trend-following strategies have also provided protection during certain episodes, but none has performed consistently across every crisis.

Figure 2 - Traditional defensive assets have shown variable behavior, diversifying portfolio defense is worth considering

Global Financial Crisis (June 2007 to March 2009)	Sovereign Crisis Debt Crisis (May 2011 to Sept. 2011)	COVID (Q1 2020)	2022 (Jan to Sept.)	Tariffs (2/19/2025 to 4/8/2025)	Iran Conflict (1/26/26 to 3/20/25)
-45% SP 500	-17% SP 500	-20% SP 500	-24% SP 500	-19% SP 500	-6% SP 500
41% Gold	31% Long Treasuries	21% Long Treasuries	36% Trend	2% Gold	3% Dollar
33% Long Treasuries	4% Gold	4% Gold	18% Dollar	1% Long Treasuries	1% Trend
17% Trend	6% Dollar	3% Dollar	-9% Gold	-3% Dollar	-2% Long Treasuries
4% Dollar	2% Trend	2% Trend	-30% Long Treasuries	-11% Trend	-11% Gold

■ S&P 500
 ■ Long Treasuries
 ■ Gold
 ■ Dollar
 ■ Trend

Source: Invesco. **Past performance does not predict future returns.** Diversification does not guarantee a profit or eliminate the risk of loss. The performance shown is for illustrative purposes only and does not represent the performance of any Invesco products.

This variability is not evidence that defensive assets have failed. It reflects the fact that market shocks have different causes. A recession, inflation shock, liquidity crisis, and loss of confidence in monetary or fiscal institutions are not economically equivalent events. The assets that protect against them therefore should not be expected to behave identically.

Instead, investors may need to diversify the sources of defense itself. High-quality bonds have historically provided important protection against disinflationary recessions. Options could provide contractual protection rather than relying on correlations remaining stable. Trend-following strategies can adapt as persistent market movements emerge. Gold and selected currencies may respond to concerns about monetary credibility or financial instability. The objective is not to replace bonds, but to avoid asking bonds to protect the portfolio against every possible environment.

Inflation protection must be explicit

Inflation presents a particular challenge because it can weaken both capital preservation and diversification at the same time. A portfolio may remain stable in nominal terms while losing purchasing power, at the same time conventional bonds may provide less protection against equity market weakness if both assets are responding to the same inflation shock.

Inflation-linked bonds could provide direct linkage to reported inflation, while commodities may offer sensitivity to changes in energy, food, metals, and other input costs. Infrastructure and real estate may provide exposure to physical assets and revenues that can adjust over time, although the strength of that protection depends on valuations, financing structures, contractual terms, and the ability to pass higher costs through to users. Gold may play a different role, responding less to current consumer prices than to changes in real yields, currency confidence, and perceptions of monetary credibility. Increasingly, gold serves as a fiscal and monetary shock absorber.

These assets should not be treated as interchangeable. Each protects against a different expression of inflation and introduces its own risks. Nor should they be viewed only as tactical trades deployed after inflation has already appeared. If inflation is becoming a recurring feature of the investment environment, inflation-sensitive assets may be relevant considerations within portfolio architecture.

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Diversifying the resilience engine

A total portfolio perspective brings defensive assets, inflation protection, and diversifying strategies into a common framework. Every investment can be assessed according to the shock it is designed to address, the strength of that relationship, its expected cost, its liquidity, and its interaction with the rest of the portfolio.

This matters because apparent asset class diversification can conceal common economic exposure. Portfolios divided between equities and bonds may appear diversified, but both allocations can remain vulnerable to rising inflation and interest rates. Conversely, strategies housed in different parts of the portfolio may provide complementary forms of protection against recession, inflation, market trends, liquidity stress, or changes in monetary credibility.

Broadening resilience beyond bonds is therefore not an argument for abandoning traditional fixed income. It is an argument for recognizing that bonds represent one form of defense rather than the entire resilience architecture. A more robust approach combines assets that can protect during falling growth environments, assets that can preserve purchasing power during inflationary periods, and diversifiers that do not depend entirely on either equities or bonds performing as expected.

Conclusion: Designing for changing correlations

Resilience is not simply a collection of low-volatility assets. It is the capacity of a portfolio to absorb shocks, preserve purchasing power, maintain liquidity, and continue pursuing its long-term objectives across a wider range of economic environments.

In the post-2000 era, investors could often rely on a stable negative correlation between stocks and bonds to provide much of that resilience. In a world of more persistent and variable inflation, that relationship may become more positive, more volatile, and more dependent on the source of the shock. Bonds will remain an important portfolio allocation, particularly during disinflationary periods, but they may no longer be sufficient as the portfolio's primary or exclusive source of defense. Due to higher yields and equity valuations, bonds may actually be an important return driver over the next market cycle.

Portfolios may therefore require multiple lines of resilience: defensive assets that protect against economic contraction, inflation-sensitive assets that preserve purchasing power, and diversifying strategies that can respond when traditional correlations become unstable. The objective is not to predict whether the next shock will come from growth, inflation, liquidity, or policy. It is to build a portfolio that does not depend on stocks and bonds always moving in opposite directions.

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