INTELLIGENCE SERIES · PORTFOLIO ANALYTICS

Diversification Did Not Disappear. It Moved.

A twenty-year audit of cross-asset correlations, what they mean for the multi-asset portfolio, and what to do about it

+0.15

Equities against long Treasuries. The 97th percentile of twenty years, against a QE-era average of −0.41.

+0.33

Equities against gold. The highest in eleven years. Its strong 2026 is the cause, not a coincidence.

−0.11

Equities against commodities. The 1st percentile, and the only liquid negative correlation available.

Three Horizons Capital · July 2026 · Market data as at 14 July 2026

Eight cross-asset relationships · 252-day rolling windows · Twenty years of daily total returns

Executive summary

1. **The mechanism that makes a 60/40 portfolio work has inverted, and the number is small enough to have been missed.** US equities against long Treasuries sit at **+0.15**, the 97th percentile of the last twenty years, against a QE-era average of −0.41. Against the aggregate bond index, the pair most portfolios actually hold, the reading is **+0.30**. The relationship turned positive in November 2022 and has stayed positive apart from three trading days in April 2025.

2. **Gold has stopped hedging equities, and its strong 2026 is the reason rather than a coincidence.** At **+0.33** it is the highest in eleven years. The driver is central bank accumulation and dollar diversification, which is a monetary story rather than a risk-off one, so gold now rallies alongside equities instead of against them.

3. **The one asset genuinely diversifying is the one almost nobody holds.** Commodities at **−0.11** against a twenty-year average of +0.36, the 1st percentile. Negative in only two brief episodes in nineteen and a half years. This is a condition, not a property, and it will revert.

4. **This is an implementation gap, not a forecasting failure.** The 2026 long-term capital market assumptions already carry equities against aggregate bonds at **+0.295** against a market realising **+0.30**. The assumption sets re-based. The portfolios built on them did not.

5. **Rebuilt around what currently diversifies, the portfolio is return-neutral, and the honest description of the trade is narrower than a headline suggests.** Expected return 5.93% against 5.92%. It is materially better against inflation and modestly worse in a deflationary recession. That is a choice about which risk is being protected against, not a free improvement.

What this report deliberately does not contain

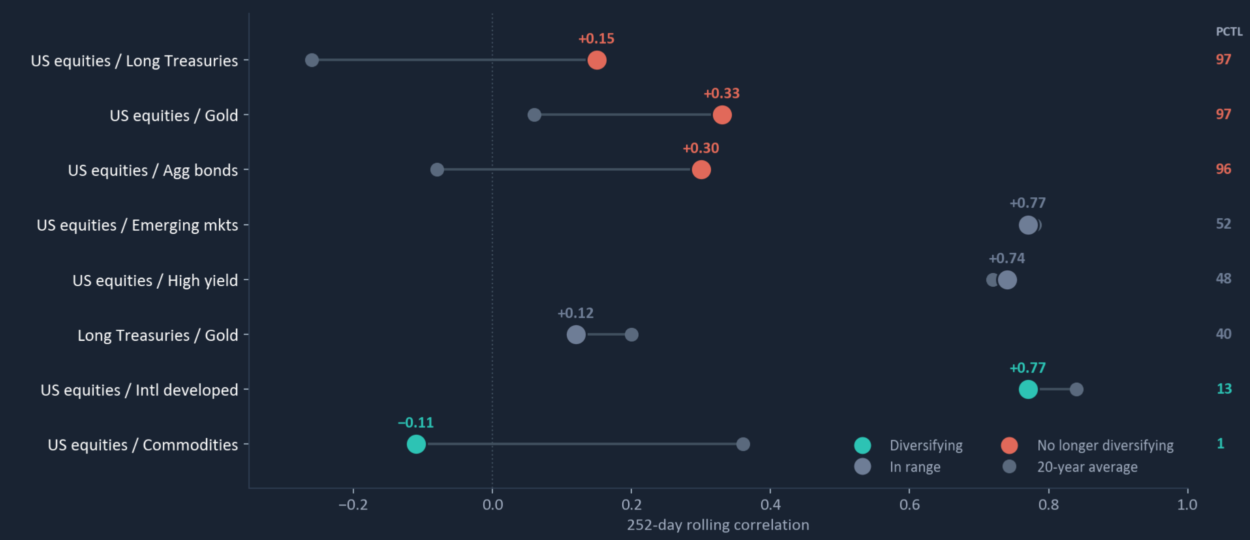
Two figures a reader might expect are withheld. **No volatility reduction is published**: run on the same weights, the modelled figure moves by an order of magnitude depending on how a short-duration credit sleeve is mapped and which correlation matrix is applied, and no standard modelling stack offers a current-regime correlation source. **No risk-adjusted return ratio is published**, because the standard convention computes it from a return that differs from the one displayed alongside it. Both decisions are explained in section 6.

