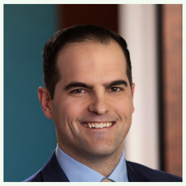
PRIVATE WEALTH MANAGEMENT INSIGHTS

DIVERSIFICATION:
A REMINDER OF THE BOND MARKET'S ROLE

Recency bias is the cognitive tendency to place too much weight on recent events or information when making judgments and decisions, often at the expense of historical context or long-term trends. It's something that we see from investors all too often in today's environment. Since 2020, the stock and bond markets have experienced increased correlation, particularly as inflation and interest rates have risen. That, paired with the Federal Reserve (Fed) maintaining attractive cash yields, has led to many investors looking to protect their principal with a mix of stocks and cash. However, history shows that leaving bonds out of the mix could be leaving investors exposed to the very risk they are looking to avoid.



Mark Lewis, CFA, CFP®

Principal, Senior Wealth Advisor

Historical Context and Lessons Learned

Instead of focusing only on recent market trends, it is informative to review historical periods with similar monetary conditions, such as 1990, 2000, and 2008. These years began with flat yield curves and higher fed funds rates following previous tightening cycles. Comparing these periods to current conditions may be the key to building principal protection in a world of higher rates. The following is a summary of market environments prior to each S&P 500 pullback and the subsequent one- and three-year performance of cash, bonds, and the S&P 500.

1990 Backdrop:

- Oil prices spiked because of The Persian Gulf crisis.
- The Fed employed a restrictive monetary policy to combat inflation.
- Real estate prices fell, leading to defaults on mortgages.
- Consumers reduced spending and focused on paying down previous borrowing.

	12/31/1989 – 12/31/1990 (1 Year)	12/31/1989 – 12/31/1992 (3 Year)
FTSE (3-Month) Treasury Bill Index	7.92%	5.75%
Bloomberg US Aggregate Bond Index	8.96%	10.73%
Bloomberg 10-Year Municipal Bond Index	7.34%	9.44%
S&P 500 Index — Total Return	-3.10%	10.81%

2000 Backdrop:

- Easy capital of the late 1990s led to a speculative asset bubble for many internet companies.
- Tighter monetary policy caused capital to dry up, causing investors to question lofty valuations.

	12/31/1999 – 12/31/2000 (1 Year)	12/31/1999 – 12/31/2002 (3 Year)
FTSE (3-Month) Treasury Bill Index	5.96%	3.90%
Bloomberg US Aggregate Bond Index	11.63%	10.10%
Bloomberg 10-Year Municipal Bond Index	10.76%	8.48%
S&P 500 Index — Total Return	-9.10%	-14.55%

2008 Backdrop:

- Years of low interest rates in response to the decade's earlier economic struggles led to a housing bubble fueled by speculative borrowing.
- De-regulation allowed financial institutions to take excessive risk.
- As the Fed began raising interest rates in 2004, adjustable-rate mortgages became unaffordable for many subprime borrowers, causing the real estate market to crash.
- Banks stopped lending because of this, causing economic liquidity to dry up.

	12/31/2007 – 12/31/2008 (1 Year)	12/31/2007 – 12/31/2010 (3 Year)
FTSE (3-Month) Treasury Bill Index	1.80%	0.69%
Bloomberg US Aggregate BondlIndex	5.24%	5.90%
Bloomberg 10-Year Municipal Bond Index	1.52%	5.08%
S&P 500 Index — Total Return	-37.00%	-2.86%

As GW&K's Global Strategist Bill Sterling points out, "In three major equity setbacks (1990, 2000, 2008), core bonds were positive over the next year and beat cash — and over three years they compounded while stocks were still digging out. T-bills yield about 3.9% (as of 9/30/2025) and a broad bond index yields about 4.4% with ~6 year rate sensitivity. If growth slows and the Fed makes more cuts, cash's yield will reset lower, but high-quality bonds can appreciate and lock in today's income. That's why a stock/bond/cash mix typically diversifies better than cash and stocks alone."

Key Takeaways

Principal protection involves more than simply holding cash: it means diversifying investments and monitoring that diversification as economic cycles change. And with stocks continuing to be an essential inflation hedge, it may be beneficial to remind investors of how the last 5 years might end up being the exception rather than the rule when it comes to cash providing more downside protection than bonds.

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