Insight Series

Rethinking Diversification:

Bonds, Commodities and Trend in the Current Market Regime

June 2026

The world appears to have entered a period in which the structural forces that shaped the past 25 years of economic growth – relatively unrestrained globalisation, deep trade integration, abundant energy and the free movement of labour and capital – are being reassessed, as their economic, political and social consequences become increasingly contentious. As tensions surface, geopolitical frictions and direct conflicts have re-emerged, exposing the fragile link between economic prosperity and geopolitical stability.

Should this re-assessment prove to be a structural macro shift rather than a short-lived adjustment, the consequences for investors' portfolios will be significant. In this environment, portfolio construction must adapt towards greater resilience and adaptability; properties trend-following strategies are able to deliver.

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Since the oil crises of the 1970s and 1980s, the world has experienced relatively few major supply disruptions. This has contributed to a prolonged period of generally stable energy costs. While the mid-2000s witnessed a historic rise in the price of oil, this increase was predominantly driven by demand-side factors rather than supply-side frictions, with China's rapid industrialisation playing a major role. The discovery of shale and its exploitation in the mid-2010s was a major energy breakthrough which heavily contributed towards this period of relatively abundant and cheap energy **(Figure 1)**.

Concurrently, the past 40 years witnessed comparatively fewer major global conflicts **(Figure 2)**. One explanation may lie in the substantial peace dividend generated by expanding commercial ties during a period of rapid globalisation and trade integration. The economic benefits derived from this integration likely helped align national interests, reducing the incentives for direct conflict and, by extension, the likelihood of energy-driven supply-side shocks that typically accompany such disruptions.

As a result, a series of notable structural trends emerged from this period of energy abundance and relative peace, each with far-reaching implications on policy-making, geopolitics, trade and financial markets:

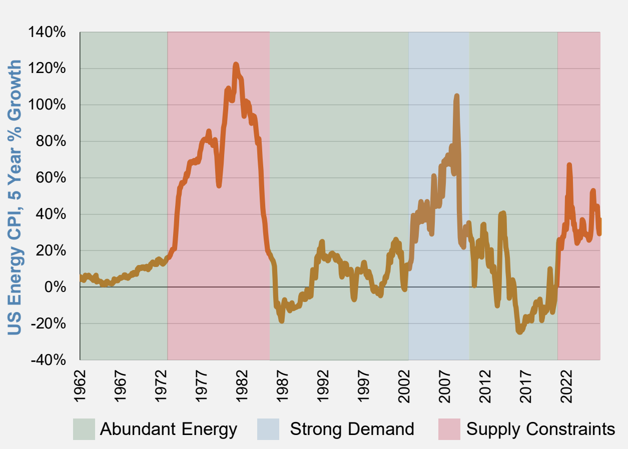

Figure 1: An Extended Era of Energy Abundance
1962 to 2026
Source: Macrobond, Gavekal

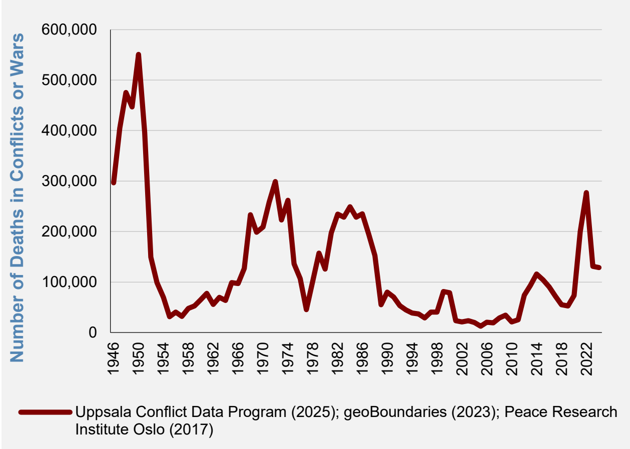

Figure 2: A Less Peaceful World?
1946 to 2024
Source: Our World in Data

- Energy security, reliability and affordability became lesser strategic priorities for policy makers, particularly in the West, where intermittent green sources of energy were favoured **(Figure 3)**.
- The threat of supply-side stagflationary shocks remained relatively low, giving monetary authorities ample room to manoeuvre and ease monetary conditions at the first sign of economic stress **(Figure 4)**.
- Resiliency gave way to efficiency both at the corporate and national level, where global integration, offshoring, and specialisation were favoured over redundancy, strategic reserves, and shorter, more secure supply chains.

