

Stock-Bond Relationship Status: It's Complicated!

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It's a well-trodden belief that stocks and bonds are like oil and water – when one zigs, the other zags. However, the relationship between stocks and bonds is far more nuanced than a straightforward inverse correlation. This paper dives deep into the correlation between stocks and bonds, uncovering hidden layers and unexpected twists, particularly focusing on the often overlooked but crucial risk of prepayment.

Prepayment risk introduces a unique challenge in the stock-bond interplay. As interest rates fluctuate, the likelihood of borrowers paying off their loans early changes, impacting bond prices and subsequently influencing stock market behavior. This paper meticulously examines how prepayment risk adds another dimension to the stock-bond relationship, creating scenarios where traditional investment strategies may falter.

By breaking down these dynamics, this research reveals just how complex the stock-bond relationship can be. It's not just about one going up and the other going down. Figuring out the hidden details helps investors do well in today's financial markets. This study aims to give investors a clearer picture of how prepayment risk affects their portfolios, leading to smarter decisions in an ever-changing market landscape.