BLOG POST
Return Correlations
03/11/2021

At the height of the COVID-19 outbreak last year, markets were in turmoil as investors assessed the ensuing damage from the economic shutdown. Asset values in general fell in unison to the downside as investors assessed the economic fallout. From a portfolio construction standpoint, there was nowhere to hide unless you went to cash or shorted the market. Ultimately, however, the markets rebounded and finished the year with new highs. What we are seeing now is a diversified market in terms of return correlations. As the table shows, correlations across the five major equity factors and U.S. Treasuries are now far from one, which suggests that portfolio diversification is working again.

- In particular, the return correlation of momentum stocks to small caps (0.53), value (0.58), and low volatility (0.57) stocks is relatively low today. This suggests that investors are now beginning to rotate into factors that underperformed in 2020.

- The return correlation of Treasury returns across equity factors remains negative (except for low volatility stocks). However, these correlations have risen materially from the depths of the COVID-19 outbreak in March 2020.

Year-to-Date Return Correlations (Source: Ycharts)						
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
Low Vol (1)	1.00					
Value (2)	0.66	1.00				
Momentum (3)	0.57	0.58	1.00			
Quality (4)	0.80	0.88	0.82	1.00		
Size (5)	0.46	0.83	0.53	0.70	1.00	
Treasuries (6)	0.17	-0.35	-0.01	-0.09	-0.34	1.00