1 The correlation landscape today

Cross-asset correlations are the hidden architecture of portfolio risk. When the relationships between major asset classes move to extremes, they reshape the risk and return trade-off of a multi-asset portfolio far more than changes in the volatility of any individual holding. July 2026 is one of the more anomalous correlation environments of the last two decades, and the composition of the anomaly matters more than its size.

Two of the three assets held for protection have stopped providing it

Current correlation against the 20-year average. Percentile rank of the current reading, right.



Three Horizons Capital. Daily total returns on liquid exchange-traded proxies, 252-day rolling windows, to 14 July 2026. Window start varies by pair with data availability.

Figure 1. Current correlation against the twenty-year average for eight cross-asset pairs, with percentile rank.

PAIR	CURRENT	20YR AVG	PCTL	READING
US equities / Long Treasuries	+0.15	−0.26	97th	No longer diversifying
US equities / Aggregate bonds	+0.30	−0.08	96th	No longer diversifying
US equities / Gold	+0.33	+0.06	97th	No longer diversifying
US equities / Commodities	−0.11	+0.36	1st	Diversifying
US equities / Intl developed	+0.77	+0.84	13th	Better than usual
US equities / Emerging markets	+0.77	+0.78	52nd	In range
US equities / High yield	+0.74	+0.72	48th	In range
Long Treasuries / Gold	+0.12	+0.20	40th	In range

The contrast between the anomalous pairs and the ordinary ones is instructive. Equity-to-equity relationships are broadly in line with history and equity-to-credit sits at the median. **The stress is concentrated entirely in the equity-to-rates complex and in gold, which are precisely the instruments most institutional portfolios rely on for cross-asset diversification.**

2 The equity hedge inverted, and it has not come back

The 60/40 portfolio does not work because bonds out-return cash. It works because of an assumed negative correlation. That assumption is no longer negative, and has not been for three years and eight months.

The equity hedge inverted in November 2022 and has not come back

Rolling 252-day correlation, US equities against long Treasuries. Below the line is where the 60/40 works.

Three Horizons Capital. Series begins July 2003, the first full 252-day window after the proxy inception. Positive throughout since 10 November 2022 apart from three trading days in April 2025.

Figure 2. Rolling 252-day correlation, US equities against long Treasuries. Below the line is where the 60/40 works.

Between 2010 and 2021 the relationship averaged −0.41. Bonds cushioned equity drawdowns mechanically, without any allocator having to be right about anything. The relationship turned positive on 10 November 2022 and has remained so apart from three trading days in early April 2025.

The practical consequence is specific. A thirty per cent allocation to aggregate bonds held as a stabiliser is not stabilising. It is not materially increasing risk either. It is simply not performing the function its portfolio weight implies, and has not been for nearly four years.

This is a narrower claim than the one usually made. It is not that bonds are a poor asset or that fixed income should be reduced. Bonds still generate income, still carry a credit premium, and still rally in a genuine deflationary panic. The single function that has stopped is duration acting as an equity hedge, and that is the function the allocation was sized for.

3 The other two anomalies

Gold has become a currency position, not an equity hedge

Gold earned its place in institutional portfolios by having almost no relationship with equities: it averages +0.06 across our full history and spends long stretches slightly negative. That indifference was the product being bought. It now sits at **+0.33**, the highest reading in eleven years and the 97th percentile of twenty.

The driver is not fear. It is central bank reserve accumulation and the gradual diversification away from the dollar, which is a monetary rather than a risk-off phenomenon, and it changes the sign of the relationship. When the common factor is the currency, a weaker dollar lifts the dollar price of gold and supports risk appetite simultaneously.