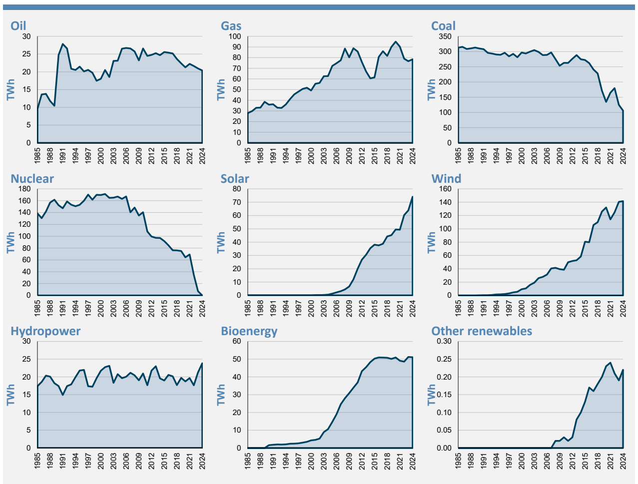

Figure 3: Electricity Production by Source, Germany 1985 to 2024
Source: Our World in Data

Figure 4: Bonds' 40 Year Secular Bull Market 1980 to 2026
Source: Macrobond

This decade however, a series of events seems to have eroded the structural foundations that underpinned this globalised and energy-abundant economic system, whose deep integration and efficiency subdued macro-economic volatility and helped sustain the relatively non-inflationary growth of the previous ~25 years **(Figures 5 and 6)**:

- The COVID-19 crisis exposed the fragility of optimised and integrated supply chains and labour forces, shaped by nearly 25 years of expanding globalisation, and forced companies to shift their supply chain strategies from just-in-time to just-in-case.

- The freezing of Russian state assets demonstrated that holding sovereign bonds carries substantial, previously unrecognized geopolitical risk. This has triggered a structural shift, prompting central banks to diversify away from G7-denominated debt – which are the backbone of the global financial system given their role as the absorber of global excess savings – and towards alternative assets.

- More recently, the Iran war has disrupted the global balance of power, with ~20% of global oil flows taken offline through low-cost and novel forms of warfare. This has exposed the growing insecurity of critical sea lanes and is compelling countries to reassess their vulnerability to both energy and broader supply shocks.

Taken together, these events point to a broader weakening of the global system that has prevailed over the past 25 years – one built on efficiency, deep interdependence and the assumed security and neutrality of supply chains, reserve assets and energy flows. They suggest that the current economic system may be approaching its boundaries, with rising frictions signalling a shift towards a more constrained, fragile and strategically contested regime. The implications of this change in economic system are likely to be far-reaching, reshaping national security priorities, altering global power dynamics and reconfiguring global supply chains.

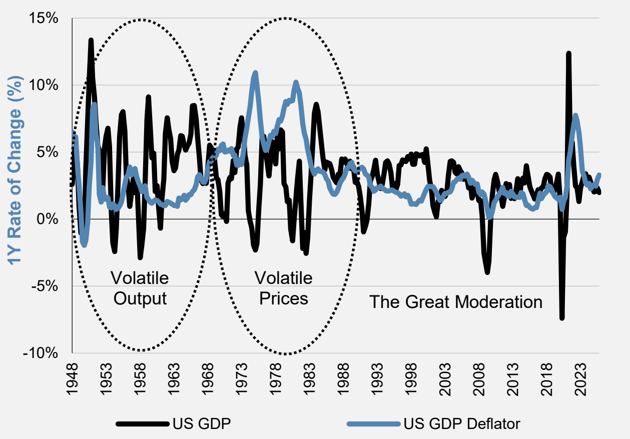

Figure 5: The End of The Great Moderation
1948 to 2025
Source: Macrobond, TS Lombard – Dario Perkins

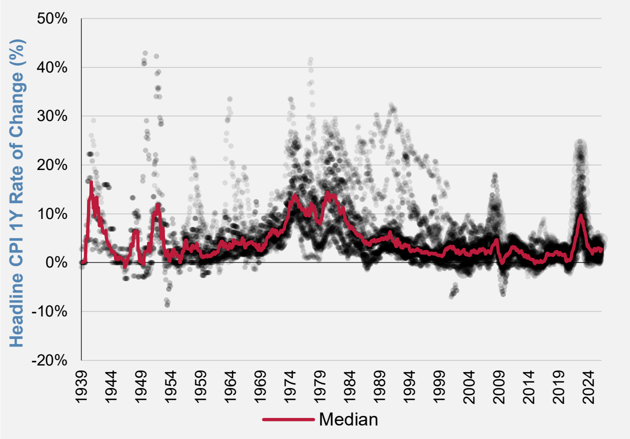

Figure 6: OECD Members Inflation Rate
1939 to 2026
Source: Macrobond, Reserve Bank of Australia

