Rising stock–bond correlations strengthen the strategic case for commodities

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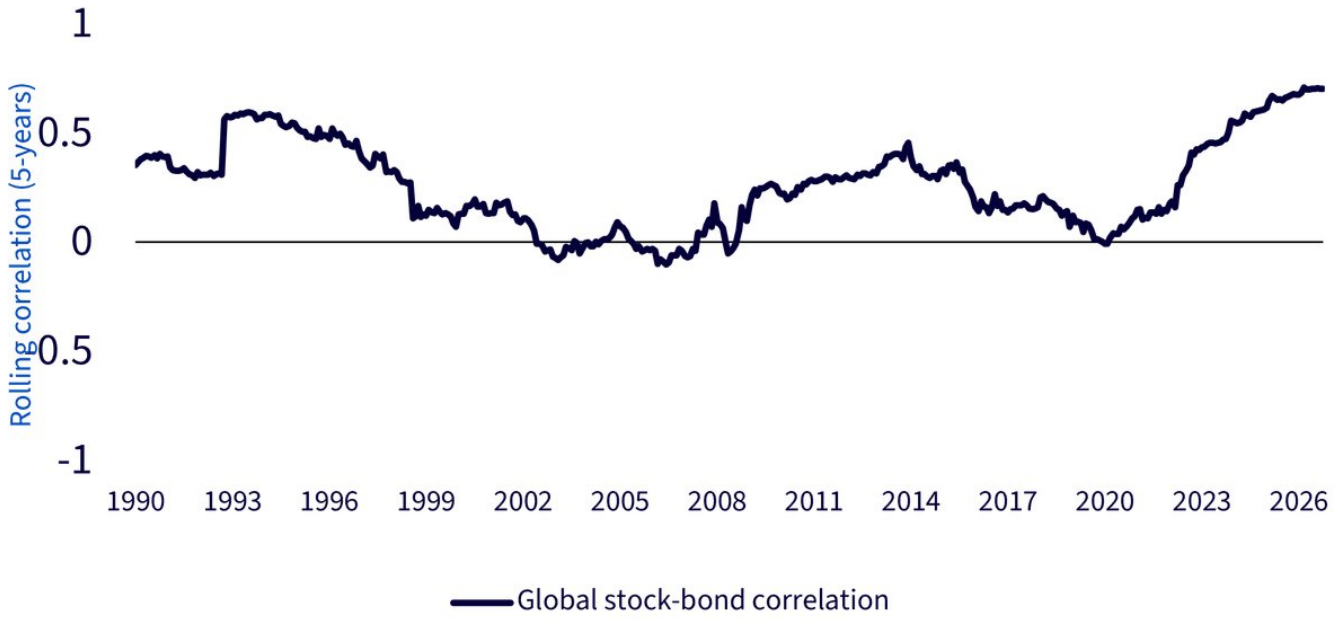
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Key Takeaways

- Rising stock–bond correlations are weakening diversification in traditional multi-asset portfolios.
- Greater inflation uncertainty helps explain why stocks and bonds increasingly move together.
- Low correlations with stocks and bonds, alongside positive sensitivity to unexpected inflation, strengthen the strategic case for broad commodities.

2026 saw yet another sharp bond sell-off, driven by higher-than-expected inflation as well as doubts about the sustainability of high debt burdens. Government bond yields reached highs in developed markets, and as yields move inversely to prices, bond investors incurred losses. A closer look reveals a more systematic and persistent challenge for allocators: the 5-year correlation coefficient between global stocks and bonds has reached 0.7, higher than in any other 5-year period since January 1985 (Figure 1).

Figure 1: Global stock-bond correlation reaches its highest level since 1985



Source: Bloomberg Finance L.P., WisdomTree, from January 1985 to October 2026 based on monthly total returns (unhedged) in US Dollars of the MSCI World Index and the FTSE World Government Bond Index. **Historical performance is not an indication of future performance and any investments may go down in value.**

