

Are bonds a reliable safety net for my portfolio in a drawdown?

September 25, 2026 | Travis Army, CFA

The playbook has been the same for decades: fixed income is the diversifier, the safety net for when equities fall. When markets get risky, that's where investors run. But that safety only works when the crisis lowers rates. In a rate-shock regime, correlations can turn positive, the 60/40 can lose its defense, and both halves of the portfolio can fall together. A shift to fixed income only becomes a shift to safety in the right regime. In the wrong one, it's just a different seat in the same storm.

Key takeaways

1. When correlations turn positive, the safety net gives way. It has happened repeatedly through history, but 2022 is the example everyone lived through: stocks and bonds fell together, leaving the S&P 500 down 18% on a total-return basis (about 25% peak to trough), the Bloomberg US Aggregate Bond Index down 13%, its worst year on record, and the traditional 60/40 portfolio down roughly 16%. The 40 did not cushion the 60, it fell with it.

2. Correlation turns positive in regimes driven by rate shocks. When the crisis is inflation, forced Treasury selling, or deficit fears, yields rise into the panic and fixed income falls alongside stocks. Bonds cannot rescue you from a crisis when bonds are where the crisis lives. Growth shocks (2008, 2020) are the opposite: they make the Fed cut, yields fall, and bonds rally. The diversification fixed income provides only works in certain market environments.

3. Bonds are a regime bet, not a guarantee. With yields around 5%, the Bloomberg US Aggregate Bond Index offers more protection against rising rates, since more income can offset price declines. But that cushion only softens the fall; it doesn't change the direction. And yields have recently continued to climb from inflation, heavy Treasury supply, and a Fed that has resumed hiking. Stock-bond correlation has hit some of its highest levels since the late 1990s. In a regime like this, the hedge can become a passenger. The real question is which regime we're heading into.

4. Real diversification shouldn't depend on the regime. Our portfolios are built around each client's needs, with the goal of true diversification: protection designed into what you own, so it relies less on which kind of shock arrives or on a correlation holding.

Sources: S&P Dow Jones Indices and Bloomberg, as of 12/31/2022 and 9/25/2026; Federal Reserve Bank of San Francisco, Economic Letter 2026-21, Aug. 10, 2026; Federal Reserve, FOMC statement, Sept. 16, 2026. Notes: 2022 figures are calendar-year total returns for the S&P 500 and the Bloomberg US Aggregate Bond Index; the peak-to-trough decline is measured from the 1/3/2022 high to the 10/12/2022 low. The 60/40 portfolio is 60% S&P 500 and 40% Bloomberg US Aggregate, rebalanced annually. Yield is the index yield to worst. The 60/40 portfolio is hypothetical, shown for illustration only, and does not reflect advisory fees, transaction costs, or taxes. Statements about future conditions are opinions. See Important Disclosures.

Rate shocks vs. growth shocks

Most major drawdowns lean toward one of two types. In a growth shock, the fear is recession: investors expect the Fed to cut, yields fall, and fixed income cushions the crash. That is 2000-02, 2008, and 2020, the environment where the diversification does its job. In a rate shock, the problem is interest rates themselves. Sometimes inflation forces the Fed to hike, as in the 1970s, 1994, and 2022. Sometimes long-term yields surge on their own and drag stocks down with them, as in the fall of 2023. And sometimes the stress starts inside the Treasury market, when investors sell government bonds instead of buying them, as in the brief selloff of April 2025. Either way, yields rise into the panic instead of falling, and both halves of the portfolio can drop together. The correlation is not a fixed property of the assets; it's a readout of which kind of shock is dominating. The same bond can be a hedge in one crisis and a liability in the next.

Sources: [Federal Reserve; U.S. Department of the Treasury; Bloomberg]. Notes: The classification of historical drawdowns as growth shocks or rate shocks reflects the views of The Invictus Collective.

The makings of a rate shock

In a rate shock, the damage tends to move through a portfolio in a familiar way. Yields typically rise first, and because bond prices move opposite to yields, fixed income falls as they climb. Stocks, priced off the same rates, often come under pressure next, and any risks they were already carrying, like stretched valuations or a growth scare, may have little to cushion them. The usual flight to safety offers less shelter, because the place money typically flies to is where the trouble started.