For investors, this transition is particularly consequential, requiring a reassessment of capital allocation and, critically, the role different asset classes play in the construction of resilient and genuinely diversified portfolios. In our view, three major themes emerge as probable outcomes of this shift, with their impact already beginning to unfold:

1. Fixed income's ability to diversify equity risk is structurally impaired

In a regime defined by exogenous shocks, bonds struggle to diversify away equity risk, something they had very successfully done for the past 25 years. In such environments, correlations between equities and fixed income tend to turn positive, due to the persistence of inflation risks, undermining the defensive role of bond allocations in multi-asset portfolios. A dynamic clearly observed during the inflation shock of 2021-22 **(Figure 7)**.

This shortfall is further exacerbated by the fact that the major sovereign debt issuers (e.g., United States, United Kingdom, or France) carry elevated debt burdens, constraining policymakers' ability to respond to inflationary pressures or supply shocks without destabilising public finances.

Likewise, monetary authorities face acute trade-offs when combating the stagflationary forces exogenous supply shocks can create. Either tightening policy to contain inflation at the risk of suppressing growth or easing conditions to support activity at the cost of de-anchoring inflation expectations.

In such an environment, bonds are no longer reliable shock absorbers, but assets increasingly exposed to some of the same forces driving equity risk – namely inflation volatility and policy uncertainty. As a result, their role as the cornerstone defensive allocation is being fundamentally challenged, particularly in the case of bonds issued by heavily indebted sovereign issuers.

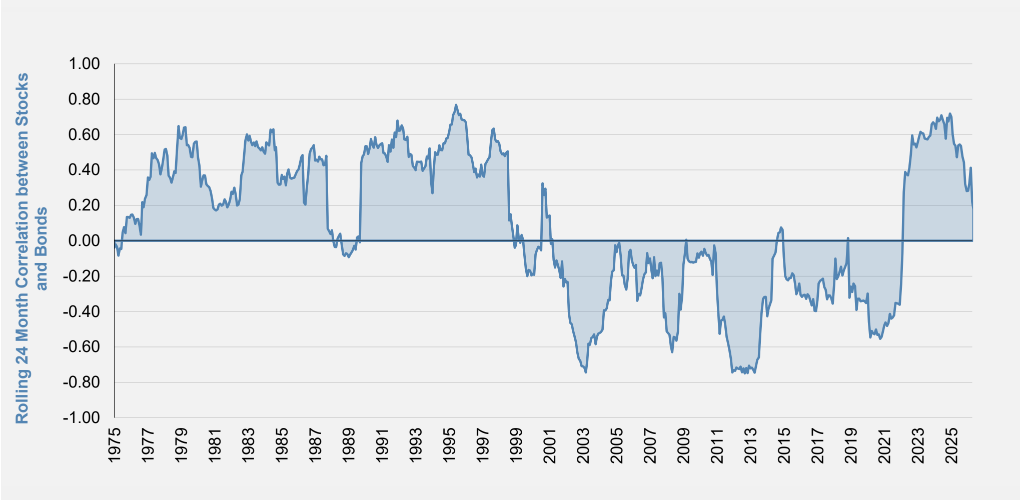

Figure 7: A Positive Stock Bond Correlation Weakens Diversification Effect 1975 to 2026
Source: S&P 500 Index & Bloomberg US Treasury Total Return Unhedged USD

2. Stores of value are being redefined

The appeal of Western fixed income markets, which have historically absorbed global excess savings, has been further undermined by geopolitical developments at the turn of the decade. The confiscation of Russian reserves by Western governments sent an unequivocal message to sovereign investors: financial assets are not politically neutral and can be weaponised. In this context, assets with no counterparty risk – most notably gold – have re-emerged as strategic stores of value, with central banks increasingly diversifying their reserves as confidence in traditional reserve assets is reassessed. As central banks intensified their purchases of gold **(Figure 8)**, the metal decoupled from its traditional return driver – namely real rates – reflecting the growing influence central banks have had this decade on the metal's rally **(Figure 9)**.