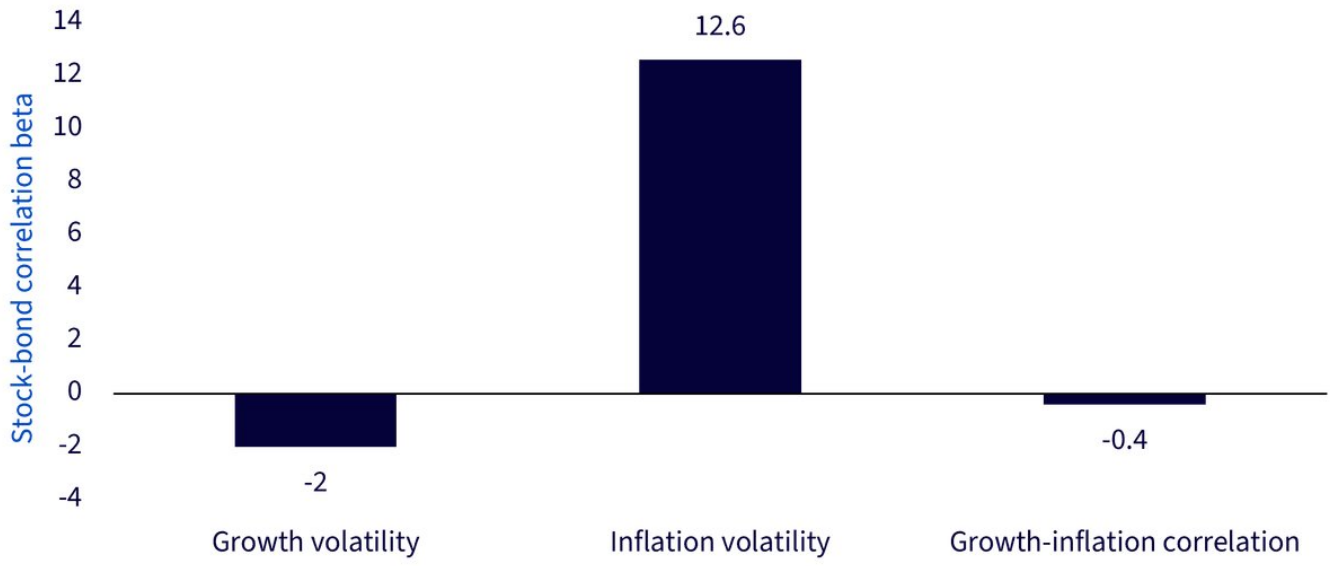
A high stock-bond correlation is a problem for asset allocators as it reduces bonds' ability to de-risk the equity portion of a multi-asset portfolio and to produce attractive risk-adjusted returns.

As correlation rises and diversification benefits weaken, portfolio volatility increases. Hence, investors relying solely on stocks and bonds may need to reduce equity allocations to maintain a given risk target. That, on the flip side, can lead to lower expected long-term returns.

What drives stock-bond correlation?

Brixton et al. (2023) introduce a simple empirical framework that explains changes in stock-bond correlation over time. By regressing observed correlation against growth volatility (industrial output volatility), inflation volatility, and the correlation between growth and inflation, they find significant coefficients that help explain the directional effects of these variables on stock-bond correlation (Figure 2). After controlling for these three variables, the level of inflation adds little explanatory power, leading the authors to argue that uncertainty is the dominant factor explaining stock-bond correlation.

Figure 2: Growth and inflation uncertainty help explain stock–bond correlation



Source: Brixton, A., Brooks, J., Hecht, P., Ilmanen, A., Maloney, T. and McQuinn, N. (2023) 'A changing stock–bond correlation: drivers and implications', The Journal of Portfolio Management, 49(4), pp. 64–80.

