The Editorial

60/40 alive and kicking

Diversification is the closest you get to a 'free lunch' in investing, yet at the same time the popular 60/40 framework is perhaps the relationship that has been declared dead most times. The basic case for the 60/40 portfolio has always been straightforward: combine two asset classes, specifically equities and bonds, with different return drivers and reduce the overall risk of the portfolio. However, a common misunderstanding is that to achieve diversification you necessarily need to have negative correlation. Quite frankly, to achieve diversification, the correlation simply needs to be less than one. Of course, a negative correlation simply makes that benefit larger in modern portfolio construction, but you still have diversification even without it being negative

Most investors will still have fresh in their memory that 60/40 has been declared dead at least twice during the past 10 years. First by the zero interest rates environment, and then again in 2022, when inflation shocked both sides of the 60/40 simultaneously. However, we'd argue that it survived both, and it will likely also survive today's concerns about public debt, rising term premia, equity concentration and AI-driven market leadership, which has led to obituaries by some commentators.

To us, the real question on this topic essentially boils down to what macro regime we are in, and more fundamentally whether recent episodes warrant a fundamental rethink of how the 60/40 behaves. We argue today that it's alive and kicking offering the diversification it is expected to when it is demand shock that dominates. While in the case of a supply shock, the answer is not as straightforward. Therefore, we do not want to declare 60/40 dead. Not even close.

Diversification is not the problem: it's the shock

We can naturally always debate what diversification means, because quite literally anything with a correlation less than one offers some different attributes to the diversification debate. To us, the case for 60/40 has never been that bond prices must always rise when equities fall: it's more about whether equities and bonds are exposed to different return drivers and regimes.

How to calculate the correlations is a question of personal preference, and may change depending on the use case. In today's piece we focus on the monthly changes and a correlation window of one year. However, as the chart below shows, you may temporarily reach different conclusions if you change the analysis window. Today, if you look back two years, you end up with a slightly negative correlation, while you reach a highly positive number if you use the 1y window. Strictly speaking, for TAA considerations, the shorter the window the better, for SAA considerations, the longer the window the better.

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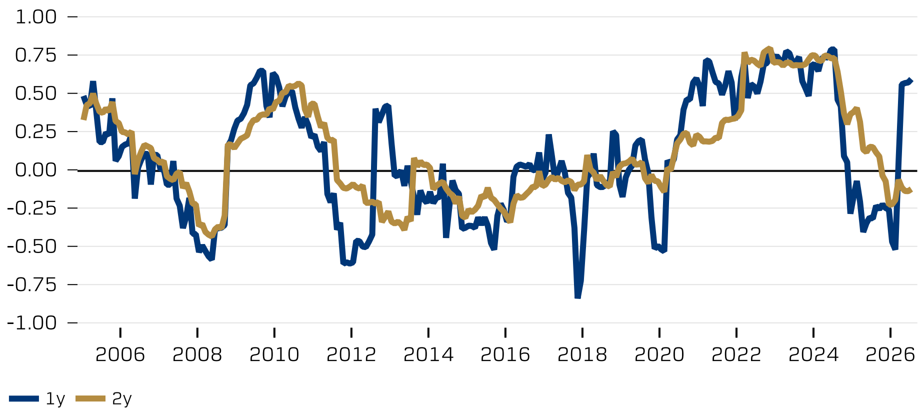
60/ 40 correlation the past 20y, MSCI ACWI local and total global bond index



Note: Correlation between monthly changes of equities and bonds.
Source: Bloomberg, Macrobond, Danske Bank

It's not the level per se, it's the regime...