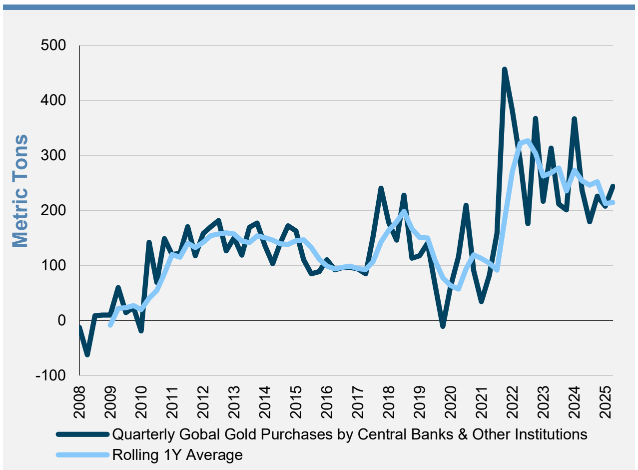

Figure 8: Central Banks Diversify into Gold 2008 to 2026
Source: Macrobond, World Gold Council

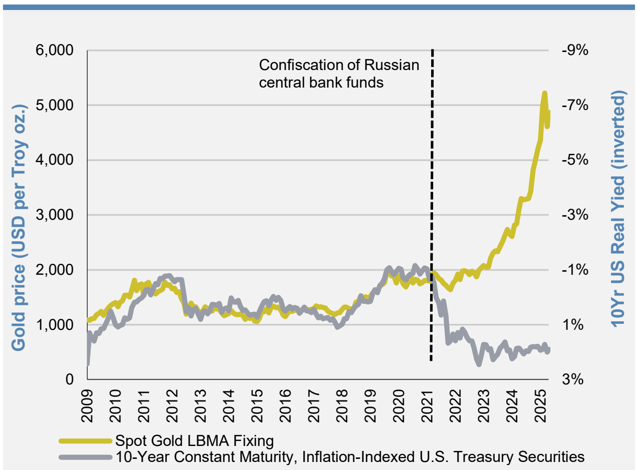

Figure 9: New Forces Drive the Price of Gold 2009 to 2026
Source: Macrobond, US Department of Treasury, LBMA

3. Commodities re-emerge as strategic assets

The wars in both Ukraine and Iran have displayed the vulnerability of economies to energy crises. At its core, the economy is a system of energy transformation, and without reliable access to energy, economic activity can quickly stall. This is why countries are now turning back towards cheap and reliable sources of energy to fend off the threat of high prices. Germany for instance (as they did in 2022) is considering firing up idle coal plants once again to alleviate the pain from rising energy costs caused by the war in Iran. In Italy, Prime Minister Giorgia Meloni has called for an immediate suspension of the EU's emissions trading system to help reduce costs for energy producers and curb energy prices for the Italian economy. These developments show how a number of the policy directions of the last few decades (in this case Europe's ambitious green energy transition) are starting to reverse as they clash with the harsh realities of energy scarcity.

The closure of the Strait of Hormuz highlights that resource vulnerability is not solely an energy issue. Since the strait closed, fertiliser exports have collapsed and flows of key industrial inputs ranging from aluminium to specialised gases critical to semiconductor production have been severely disturbed. While this recent event has brought resource scarcity risks into sharper focus, earlier episodes – from the 2022 energy crisis to last year's US-China tensions around rare earths – already signalled the growing strategic importance of commodities in global geopolitics.

From an investment perspective, this shift is significant. In a regime potentially increasingly shaped by supply-side shocks, commodities emerge as a strategic asset class rather than being predominantly a play on the economic cycle. They offer diversification in environments where bonds struggle, provide protection against structurally higher inflation, and give investors direct exposure to the forces now reshaping the global economy – namely geopolitical fragmentation, resource scarcity, and intensifying technological competition. As such, energy (but commodities more broadly) should no longer be a peripheral allocation. Instead, they should be candidates for core components of well-diversified portfolios to help navigate a more fragmented and resource-constrained world. As shown below, current energy sector exposure via a passive S&P 500 allocation is near historical lows **(Figure 10)**.

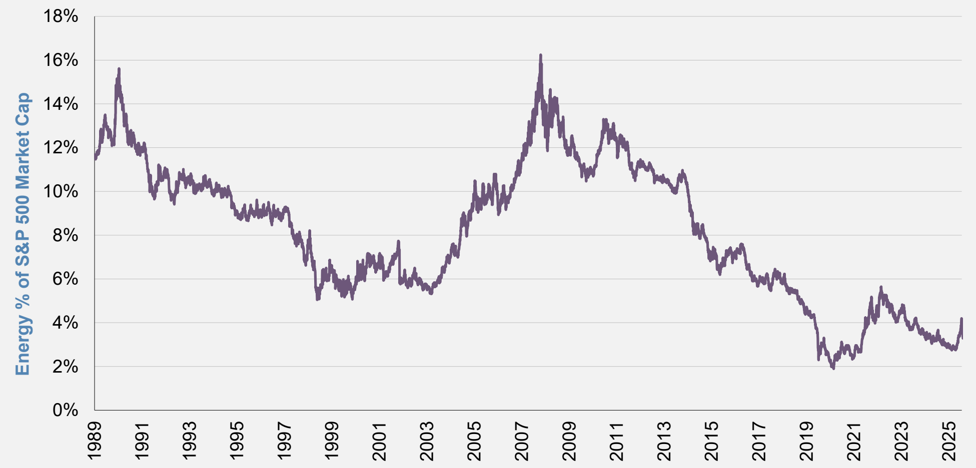

Figure 10: Investors' Energy Exposure Remains Minimal 1989 to 2026
Source: Macrobond, Gavekal