The implication for construction is that gold should be sized as geopolitical and currency optionality, which is a defensible role, rather than as an equity hedge. Sizing it as a hedge means holding an asset that will fall alongside the exposure it was bought to offset.

For accuracy: this is not a record. The correlation reached +0.44 in April 2010. An eleven-year high is the correct description and it is sufficient.

Commodities are diversifying, conditionally

Commodities sit at **−0.11** against US equities, against a twenty-year average of +0.36. That is the 1st percentile. In nineteen and a half years of daily data the relationship has been negative in only two brief episodes: several weeks in the autumn of 2008, and continuously since late April 2026.

The mechanism is trade policy. Commodity demand has been suppressed by weaker Chinese industrial activity and disrupted trade flows while US equities have run on domestic technology and nearshoring narratives, pulling the two in opposite directions.

> **This is a condition, not a property. The +0.36 long-run average is the honest number, and the current reading will revert when global growth re-synchronises or the trade disruption is absorbed. Section 8 specifies the trigger.**

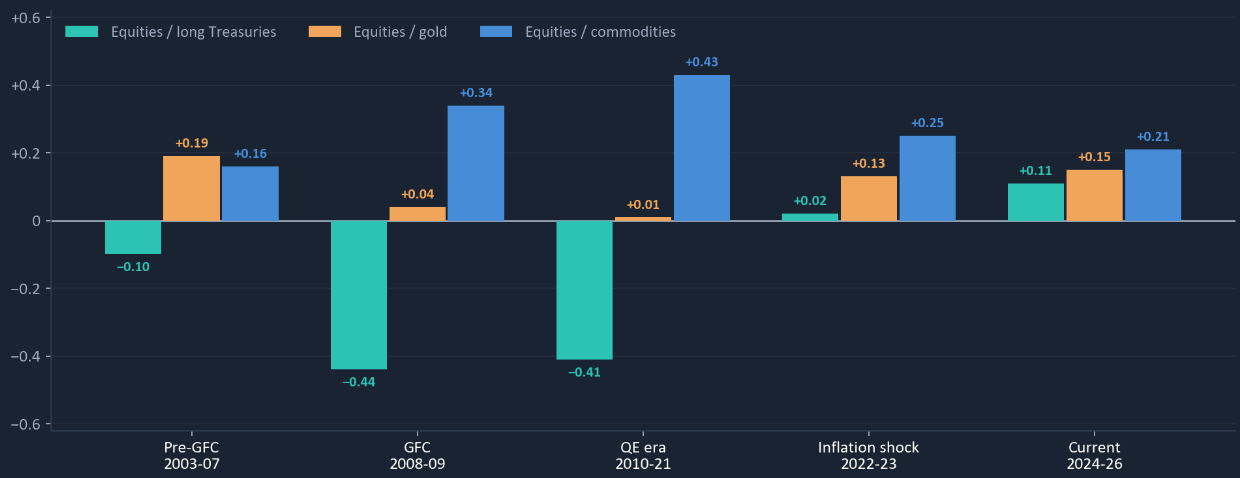
4 One mechanism, not three coincidences

Three anomalies appearing together invites the suspicion of noise. They share a cause, and the cause is what makes this a regime rather than a run of unusual readings.

Inflation has returned as a portfolio-relevant factor after roughly forty years of absence. When growth is the dominant factor, equities and bonds respond to it in opposite directions: weak growth hurts earnings and lowers policy rates, so bonds rally as equities fall. When inflation is dominant, both respond in the same direction, because rising inflation expectations lift the discount rate applied to equity earnings and push bond yields higher simultaneously. **The hedge does not weaken. It inverts.** The same regime change links gold to equities through the dollar, and separates commodities from equities through trade-driven disinflation in industrial demand.

The QE era was the outlier, and it is the era most portfolios were designed in

Average rolling correlation by regime.



Three Horizons Capital. The gold proxy begins November 2005 and the commodity proxy February 2007, so the pre-GFC column covers a partial window for those two pairs.

Figure 3. Average rolling correlation by macroeconomic regime, 2003 to 2026.

