



The 60/40 Didn't Fail. The 40 Did.

For a US dollar investor over the past decade, the equity half of the 60/40 did its job in every market we tested. The government bond half earned less than cash in eight of nine. Replace it with market neutral and the Sharpe ratio of the 60/40 rose in every market we could compare.

8 of 9

Government bond legs that earned less than US cash for a dollar investor, February 2016 to August 2026; four lost money outright

4.34% at 3.72% volatility

A market neutral composite's return and risk: a higher return than every government bond leg and lower volatility than any of them

+0.02 to +0.43

Rise in the 60/40's Sharpe ratio when market neutral replaced bonds, in all nine markets, from China to Japan

THE FINDING IN ONE LINE

For a dollar-based allocator, the decade's 60/40 problem sat in the bond leg, not the equity leg: swapping government bonds for market neutral raised risk-adjusted returns in every market tested, at the cost of the hedge government bonds are held for, a deflationary crash, which this sample did not contain.

Three Horizons Capital, Portfolio Analytics. Monthly data, February 2016 to August 2026; market neutral composite May 2016 to September 2026. US dollars.

01 For a dollar investor, the bond leg earned less than cash in eight of nine markets

A widely shared chart maps the risk and return of the 60/40 across eight markets. We rebuilt it from priced monthly return series, extended it to China and Japan, and stated every figure in US dollars: what a dollar-based allocator actually earned in each market, including the currency move. Each market has three portfolios: all government bonds, all equities, and a 60/40 rebalanced monthly.

The bond legs are where the decade went wrong. Measured against the 2.34% average return on US three-month bills, eight of the nine government bond legs delivered a negative Sharpe ratio. Four lost money outright: Japan (−3.98% a year), Germany (−1.51%), the United Kingdom (−1.20%) and Sweden (−1.08%). Rising yields from 2021 to 2023 did the damage, compounded outside the United States by each currency's fall against the dollar. China was the exception, at 3.61% a year on 4.77% volatility.

Market neutral out-earned every bond leg, with less volatility than any of them



Source: Three Horizons Capital analysis, US dollar returns, February 2016 to August 2026. Market neutral: nine funds, equal-weighted, May 2016 to September 2026.

MARKET	BONDS: RETURN	BONDS: VOLATILITY	BONDS: SHARPE	EQUITIES: RETURN	EQUITIES: SHARPE
United States	1.05%	4.78%	-0.27	15.67%	0.86
Canada	0.80%	7.93%	-0.19	13.71%	0.66
Switzerland	1.99%	10.73%	-0.03	10.95%	0.60
Japan	-3.98%	10.61%	-0.60	9.80%	0.53
France				10.15%	0.43
Sweden	-1.08%	10.94%	-0.31	10.95%	0.42
United Kingdom	-1.20%	12.04%	-0.29	8.79%	0.41
Australia	1.62%	11.06%	-0.07	10.27%	0.40
Germany	-1.51%	5.53%	-0.70	9.39%	0.36
China	3.61%	4.77%	0.27	6.24%	0.17

The equity legs, by contrast, earned between 6.24% and 15.67% a year, with a positive Sharpe ratio in every market. France appears equities-only in this build; it gets its first full line in the market neutral build below.

02 The bond leg, not the equity leg, set each 60/40's result

MARKET	60/40 WITH BONDS: RETURN	VOLATILITY	SHARPE
United States	9.92%	9.77%	0.78
Canada	8.59%	12.95%	0.48
Switzerland	7.48%	11.56%	0.44
Australia	6.94%	15.68%	0.29
Sweden	6.24%	15.65%	0.25
Germany	5.40%	12.24%	0.25
China	5.71%	14.58%	0.23
United Kingdom	4.93%	13.01%	0.20
Japan	4.35%	10.52%	0.19

The United States had the best 60/40 in the set by a wide margin, a Sharpe ratio of 0.78 against 0.48 for Canada in second place. Japan shows the mechanism most clearly. Its equities returned 9.80% a year with a Sharpe ratio of 0.53, fourth of the ten markets. Its 60/40 returned 4.35%, the lowest in the set, pulled down by a bond leg that lost 3.98% a year in dollars as yield-curve control ended and the yen weakened.