A rate-shock regime does not announce itself in advance; it assembles quietly, one condition at a time. Today, several of those conditions are already in place. Inflation remains above the Fed's target, and the Fed has resumed raising rates for the first time since 2023. The 10-year Treasury yield has reached its highest level since 2007. Meanwhile, equities have spent much of the year near record highs. None of this guarantees a rate shock, but the forces behind it are still at work. Oil prices have been

swinging sharply, and each spike feeds new inflation fears. The government and corporations keep borrowing heavily, and when investors sell off Treasuries or show less appetite for new ones, bond prices fall and rates rise. Any of these can push rates higher, often with little warning. Today's bonds do have one advantage over 2022's: they yield about 5%, compared with under 2% at the start of 2022, so they can absorb more of a rise before they lose money. But that income only softens the blow. If rates keep climbing, bonds can still fall, and they can fall at the same moment as stocks. That timing is what matters for diversification.

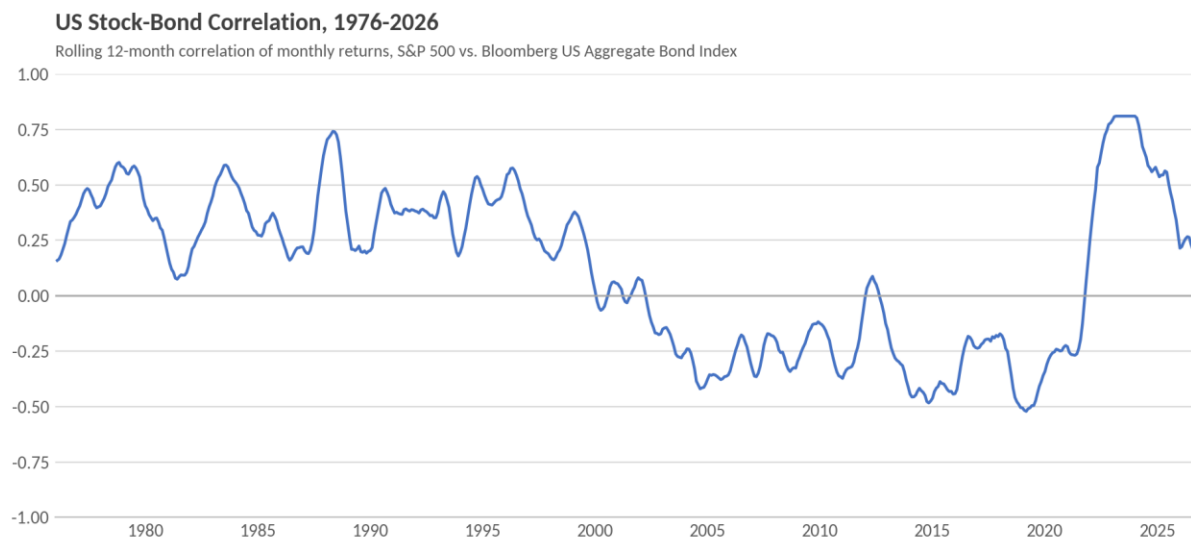
Sources: Market data as of 9/25/2026. Federal Reserve, FOMC statement, Sept. 16, 2026; U.S. Department of the Treasury; Bloomberg; S&P Dow Jones Indices; U.S. Bureau of Economic Analysis. Notes: Bond yields are the Bloomberg US Aggregate Bond Index yield to worst as of 12/31/2021 and 9/25/2026. Statements about future market conditions are opinions and are not guarantees. See Important Disclosures.

When the 40 falls with the 60

2022 was one story told across every asset: inflation forced the fastest repricing of interest rates in four decades, and everything priced off those rates fell at once. In this rate-shock regime, CPI peaked at 9.1%, the Fed took its policy rate from near zero to 4.25–4.50% in nine months, and the 10-year Treasury yield rose from 1.5% to more than 4% at its peak. Bonds entered that storm with the worst starting point in decades: years of low rates had stretched index duration to record highs while leaving yields with almost no coupon cushion. Maximum rate sensitivity met minimum protection. Stocks were repricing off the same discount rate, so the two fell together, and there was nowhere for the 60/40 portfolio to hide.