REGIME	EQUITIES / LONG TREASURIES	EQUITIES / GOLD	EQUITIES / COMMODITIES
Pre-GFC, 2003 to 2007	−0.10	+0.19	+0.16
Global financial crisis, 2008 to 2009	−0.44	+0.04	+0.34
QE era, 2010 to 2021	−0.41	+0.01	+0.43
Inflation shock, 2022 to 2023	+0.02	+0.13	+0.25
Current, 2024 to 2026	+0.11	+0.15	+0.21

The QE era shows the most reliably negative stock-bond reading in the series. **That was the environment in which the current generation of strategic asset allocations was built, tested and approved.** It was also the most favourable diversification environment of the last two decades and the furthest from present conditions.

The gold proxy begins November 2005 and the commodity proxy February 2007, so the pre-GFC column covers a partial window for those two pairs.

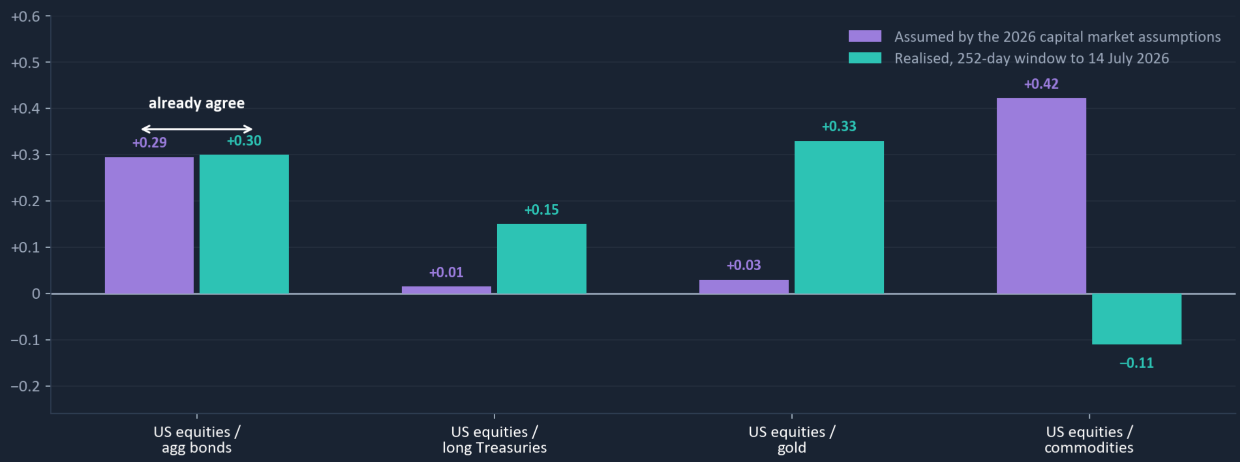
5 The assumptions already re-based. The portfolios did not.

The intuitive version of this story is that the industry's forward-looking models are stale, still calibrated to conditions that ended in 2022. We tested that and it is not the case.

> **The 2026 long-term capital market assumptions put US large-cap equities against aggregate bonds at +0.295. The realised twenty-year-window reading is +0.30. On the single relationship that defines the 60/40 portfolio, the assumption set and the market are in almost exact agreement.**

The forward-looking assumptions already re-based. The portfolios did not.

Assumed correlation in the 2026 long-term capital market assumptions against what is actually realising.



Three Horizons Capital, against third-party 2026 long-term capital market assumptions. Realised figures computed from daily total returns on a 252-day window.

Figure 4. Assumed correlation in the 2026 capital market assumptions against what is realising.

This reframes the problem. It is not a forecasting failure in which better inputs would have produced a better answer. **It is an implementation failure.** The assumption sets updated, the strategic allocations built on top of them were not rebuilt, and the gap has been visible in documents that investment committees receive and approve annually. It also means acting on this requires no market view: the information is already on the table.