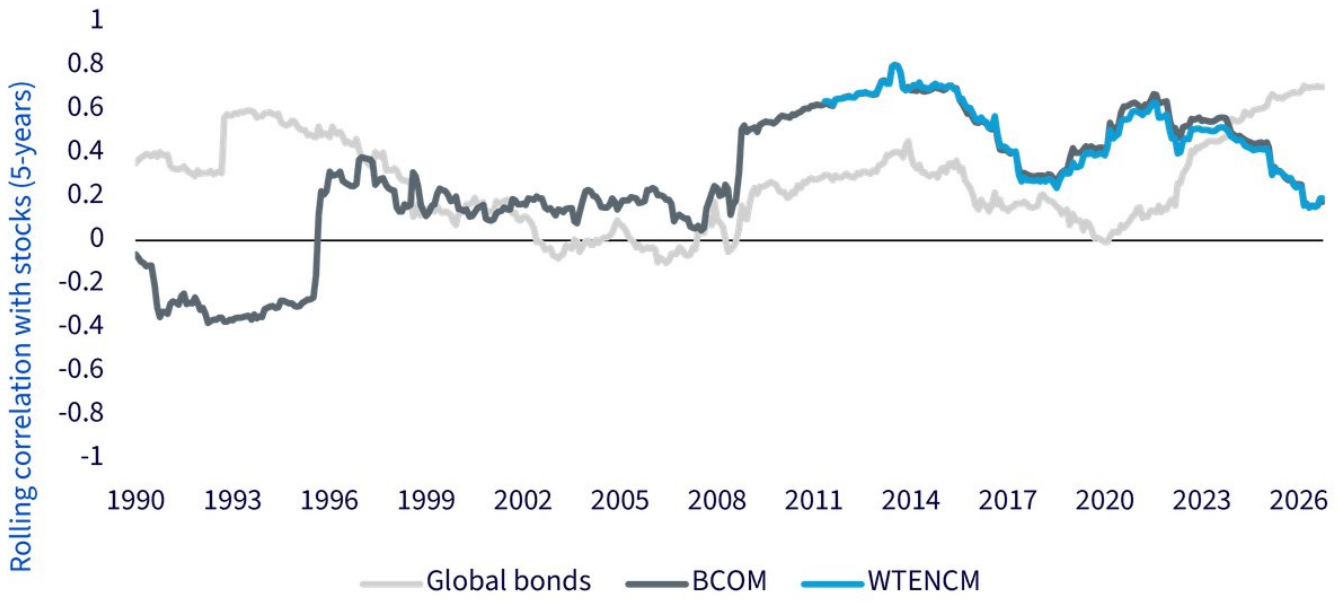
The takeaways are straightforward: higher uncertainty around growth lowers stock-bond correlation, while higher uncertainty around inflation leads to higher correlation. When growth and inflation move together, stock-bond correlation tends to fall. Conversely, when they move in opposite directions, it tends to rise.

Another takeaway is that inflation volatility, or the level of uncertainty around inflation, explains much more of the variation in correlation than growth risks. Looking back over the past 5 years, supply-driven inflation shocks have been more frequent: the rapid economic recovery following Covid-19 overwhelmed disrupted supply chains, the outbreak of war in Ukraine saw energy and agricultural prices spike, and, more recently, the war in Iran created yet another energy-led inflation shock. Viewed through this framework, the rise in stock-bond correlation is consistent with the current macroeconomic backdrop.

Broad commodities as an alternative diversifier

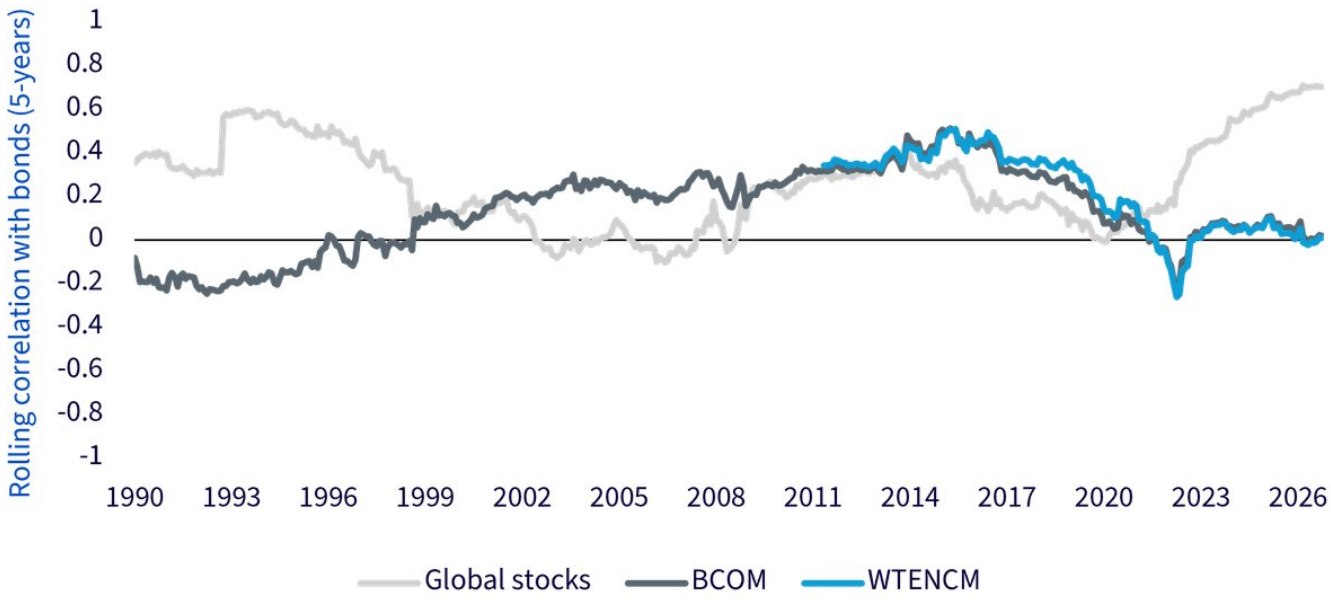
As mentioned at the beginning of this blog, rising stock-bond correlations pose a headache for multi-asset allocators. Bonds contribute less to improving risk-adjusted returns, and the recent sell-off has frustrated investors looking for stable returns. Commodities, on the other hand, measured by the Bloomberg Commodity Index (BCOM), have seen falling correlations with both stocks and bonds (Figures 3A and 3B). By October 2026, commodities' 5-year rolling correlation with global equities had fallen to 0.18, while its correlation with global government bonds stood at 0.02.