This environment raises a key question: how can investors navigate regimes characterised by persistent supply shocks when fixed income markets may no longer provide reliable diversification? In our view, increasing commodity exposures and particularly, energy exposure, seems like a sensible choice.

Other attractive avenues also exist. Particularly, within the liquid alternative space, trend following strategies run by Commodity Trading Advisors (CTAs), have successfully and consistently diversified away equity market risk across numerous market regimes, and particularly during inflationary (and stagflationary) episodes. These strategies, which can benefit from price trends across markets, possess several key properties that make them well suited to this type of environment:

- **Diversified commodity exposure**

  CTAs provide a systematic and liquid way of obtaining a broad exposure to commodities via futures markets. Trading a broad universe of commodities can provide exposure to both idiosyncratic price dislocations (e.g., crop-specific shocks or weather-driven supply disruptions such as those driving cocoa prices in 2024) as well as large-scale macro repricing driven by structural transitions (e.g., the shale oil revolution in 2014 or the precious metals rally of 2024-25). Importantly, commodity exposures within CTA portfolios are not passive but dynamically managed, providing tactical long and short exposure aligned with the strength and direction of prevailing trends. This flexibility allows the portfolio to scale exposure when trends are strong and reduce it when opportunities are limited, rather than maintaining a potentially costly passive long exposure.

- **Unbiased signal construction**

  The systematic, long/short nature of trend-following allows CTAs to capture trends from both rising and falling prices across asset classes, reducing reliance on any single macro regime. In contrast, traditional long-only bond allocations perform best when growth shocks, rather than inflation shocks, threaten the economy. As previously discussed, their defensive role is significantly weakened in inflationary regimes, where bonds lose some of their diversification properties. By contrast, CTAs can adapt to both rising and falling rate environments. This structural flexibility was evident during the 2022 global rate repricing, when trend strategies were able to benefit from sustained moves in bond markets.

- **Structural capture of regime-driven trends**

  Systematic trend-following strategies are specifically designed to capture sustained price trends that can emerge during significant macro regime shifts. In environments characterised by persistent macro shocks, policy uncertainty, and geopolitical fragmentation, asset prices tend to exhibit stronger and more persistent directional behaviour across asset classes, with CTAs consequently delivering significant and diversifying sources of returns (1970s, 1980s, late 1990s, 2008, 2014, 2022). Please see our *Living With Trend* paper that elaborates on this topic.

- **Cross-asset diversification**

  By operating across equities, fixed income, currencies and commodities, CTAs are inherently positioned to exploit relative and absolute price movements when cross-asset correlations break down. This feature becomes particularly valuable in regimes driven by exogenous supply shocks, where diversification benefits within traditional portfolios tend to deteriorate.

In conclusion, the world seems to have entered a period in which the structural forces that shaped the past 25 years of economic growth – relatively unrestrained globalisation, deep trade integration, abundant energy and the free movement of labour and capital – are being reassessed. The limits of this global system, and in particular its negative externalities, have moved to the forefront of economic and political discourse as their implications for manufacturing, employment, fiscal sustainability and global competitiveness have become increasingly apparent. Perhaps not coincidentally, geopolitical tensions and direct conflicts have re-emerged, underscoring the fragile relationship between economic interdependence and geopolitical stability.

For investors, this reassessment seems to mark more than just a cyclical adjustment; it points to a structural shift in the macro and market regime under which portfolios must operate. In a world potentially increasingly shaped by supply-side shocks, resource constraints and geopolitical fragmentation, the diversification frameworks that proved robust during the era of global disinflation can no longer be taken for granted. The challenge ahead is therefore not simply one of navigating higher macroeconomic volatility, but of adapting portfolio construction to a fundamentally different equilibrium – one in which resilience, adaptability and dynamism become indispensable. In this context, trend-following strategies – by virtue of their cross-asset reach, adaptive long/short structure and ability to capture persistent regime-driven trends – are well positioned to help deliver these properties.

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