



## Portfolio Construction

---

### Quick Clips: The Stock/Bond Correlation

Q2 2022

The relationship between stocks and bonds has long been a crucial measure for portfolio management in traditional portfolios. For the past two decades, the stock/bond correlation (SBC) has been consistently negative, and investors have been able to rely on their bond investments for portfolio protection when equities sell off. However, macroeconomic changes – like heightened inflation risk – could push this key asset allocation input into positive territory.

The relative importance of growth to inflation uncertainty will be a key driver of the stock/bond correlation (00:30):

Submit

0:00

/

0:00

Inflation risk has been top of mind for many investors, and a lesser known consequence of heightened levels is the potential for a positive stock/bond correlation. A positive correlation could impact overall portfolio risk and require adjustments to current allocations.

A positive stock/bond correlation may drive portfolio risk higher, which may impact stock allocations (00:35):

Submit

0:00

/

0:00

With reduced diversification between stocks and bonds, we think investors should re-evaluate their overall portfolio allocations. In this challenging environment of high valuations, monetary policy tightening and heightened macroeconomic risks, alternatives may be a good solution to help manage risk and enhance portfolio returns.

Investors may need to look to their alternative allocations to provide diversification (00:29):

Submit

0:00

/

0:00

So what is the longer-term outlook and how can investors prepare? While the SBC has trended upwards, a prolonged shift would require longer-term inflation uncertainty coupled with additional shocks or monetary policy errors. This scenario remains a tail risk for investors, and we believe that awareness of the SBC drivers and investment implications, as well as rethinking a portfolio's diversifiers will be critical to navigating a changing SBC.

The SBC outlook is one of several tail risks for investors (00:42):

Submit

0:00

/

0:00

This document has been provided to you solely for information purposes and does not constitute an offer or solicitation of an offer or any advice or recommendation to purchase any securities or other financial instruments and may not be construed as such. The factual information set forth herein has been obtained or derived from sources believed by the author and AQR Capital Management, LLC ("AQR") to be reliable but it is not necessarily all-inclusive and is not guaranteed as to its accuracy and is not to be regarded as a representation or warranty, express or implied, as to the information's accuracy or completeness, nor should the attached information serve as the basis of any investment decision. This document is intended exclusively for the use of the person to whom it has been delivered by AQR, and it is not to be reproduced or redistributed to any other person. The information set forth herein has been provided to you as secondary information and should not be the primary source for any investment or allocation decision. Past performance is not a guarantee of future performance.

This material is not research and should not be treated as research. This paper does not represent valuation judgments with respect to any financial instrument, issuer, security or sector that may be described or referenced herein and does not represent a formal or official view of AQR. The views expressed reflect the current views as of the date hereof and neither the author nor AQR undertakes to advise you of any changes in the views expressed herein.

The information contained herein is only as current as of the date indicated, and may be superseded by subsequent market events or for other reasons. Charts and graphs provided herein are for illustrative purposes only. The information in this presentation has been developed internally and/or obtained from sources believed to be reliable; however, neither AQR nor the author guarantees the accuracy, adequacy or completeness of such information. Nothing contained herein constitutes investment, legal, tax or other advice nor is it to be relied on in making an investment or other decision. There can be no assurance that an investment strategy will be successful. Historic market trends are not reliable indicators of actual future market behavior or future performance of any particular investment which may differ materially, and should not be relied upon as such.

The information in this paper may contain projections or other forward-looking statements regarding future events, targets, forecasts or expectations regarding the strategies described herein, and is only current as of the date indicated. There is no assurance that such events or targets will be achieved, and may be significantly different from that shown here. The information in this document, including statements concerning financial market trends, is based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons.