

When bonds stop protecting your portfolio: lessons from recent market crashes

By Jesper Rangvid

Stocks typically deliver higher returns than bonds, but they also come with greater risk—making bonds a key tool for managing overall portfolio volatility. Traditionally, bonds have also provided diversification, helping to offset equity losses during downturns. While this held for decades, it has broken down in recent episodes such as the 2022 inflation surge and the Iran war, when stocks and bonds declined at the same time. Why has this shift occurred, and what does it mean for your portfolio?

Stocks offer higher expected returns than bonds, so why invest in bonds at all? There are two main reasons: to match the level of risk in your portfolio to your risk tolerance, and to diversify.

This post focuses on diversification, but the first point matters too, so it's worth a quick look.

Mixing stocks and bonds to adjust risk and returns

Stocks are risky and offer higher expected returns. Bonds are less risky and, as a result, offer lower expected returns.

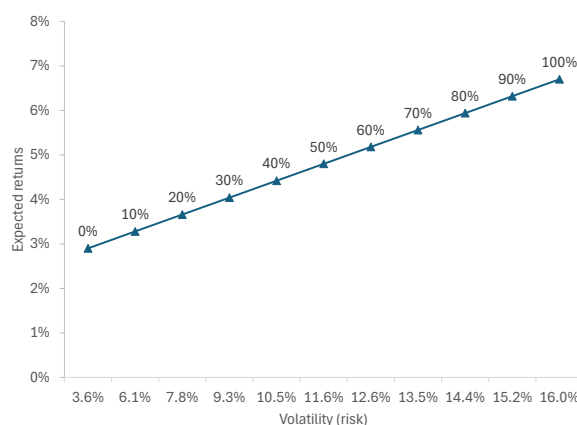
In the Council for Return Expectations that I chair ([link](#)), we expect global stocks to return 6.7% per year on average over the next decade (in euros and before investment costs), while safe government and mortgage bonds are expected to return 2.9%. The

volatility of stocks is expected to be around 16%, compared with about 3.6% for bonds. In other words, stocks move up and down much more than bonds.

Because of this, changing how much you allocate to stocks versus bonds directly affects the risk in your portfolio, and therefore its expected return, as illustrated in Figure 1.

Figure 1. Expected risk and return on bond-stock portfolios for different allocations to stocks (0%, 10%, etc., indicated above the line).

Source: Council for Return Expectations and J.Rangvid.



Take the (in)famous 60/40 portfolio: 60% in stocks and 40% in bonds. Using the Council's numbers, Figure 1 shows that you can expect an annual return of around 5.2%, with a risk (standard deviation) of 12.6%.

How to interpret risk? In simple terms, the most likely outcome is an annual return of 5.2%. But there's roughly a 1-in-6 chance that your return in any random year will be lower than $5.2\% - 12.6\% = -7.4\%$, in other words that you lose 7.4% in a random year. (The more technically minded reader will recognise that this assumes normally distributed returns.)

If you increase your allocation to 80% stocks, your expected return rises to 5.9%—but so does your risk. Now there’s a similar 1-in-6 chance of losing as much as 8.5% in a year.

So bonds help you reach the level of risk you’re comfortable with. If you’re willing to take on more risk, you can allocate more to stocks and less to bonds. That raises your expected returns—but also the potential downside.

There’s one thing I’ve deliberately glossed over so far—and something the more technical readers will already have spotted: I haven’t said anything about the correlation used in these calculations. That brings us to the second reason for holding both bonds and stocks in your portfolio, the main topic of this analysis.

Correlation between stocks and bonds

You’ll often hear that bonds help diversify your risk—especially when you need it most, during crises and recessions.

In a recession, demand falls and companies cut back, which hurts profits and pushes stock prices down. At the same time, inflation tends to ease. Because central banks want to avoid both very low and very high inflation, they typically lower interest rates to support the economy in a crisis. Lower policy rates feed through to lower bond yields—and lower yields, by definition, mean higher bond prices.