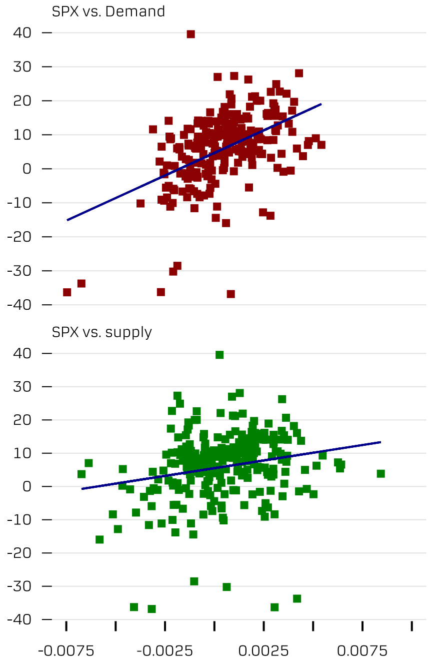
It is often referenced that the 60/40 stability depends on the interest level or the inflation level. And specifically it has been argued that once the US 10y yield approaches 4.5-5%, and/or inflation reaches around 3.5% or higher, the correlation becomes positive, and thus non-diversified in the traditional portfolio theory sense. The low interest/yield environment through most of 2010 offered the desired diversification.

However, there is some truth in the point that the starting yield level matters for expected returns and the room for bonds to rally, but it is not the full story. To us, the critical question to answer concerns the catalyst of the bond/equity move. For example, a higher yield caused by better growth is very different from a higher yield caused by an adverse supply shock. A fiscal-risk move is different from successful policy normalisation. Higher starting yields affect expected returns and the room for bonds to rally, but they do not tell us enough about diversification. The regime does.

To dig deeper into the discussion, we use the recent paper by *Bekaert, Engstrom and Ermolov* (2026). They do not directly address the 60/40, but they provide a really interesting framework which we can apply to analyse today's question.

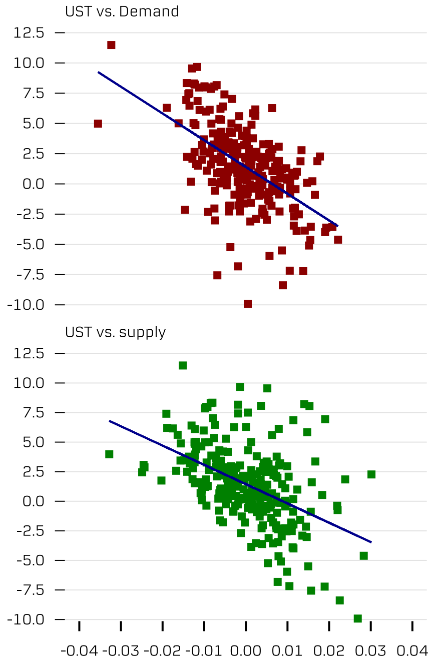
Using their framework, we clearly observe demand shocks tend to preserve the classic diversification role of bonds. Supply shocks do not allow for the same conclusions, due to the (lack of) sensitivity between equities and supply dynamics. Between 2005 and 2019, there is no particular correlation between equities and the supply factor, but from 2022 the question leads to ambiguous conclusions. What this essentially also implies is that equities are less responsive to supply shocks from a portfolio perspective, and thus, it is not the inflation that lowers the correlation, it's the regime driver.

S&P500 TR vs. demand/ supply dynamics



Note: 12M correlation window on 6M changes. Data period: 2005 until today. We have applied the framework by Ademmer, Danial, Sakthivel and Roye (2022) to gauge supply and demand drivers.
Source: Bloomberg, Macrobond, Danske Bank

UST vs. demand/ supply dynamics



Note: 12M correlation window on 6M changes. Data period: 2005 until today. We have applied the framework by Ademmer, Danial, Sakthivel and Roye (2022) to gauge supply and demand drivers.
Source: Bloomberg, Macrobond, Danske Bank

... and thus its dynamics

Consequently, the challenge of the 60/40 is that it depends on the regime. This also means that building a portfolio on a 60/40 framework is not only a bet on two asset classes but more importantly, also an implicit bet on the macro shock that dominates. In a demand shocks, the diversification aspects holds, in a supply shock it may not, regardless of whether yields start at 3%, 4% or 5%. Of course, you may argue that supply shocks lead to inflation, but the key nuance is that the level is less relevant that the regime.