Sources: U.S. Bureau of Labor Statistics; Federal Reserve; U.S. Department of the Treasury; Bloomberg. Notes: The CPI peak is the 12-month change for June 2022. The 10-year Treasury yield change is measured from 12/31/2021 to its October 2022 closing high. The policy rate range reflects the FOMC target range as of 12/14/2022.

Fifty years of evidence



Source: The Invictus Collective reconstruction based on the published research cited below; index data begins at Bloomberg US Aggregate Bond Index inception, 1976. For illustrative purposes only. Past performance and past correlations are not indicative of future results. Indexes cannot be invested in directly. See Important Disclosures.

The chart covers the Bloomberg US Aggregate Bond Index's full history, back to 1976. For its first quarter century, correlation was positive: through the inflation era and the long bull markets that followed, stocks and bonds spent most of their time moving together. The reliably negative stretch, roughly 2000 through 2021, came later: two decades in which the major crises originated from the growth side, and rates fell into each one. That stretch is the era the modern playbook was written in. The right edge of the chart is today, with correlation at some of its highest levels since the late 1990s. Even inside the index's own lifetime, the hedge has been far from guaranteed.

Sources: AQR, "A Changing Stock–Bond Correlation," *Journal of Portfolio Management*, 2023; Molenaar et al., "Empirical Evidence on the Stock–Bond Correlation," *Financial Analysts Journal*, 2024; BlackRock, "Bonds Starting to Offer More Diversification," Dec. 22, 2025; Federal Reserve Bank of San Francisco, *Economic Letter* 2026-21, Aug. 10, 2026.

Why the usual shelters fall short

Cash and short-term Treasuries offer a stable place to wait out rising rates, but the return is modest and inflation can erode purchasing power. They also don't rise to offset losses elsewhere, so their value depends on timing the shift back into stocks and bonds. Inflation-protected Treasuries can offer protection, but rates can rise for reasons unrelated to inflation, such as Fed tightening or heavy government borrowing, and TIPS fall when they do. In 2022, the Bloomberg US TIPS Index lost roughly 12% during the worst inflation in 40 years. Each works in some conditions and struggles in others, which makes each a bet on what comes next.

Source: Bloomberg, as of 12/31/2022. Notes: 2022 calendar-year total return for the Bloomberg US TIPS Index.

Protection that does not check the regime

Bonds still have a role: income, and a real cushion when the next crisis comes from the growth side. But diversification that works in only one shock regime is conditional, and the regime is not something anyone controls. We build portfolios around each client's needs with diversification that is structural rather than statistical: protection designed into the terms of what you own, rather than resting on how two markets happen to move together.

There are tradeoffs to every approach, and the right mix depends on your goals, timeline, and what you already own. Every portfolio is different, and so is every conversation. Reach out, and we'll help you gain clarity on what you own and how it's diversified.

Important Disclosures

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Past performance and risk. Past performance does not guarantee future results. All investing involves risk, including the possible loss of principal. No investment strategy, including diversification or asset allocation, can ensure a profit or protect against loss.

Index and hypothetical portfolio information. Indexes are unmanaged, do not reflect fees, expenses, or taxes, and cannot be invested in directly.

- The S&P 500 Index measures the performance of 500 large-capitalization U.S. stocks.
- The Bloomberg US Aggregate Bond Index measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market.
- The Bloomberg US Treasury Inflation-Protected Securities (TIPS) Index measures U.S. Treasury inflation-protected securities.

The "60/40 portfolio" is a hypothetical blend of 60% S&P 500 and 40% Bloomberg US Aggregate Bond Index, rebalanced annually. It is shown for illustration only. It does not represent any actual client account or the performance of any Invictus Collective strategy, and it does not reflect advisory fees, transaction costs, or taxes, which would lower returns.

Correlation data. Stock-bond correlations shown are calculated by The Invictus Collective using rolling 12-month correlations of monthly total returns from Bloomberg, 1976–September 2026. Correlation is a statistical measure of how two assets have moved relative to each other in the past. Past correlations do not predict future correlations.

Fixed income and cash risks. Bond prices generally fall when interest rates rise, and longer-duration bonds are more sensitive to rate changes. Fixed income investments are subject to interest rate, credit, inflation, and liquidity risk. TIPS can lose value when real interest rates rise. U.S. Treasury securities are backed by the U.S. government as to timely payment of principal and interest, but their market value will change before maturity. Cash and short-term instruments may not keep pace with inflation.

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