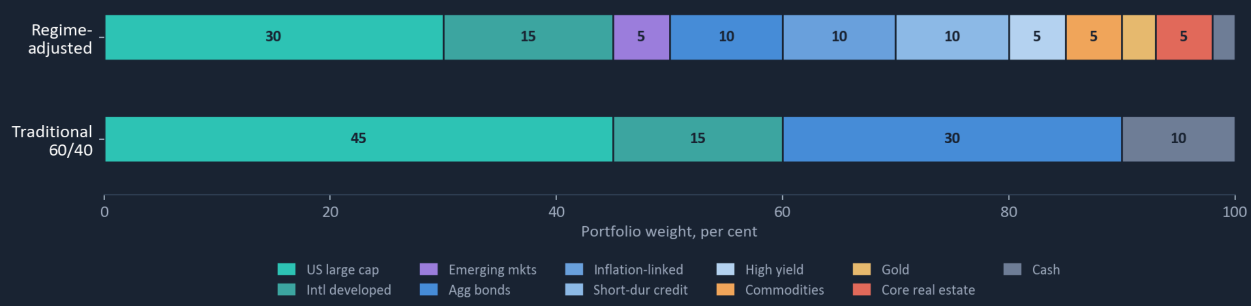
Two relationships have not re-based, and they are where a standard model sits furthest from observed conditions. Gold is assumed at +0.03 against equities and is realising +0.33, a gap of thirty correlation points. Commodities are assumed at +0.42 and are realising −0.11, a gap of fifty-three. Neither is the relationship currently attracting attention.

6 Repositioning, and the limits of what can be measured

Restructured around what is currently providing diversification, the portfolio is **return-neutral: 5.93% against 5.92%** on the published assumptions. Each change follows from the diagnosis and none requires a market view.

Same expected return, rebuilt around what is actually diversifying

Expected return 5.93% against 5.92%, on the weights published alongside this chart.



Three Horizons Capital, computed against third-party 2026 long-term capital market assumptions. Illustrative, not a recommendation.

Figure 5. Portfolio composition, traditional 60/40 against the regime-adjusted alternative.

ASSET CLASS	TRADITIONAL 60/40	REGIME-ADJUSTED	CHANGE
US large cap	45%	30%	−15
Developed international equity	15%	15%	0
Emerging markets equity	0%	5%	+5
US aggregate bonds	30%	10%	−20
Inflation-linked bonds	0%	10%	+10
Short-duration credit	0%	10%	+10
US high yield	0%	5%	+5
Commodities	0%	5%	+5
Gold	0%	3%	+3
US core real estate	0%	5%	+5
US cash	10%	2%	−8
Total	**100%**	**100%**	0

Fixed income is restructured, not reduced. The aggregate position falls from 30% to 10% and is redeployed into inflation-linked bonds, short-duration credit and a small high-yield allocation. Total fixed income rises from 30% to 35%; the composition changes, not the size, because duration is the component that has turned against the portfolio. **Commodities** enter at 5%, sized small precisely because the condition is temporary. **Gold** is introduced at 3% as currency optionality. **Equity** falls from 60% to 50% while retaining developed international exposure, which is worth more than usual at the 13th percentile.

Short-duration credit is mapped to the short-duration government and credit blend; inflation-linked bonds to TIPS. Both mappings materially affect the modelled risk result, which is the subject of the next page.

Why this report publishes no volatility figure

We had intended to publish the size of the risk reduction alongside the return. Running these exact weights through the same engine, **the reduction moves by an order of magnitude** depending on two entirely defensible modelling choices: how a short-duration credit sleeve is mapped to a modelled asset class, and which correlation matrix is applied underneath. Three independent computations of the same portfolio produced three different answers, and none was wrong.

> **A benefit that moves that much on choices the analyst makes is not a finding about the portfolio. It is a finding about the model.**

And a structural limit worth stating plainly

Section 3 measured gold's correlation with equities at +0.33. **No standard portfolio model can represent that figure.** The published capital market assumptions used across the industry carry gold at +0.03 against equities. The realised-correlation datasets that might correct it do not cover gold at all. And there is no current-regime correlation setting in a standard modelling stack: the available choices are a published long-run matrix or a twenty-year average, and both of them say gold diversifies.

The model therefore credits gold with protection the data says it has stopped providing, and charges the portfolio for a commodity correlation it is not currently experiencing. This is the same problem as the one in section 7, in a different place: there, the stress test does not examine the assets the portfolio bought; here, the covariance matrix cannot see the regime change the report is about.

What survives is the part that does not depend on any of it. The expected return is a weighted sum of published assumptions involving no correlation input, and on these weights the rebuilt portfolio matches the traditional one. The direction of the risk change was consistent across every combination tested. The magnitude is not something we are willing to put in print.

A note on risk-adjusted return ratios

No risk-adjusted return ratio appears in this report. The standard convention computes the ratio from an arithmetic return while displaying a compound return alongside it, so a reader recomputing the ratio from the figures shown will not reproduce it. Until that is disclosed at the point of output, we prefer to publish neither.