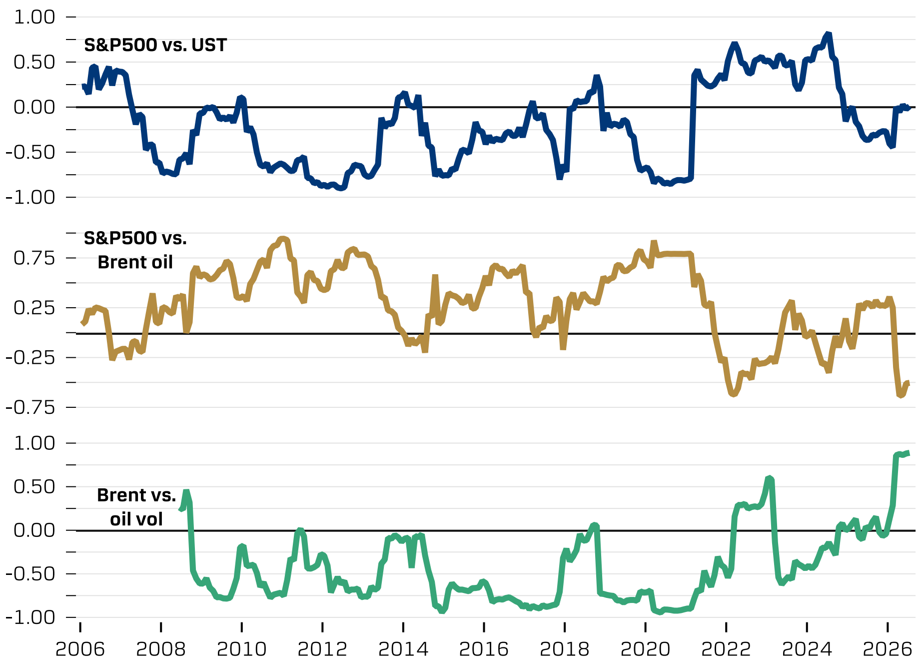
The Covid/supply regime change

Anyone following financial markets in recent years knows what has happened since Covid, particularly when it comes to supply shocks. The pre-pandemic decade was largely dominated by a demand-driven economy with low inflation volatility and central banks with an easing bias, leaving the financial markets in a demand driven setting. In 2022, the shock came from the supply side in the form of an energy and supply chains shock, thus forcing inflation and rates higher.

In the context of correlations, what we saw was that the bond-equity correlation was virtually negative across all correlation windows throughout the decade leading up to the supply shock. After changing "sign" around 2022, only recently have certain "windows" started to exhibit negative correlations again (blue line).

To further illustrate the point of the supply shock in 2022, which is implicitly assumed by investors today, we should examine the correlation between equities and the oil price as an example. In 2022, we clearly saw a change from the correlation being largely positive to hovering around 0 (gold line). However, and more importantly if you examine the change in oil prices and the implied volatility of oil, then we see that until 2022, we had a close to perfect inverse correlation between oil and its vol, meaning that if we saw an oil spike, implied vols would compress. This happens in a demand driven environment. However, between 2022 and until the Iran war in 2026, those two indicators were essentially uncorrelated indicating that vols didn't react much to oil price changes, and then most recently this changed markedly, with markets now pricing implied vol and oil prices to reflect a new (supply) regime (green line).

1y correlation windows between asset classes



Source: Bloomberg, Macrobond, Danske Bank

Why investors may still be fighting 2022

The danger is that investors turn 2022 into a permanent "rule". Looking ahead the relevant question is not whether 60/40 failed in 2022, but rather whether the forces that made it change from its recent historical pattern are becoming stronger or weaker and what the next shock will look like.