In short, when stock prices fall, bond prices have tended to rise in times of crisis.

This “you win on bonds when you lose on stocks” effect has worked well historically. But recently, it hasn’t held up as well.

To illustrate this, let’s look at five recent major stock market downturns:

- The dot.com crash.
- The financial crisis.
- The Covid crisis.
- The inflation flareup.
- The Iran War.

Bonds offered diversification in the first three crises but failed to do so in the last two.

I’ll use US data—the S&P 500 index and the 2-year Treasury yield—but the point is more general.

Dot.com bubble

In the late 1990s, stock prices surged on the back of expectations that the internet would deliver large productivity gains (if that sounds familiar in today’s AI hype, it should). Valuations reached extreme levels and peaked around the summer of 2000, when the dot.com bubble burst. Figure 2 shows how the S&P 500 and the 2-year Treasury yield evolved from the start of the downturn; I use 1 September 2000 as the starting point.

Over the next two years, stocks lost about half their value—and yields fell sharply as well. Figure 2 shows how, as stocks dropped like a stone, yields moved down in tandem. And when yields fall, bond prices rise.

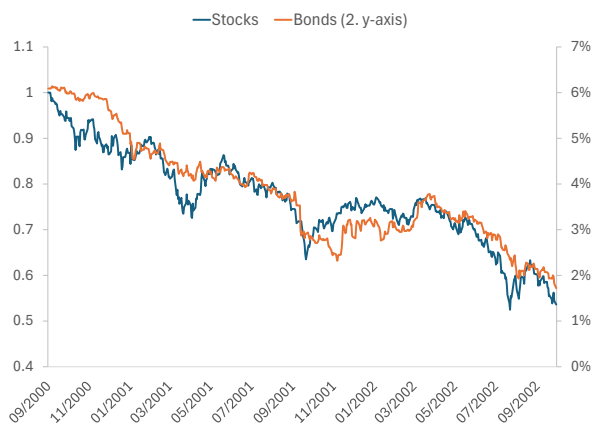
So if you held both stocks and bonds during the dot.com crash, your losses on stocks would have been partly offset by gains on your bonds.

Stocks still fell more than bonds rose—so bonds didn’t eliminate your losses—but they did cushion the blow. Put simply, you were

better off holding a mix of stocks and bonds than stocks alone. Diversification worked.

Figure 2. S&P 500 (normalized to '1' on 1 September 2000) and 2-year Treasury yields (2. y-axis). Daily data, 1 September 2000 – 30 September 2002.

Source: Datastream via Refinitiv and J.Rangvid.

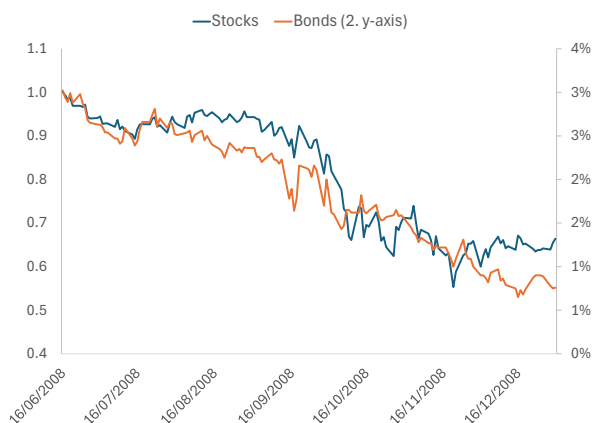


The financial crisis of 2008

The story is much the same during the financial crisis of 2008, as Figure 3 shows.

Figure 3. S&P 500 (normalized to '1' on 16 June 2008) and 2-year Treasury yields (2. y-axis). Daily data, 16 June 2008 – 31 December 2008.

Source: Datastream via Refinitiv and J.Rangvid.



From the summer of 2008 (Figure 3 starts on 16 June 2008) until stocks bottomed out in

early 2009, equities lost around a third of their value.

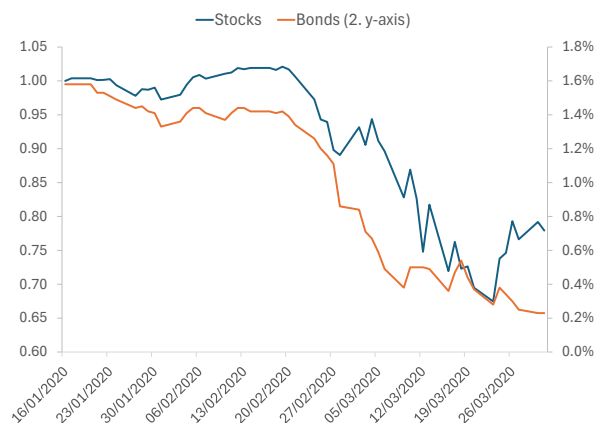
The financial crisis was a severe economic shock, so the Fed cut interest rates sharply in the autumn of 2008. Bond yields followed, as Figure 3 shows—and when yields fall, bond prices rise. That meant the bonds in your portfolio helped cushion the drop in your stocks.

Covid crisis

The Covid crisis in early 2020 tells much the same story, as Figure 4 shows.

Figure 4. S&P 500 (normalized to '1' on 16 June 2008) and 2-year Treasury yields (2. y-axis). Daily data, 16 January 2020 – 31 March 2020.

Source: Datastream via Refinitiv and J.Rangvid.



Stocks crashed in February and March 2020. By late March, they had lost 25% relative to their value at the start of the year. Once again, central banks stepped in. They cut rates, pushing bond yields down and bond prices up. As a result, a portfolio with both bonds and stocks held up better than one without bonds.

So history has taught us that bonds tend to provide diversification when stock markets crash. But then came the inflation flare-up

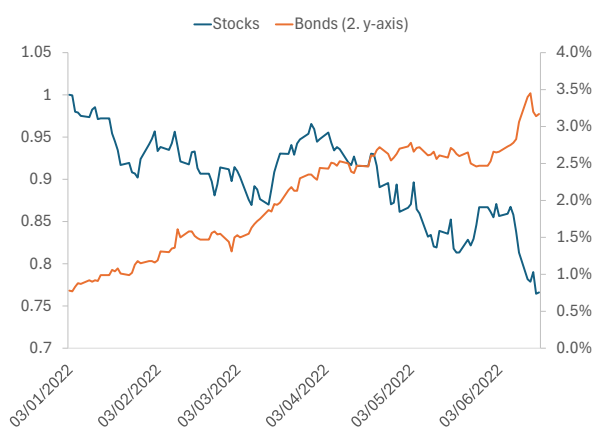
and the current Iran War—and suddenly, bonds’ role as a diversifier was called into question.

Inflation flare-up

Stocks had a rough time in spring 2022. Figure 5 shows that by mid-summer, they were worth only about 75% of their value at the start of the year. Based on past experience, you might have expected the bonds in your portfolio to cushion the blow. They didn’t.

Figure 5. S&P 500 (normalized to ‘1’ on 16 June 2008) and 2-year Treasury yields (2. y-axis). Daily data, 3 January 2022 – mid-June 2022.

Source: Datastream via Refinitiv and J.Rangvid.



Instead of the familiar pattern from earlier crises—falling yields (and rising bond prices)—2022 brought the opposite. Yields rose sharply as stock prices fell. In fact, yields increased by around three percentage points, meaning you lost money on both your bonds and your stocks. The diversification you had counted on simply wasn’t there.

Iran War

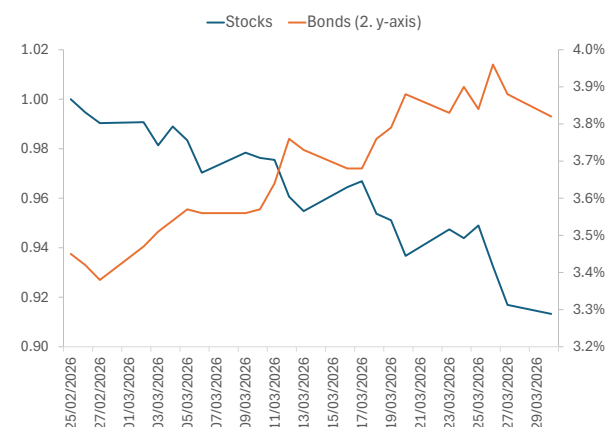
And here we are again, after another stock-market setback. Perhaps not as severe as the

earlier episodes, but still significant for the point I want to make.

Investors had hoped that 2022 was an outlier—something unusual that wouldn’t be repeated. But during the Iran War in March, stocks fell and bond prices fell too (as yields rose), as Figure 6 shows.

Figure 6. S&P 500 (normalized to ‘1’ on 16 June 2008) and 2-year Treasury yields (2. y-axis). Daily data, 25 February 2026 – 30 March 2026.

Source: Datastream via Refinitiv and J.Rangvid.



By late March, stocks had lost around 10% compared with their level in late February. But—as Figure 6 shows—yields rose. Diversification was washed out with the bathwater once again.

Why?

So why has the bond market’s traditional role as a cushion during crises broken down in these recent episodes?

The answer lies in what drove the downturns. In the first three cases—the dot.com crash, the financial crisis, and Covid—stocks fell because of economic slowdowns or outright recessions (in the dot-com case, the bursting of the bubble helped trigger one). With little or no inflation

pressure, the Fed could cut rates aggressively, pushing bond yields down and bond prices up.

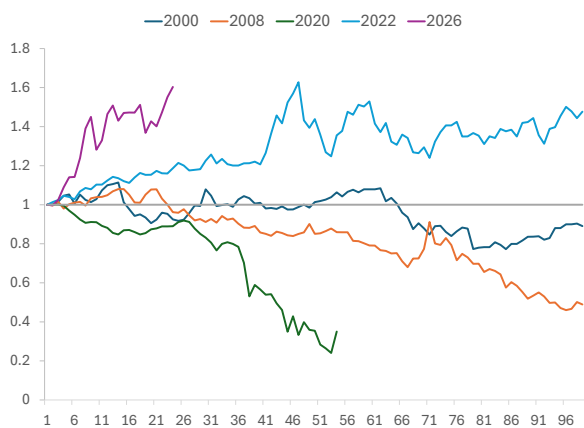
In the last two episodes, by contrast, inflation has been the key driver. And when inflation is the problem, bond yields tend to rise—not fall.

Several factors were behind the inflation surge in 2022—I've written extensively about them elsewhere ([link](#), [link](#), [link](#), and several other posts). One of the factors was rising commodity prices, especially oil. During the current Iran War, oil prices have again jumped sharply, pushing up both inflation and inflation expectations.

You can see this in Figure 7, which shows daily oil price movements during the first 100 days after stocks began to fall in each of the five episodes.

Figure 7. Oil prices developments relative to first dates in Figure 2-6, daily observations.

Source: Datastream via Refinitiv and J.Rangvid.



Oil prices rose as stock prices fell in both the 2022 inflation flare-up and the 2026 Iran War. In contrast, oil prices were flat or falling during earlier downturns—the dot.com crash (2000), the financial crisis (2008), and the Covid crisis (2020).

Higher oil prices feed into higher inflation over time, which pushes bond yields up (as in 2022 and 2026). Lower oil prices ease inflation pressures, giving central banks room to cut rates (as in the earlier episodes).

You see the same pattern when looking at inflation expectations, shown in Figure 8. (Daily data is only available from 2004, which is why the dot.com episode isn't included in Figure 8.)

The figure shows how inflation expectations evolve relative to the first day of each downturn. For example, if expectations were 2% when stocks started falling, and the chart shows 1.2 after, say, 60 days—as in the 2022 episode—that means expectations were 20% higher than at the start.