Figure 3A: Commodity correlations with global equities have fallen



Source: Bloomberg Finance L.P., WisdomTree, from January 1985 to October 2026 based on monthly total returns (unhedged) in US Dollars of the MSCI World Index, Bloomberg Commodity Index (BCOM), and WisdomTree Enhanced Commodity Index (WTENCM). **Historical performance is not an indication of future performance and any investments may go down in value.**

Figure 3B: Commodity correlations with global government bonds have fallen



Source: Bloomberg Finance L.P., WisdomTree, from January 1985 to October 2026 based on monthly total returns (unhedged) in US Dollars of the FTSE World Government Bond Index, Bloomberg Commodity Index (BCOM), and WisdomTree Enhanced Commodity Index (WTENCM). **Historical performance is not an indication of future performance and any investments may go down in value.**

Diversified commodity baskets exhibit a positive beta to unexpected inflation.1 This is intuitive, as such baskets track price developments across energy, metals, and agriculture. Therefore, the same supply-related inflation shocks that heightened stock-bond correlation also help explain the remarkable performance of commodities as a real asset this decade. Put another way, commodities can offer diversification exactly when bonds fail multi-asset portfolios.

In our whitepaper 'The Role of Broad Commodities in a Portfolio' (May 2026), we examine the optimal weight of a commodity allocation within an otherwise diversified stock–bond portfolio. Using a large number of simulations based on historical returns, resampled with replacement, the analysis suggests that an allocation of 20–23% to a broad commodity basket would have delivered the highest risk-adjusted portfolio returns under the assumptions used.

Implementing alternative diversifiers within a multi-asset portfolio requires an emphasis on low correlation with traditional asset classes, but also on meaningfully positive expected returns. The WisdomTree Enhanced Commodity UCITS ETF tracks the total return of the WisdomTree Enhanced Commodity Index (WTENCM). Starting from a weighting that emphasises economic significance and liquidity, the index systematically overweights commodities experiencing a tight or tightening supply-demand balance, as well as positive price momentum. While the index has exhibited similarly low correlations with stocks and bonds as the Bloomberg Commodity Index, its systematic approach has also delivered higher historical returns over the period analysed.2

Implications for multi-asset portfolios

Rising stock-bond correlations make diversification more challenging for multi-asset allocators. Recent supply-driven inflation shocks help explain this shift and highlight the value of assets that respond differently to inflation news.

Broad commodity baskets combine low recent correlations with stocks and bonds with positive sensitivity to unexpected inflation. This strengthens their strategic role alongside traditional allocations. The WisdomTree Enhanced Commodity Index offers a systematic approach to implementing that exposure, seeking to improve returns through smarter index construction.

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1 WisdomTree, “The Role of Broad Commodities in a Portfolio” (May 2026).
2 Source: Bloomberg Finance L.P., WisdomTree. October 2016 to October 2026. The WisdomTree Enhanced Commodity Total Return Index returned 13.21% p.a., compared with 7.89% p.a. for the Bloomberg Commodity Total Return Index. Performance includes backtested data. Backtested performance is hypothetical and does not represent actual historical investment returns. **Historical performance is not an indication of future performance and any investments may go down in value.**

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