We do not share the concerns that a supply shock (inflation) is a problem today, but at the same time, we can't conclude that the world is yet back to a 2010s style regime with demand the dominant driver. However, we see this gradually converging to that environment, i.e. going from inflation (supply) to growth (demand), which should be good news for the correlations. In a demand regime and shock, the diversification aspects work.

What 2022 destroyed has made bonds attractive again

Before concluding, one thing we can't help highlighting is the irony at the centre of the bond debate as well, which we will save for another Editorial to discuss in depth, as it may not be at the centre of the 60/40 issue but is still worth highlighting today.

While the 2022 repricing was painful it also restored the main thing bonds had been missing for more than a decade, namely income. Across large parts of the developed world, investors can now earn meaningful yields and the duration trade is no longer just an insurance policy with a negative running cost. It is an asset class that pays investors while they wait, and that is a critical aspect of the 60/40 as well. And one thing is the carry, another is the higher starting yields also improve the protection value of bonds. Quite frankly, if a demand shock hits, and growth disappoints, central banks can cut rates, bond prices will have plenty of room to rally, compensating for the loss on the equity leg due to lower activity. That room was limited in the zero-rate world. From that aspect, the 60/40 is more alive today than it has been in decades.

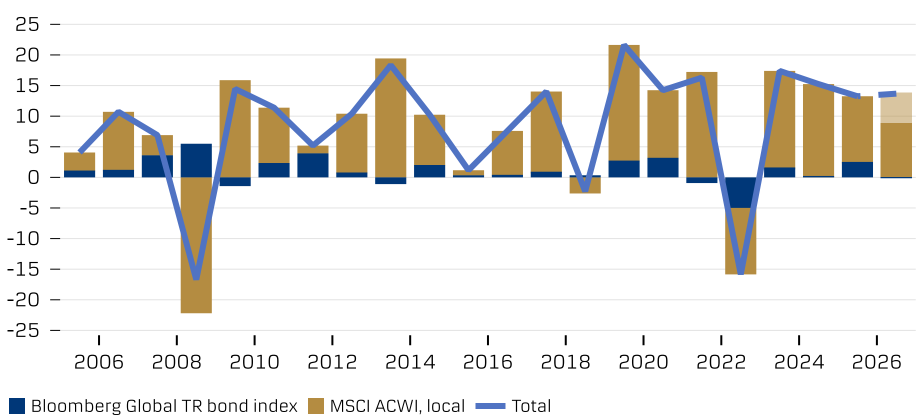
In conclusion

The conclusion to us is relatively straightforward. Building a portfolio on 60/40 is still a strong framework. The 60/40 portfolio is still alive, but admittedly its diversification abilities are conditional on the regime that we are operating in. Specifically, in a demand-led slowdown, bonds can still cushion equity weakness. In an inflationary supply shock, they may not. So, whether we find ourselves in a low or high inflation environment, a demand shock (whether positive or negative) is expected to show a negative correlation between bonds and equities, while in a supply driven shock, the correlation may not be stable, thus we may end up with positive correlation between the two asset classes. In other words, it is not inflation per se that drives the 60/40, it's the regime that dominates.

And as argued above, the 60/40 is not just a bet on two asset classes, but it is also an implicit bet on the macroeconomic regime in which those asset classes operate. So looking ahead, even when we discuss the cited reasons for the death of 60/40, we remain firmly confident that should a demand shock hit, we see the negative correlation with diversifying aspects thrive. Irrespective of the yield/inflation level, bonds yields will fall mitigating for the demand driven decline in equities.

And while not directly related to the correlation aspect, just note that the 60/40 is on track for almost a 15% return this year, should the current year to date run rate continue.

Global 60/40 portfolio performance



Note: Shaded area indicates annualised run rate of current ytd performance.
Source: Bloomberg, Macrobond, LSEG Data & Analytics, Danske Bank

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