If the line turns negative, as it does about 96 days after 16 June 2008, it means expectations have fallen below their initial level. In that case, expected inflation dropped from 2.6% to minus 0.6%, which is deflation, i.e. $-0.6/2.6 = -0.23$.

Figure 8. Inflation expectations (5-year breakeven inflation rates) relative to first dates in Figure 2-6.

Source: Datastream via Refinitiv and J.Rangvid.

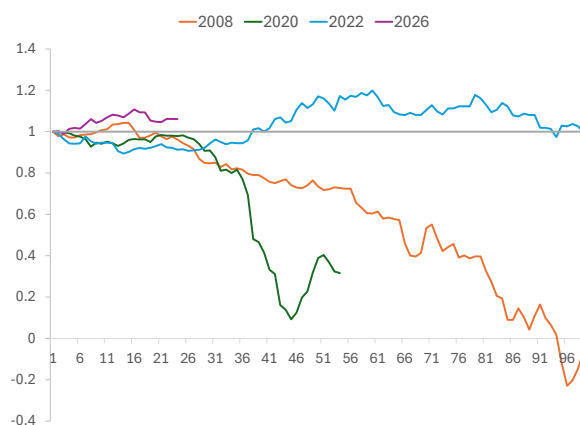


Figure 8 reinforces the same point: the 2022 inflation flare-up and the 2026 Iran War look very different from the earlier episodes. In

these two cases, inflation expectations rose (in 2022 they dipped briefly before climbing). In contrast, during 2008 and 2020, inflation expectations fell—pulling bond yields down and helping bonds cushion stock market losses.

Learnings

When stocks fall because a recession is looming, inflation typically comes under pressure. Central banks respond by cutting rates, which pushes bond yields down and bond prices up. That's what we saw during the 2000 dot.com crash, the 2008 financial crisis, and the 2020 Covid crisis. In those cases, bonds acted as a cushion in your portfolio.

When stocks fall because inflation is rising, the opposite happens. Central banks raise rates, bond yields go up, and bond prices fall. That's what happened in 2022. And if stocks fall because oil prices surge, lifting inflation expectations—as in the current Iran War—bond yields rise as well. In these situations, bonds lose their diversifying role.

Implications

If you think inflation and oil price shocks are here to stay, you may need to add other types of protection to your portfolio. Bonds alone won't do the job. This could include instruments like inflation swaps or exposure to commodities such as oil. But be careful with more questionable ideas—replacing bonds with private credit, structured “buffers”, or even Bitcoin is unlikely to solve the problem, as AQR argues in a recent piece ([link](#)).

Assets like oil or inflation swaps can hedge against inflation shocks, but they come with trade-offs. Unlike bonds, they don't provide a steady income stream. So you're giving up regular interest payments in exchange for better protection against specific risks. There may be ways to manage this trade-off, but it quickly gets complex.

On the other hand, if you believe that episodes like 2022 and the current Iran War are exceptions rather than the new normal, a traditional stock–bond portfolio may still serve you well.

Conclusion

Bonds haven't provided the same cushion during recent stock market downturns as they did in the past.

That doesn't mean you shouldn't hold bonds. They still play a key role in helping you manage the overall risk in your portfolio. But if you rely on them primarily for diversification, recent experience has been disappointing.

The reason is straightforward: in both the 2022 inflation-driven sell-off and the Iran War episode, inflation and inflation expectations rose. When that happens, bond yields rise and bond prices fall—so you lose on both sides of your portfolio.

What should you do? The honest answer is that investing has become more complex. Broadly, you have two options:

- Look for additional diversifiers—but recognise that this isn't easy.
- Or take a step back and focus on the long run. In the short run, markets move up

and down—you win some, you lose some. But over time, they tend to rise.

And here's the paradox: if you truly take a long-term view, you might be comfortable holding mostly stocks, accepting the bumps along the way in exchange for higher long-run returns.