7 Stress testing, and what the standard test does not examine

The standard six-scenario stress library applies no shock at all to several asset classes. Under the engine's convention an asset with no shock defined receives a shock of exactly zero and is treated as immune to that scenario. A portfolio can therefore improve its stress score simply by moving into buckets the library does not cover.

> **Thirty per cent of the rebuilt portfolio is invisible to every one of the six scenarios, against fifteen per cent of the traditional portfolio, and every percentage point of the rotation was funded from buckets the library shocks in every scenario.**

We completed the test, assigning each uncovered bucket a shock in each scenario anchored to an asset already present in that scenario with comparable economic character. These are analyst assumptions rather than calibrated data, and the full vector is published in Appendix B so that anyone can substitute their own and re-run the comparison.

The advantage is real against inflation and reverses in a deflationary recession

Improvement over the traditional 60/40, before and after shocking the assets the standard test ignores.

Three Horizons Capital. The completed shocks are our own analyst assumptions, anchored to comparable assets already present in each scenario, and are published in full in the appendix.

Figure 6. Advantage over the traditional 60/40, before and after shocking the assets the standard test ignores.

Scenario outcomes, before and after

SCENARIO	AS THE STANDARD TEST SCORES IT	WITH THE GAPS FILLED
Bond shock, a 2022 repeat	+3.4pp	**+3.6pp**
Inflation and stagflation	+3.8pp	**+4.2pp**
Geopolitical conflict	+0.8pp	**+1.5pp**
Recession, normal	+0.3pp	**−0.3pp**
Recession, hard	+0.2pp	**−1.7pp**
Productivity renaissance	−1.7pp	**−1.5pp**

The core argument **survives and strengthens**: in the two inflationary scenarios this repositioning exists to address, the advantage is real and increases once the missing assets are shocked properly. But the two recession scenarios **reverse**, from narrow wins to losses, because commodities fall hard in a deflationary crash and the standard test was scoring them at zero.

A third finding applies to any multi-asset portfolio. The standard test understates the absolute drawdown for **both** portfolios, by between two and seven percentage points depending on the scenario, because fifteen per cent of even the plain traditional 60/40 sits in a bucket it never shocks. In a hard recession the traditional portfolio's modelled loss moves from −19.9% to −27.3% once developed international equity is shocked properly.

8 What the repositioning is, and when it expires

The honest description

Taken together, the completed results describe something narrower and more useful than a better portfolio. **This is not a free improvement. It is a decision about which risk is being protected against.**

Rebuilt this way the portfolio is materially better if the binding risk is inflation: a rate shock, a stagflationary squeeze, cost-push pressure that does not subside. It is modestly worse if the binding risk is a deflationary recession, because the assets that diversify inflation are not the assets that protect against a credit crunch. And it gives up approximately a point and a half of upside if the current expansion continues uninterrupted.

That is a real trade with a real cost and should be made deliberately. What it should not be is made by default, which is what retaining the QE-era structure now amounts to. **The traditional 60/40 is itself a position: a bet that the negative stock-bond correlation returns.** For a decade that was a free assumption indistinguishable from prudence. Today it is an active view, and most of those holding it are not aware they hold it.

Monitoring triggers

Every anomaly in this report is a condition rather than a property, and all will revert. The following are observable and actionable.

TRIGGER	OBSERVATION	RESPONSE
Primary. Stock-bond normalisation	252-day rolling correlation, US equities against long Treasuries, sustains below −0.10 for 30 days or more	The traditional structure works again. Restore aggregate bonds and long duration as stabilisers; the case in this report weakens considerably
Commodity reversion	60-day rolling equity-commodity correlation rises above +0.20	The tactical commodity position has done its job. Reduce
Gold normalisation	252-day rolling equity-gold correlation falls below +0.10	Gold is a diversifier again and can be sized as one rather than as currency optionality
Inflation stabilisation	Core inflation settles durably below 2.5%	The common factor driving all three anomalies has gone. Reopen the diagnosis in full

The primary trigger is a single line computable weekly from public prices. **We would rather publish the conditions under which we would change our minds than be asked for them later.**

Appendix A: method and full correlation detail

All correlations are 252-day rolling Pearson correlations computed on daily total returns for liquid exchange-traded proxies covering US large-cap equities, long Treasuries, aggregate bonds, gold, developed international equities, emerging market equities, high yield credit and broad commodities. Each series runs from the proxy's inception to 14 July 2026; the first value for each pair is its first complete 252-day window. **Percentile ranks are computed against the full available history for that pair, not a common window**, and the differing start dates are stated below.

PAIR	CURRENT	20YR AVG	PCTL	SERIES BEGINS
US equities / Long Treasuries	+0.15	−0.26	97th	July 2003
US equities / Aggregate bonds	+0.30	−0.08	96th	September 2004
US equities / Gold	+0.33	+0.06	97th	November 2005
US equities / Commodities	−0.11	+0.36	1st	February 2007
US equities / Intl developed	+0.77	+0.84	13th	August 2002
US equities / Emerging markets	+0.77	+0.78	52nd	April 2004
US equities / High yield	+0.74	+0.72	48th	April 2008
Long Treasuries / Gold	+0.12	+0.20	40th	November 2005

Portfolio analytics

Portfolio expected returns are computed against third-party 2026 long-term capital market assumptions on the exact weights in section 6, and are compound rather than arithmetic. They are a weighted sum of published asset-class assumptions and involve no correlation input, which is why they are the one portfolio figure this report publishes without qualification.

Portfolio volatilities and risk-adjusted return ratios are not published, for the reasons set out in section 6.

Scenario outcomes are computed by linear shock propagation: the portfolio return is the weighted sum of asset-class shocks, and an asset with no shock defined receives a shock of exactly zero. **All six base cases have been independently reconciled against the scenario engine's own asset-level shock vectors.**

Appendix B: the completed stress shocks

The standard six-scenario library defines no shock for developed international equity, short-duration credit or commodities, and defines inflation-linked bonds in only two of the six scenarios. The shocks below are those we assigned to complete the test. **They are analyst assumptions constructed by Three Horizons Capital, not calibrated data.** Each is anchored to an asset already present in that scenario with comparable economic character, and they are published so that any reader can substitute their own and re-run the comparison.

ASSET	BOND SHOCK	STAGFLATION	GEOPOLITICAL	RECESSION, NORMAL	RECESSION, HARD	PRODUCTIVITY
Intl developed equity	−23%	−14%	−25%	−29%	−49%	+12%
Short-duration credit	−6%	−4%	−2%	−2%	−5%	+1%
Commodities	+15%	+15%	+15%	−15%	−35%	+3%
Inflation-linked bonds	defined	defined	+2%	+3%	+4%	−1%

Developed international equity is set to the mean of the euro area and Japanese shocks already present in each scenario: **−23%** in the bond shock, **−14%** in stagflation, **−25%** in geopolitical conflict, **−29%** in a normal recession, **−49%** in a hard recession and **+12%** in the productivity case. Short-duration credit is set to a duration-scaled fraction of the investment-grade corporate shock, which is why it takes materially less damage than the aggregate index in a rate spike. Commodities follow each scenario's own internal logic: they rallied in the 2022 inflation shock and in energy-driven geopolitical events, and fell sharply in the 2008 deflationary crash, which is where the thirty-five per cent assumption comes from.

Resulting portfolio outcomes, completed

SCENARIO	TRADITIONAL 60/40	REGIME-ADJUSTED	DIFFERENCE
Bond shock, 2022 repeat	−21.3%	−17.7%	**+3.6pp**
Inflation and stagflation	−11.5%	−7.3%	**+4.2pp**
Geopolitical conflict	−13.8%	−12.3%	**+1.5pp**
Recession, normal	−16.1%	−16.4%	**−0.3pp**
Recession, hard	−27.3%	−28.9%	**−1.7pp**
Productivity renaissance	+9.6%	+8.1%	**−1.5pp**

Verification

Every load-bearing figure in this report was independently re-derived from source data before publication, and two further independent reconciliations were run against production data before release. Where a figure could not be cleared to a single auditable number, it has been withheld rather than published with a caveat. Where our own source material was found to be incorrect, the correction is stated in the text rather than made silently.

Important information

Three Horizons Capital Limited, Dublin, Ireland. Market data as at 14 July 2026.