03 China and Japan widen the map more than they move the frontier

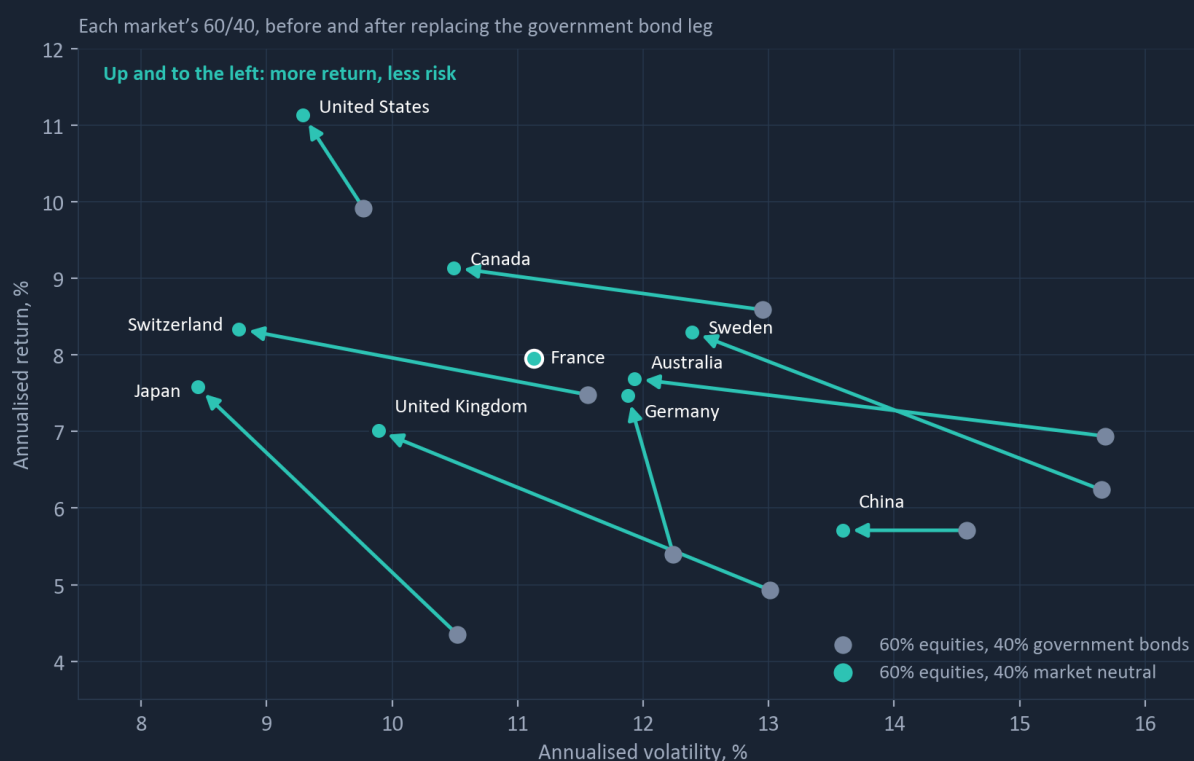
Japan slots in as a mid-risk developed equity market with the weakest bond leg of all. China is the outlier the original eight-market chart lacked: the highest equity volatility in the set (22.69%) and the lowest equity Sharpe ratio (0.17), but by far the best-behaved bond leg.

China's equities are also the least correlated with the rest, at 0.32 to 0.46 against the other nine markets, while those nine correlate with each other at 0.70 to 0.94. A China sleeve is a genuine diversifier for the equity book even though it is not rewarding on its own. Neither addition unseats the United States as the best risk-adjusted 60/40.

04 Swap the 40 for market neutral and every Sharpe ratio rises

We then replaced each market's government bond leg with a single global market neutral composite: nine equity market neutral funds, equal-weighted, in US dollars, from May 2016 to September 2026. Over its history the composite returned 4.34% a year on 3.72% volatility, a Sharpe ratio of 0.54. That is a higher return than every government bond leg and lower volatility than all nine, including the two quietest, the United States (4.78%) and China (4.77%).

Swap the bonds for market neutral and every 60/40 moved up, left, or both



Source: Three Horizons Capital analysis, US dollar returns, February 2016 to August 2026. France is shown in the market neutral build only.

Every 60/40 moved to more return, less risk, or both. In every market we could compare, the blend's return rose or held and its volatility fell.

The Sharpe ratio rose in all nine markets; most in Japan, least in China



MARKET	60/40 WITH BONDS: SHARPE	60/40 WITH MARKET NEUTRAL: RETURN	VOLATILITY	SHARPE	LIFT
United States	0.78	11.13%	9.29%	0.95	+0.17
Switzerland	0.44	8.34%	8.78%	0.68	+0.24
Canada	0.48	9.14%	10.49%	0.65	+0.17
Japan	0.19	7.58%	8.45%	0.62	+0.43
France		7.96%	11.13%	0.50	
Sweden	0.25	8.30%	12.39%	0.48	+0.23
United Kingdom	0.20	7.01%	9.89%	0.47	+0.27
Australia	0.29	7.69%	11.93%	0.45	+0.16
Germany	0.25	7.47%	11.88%	0.43	+0.18
China	0.23	5.71%	13.59%	0.25	+0.02

The size of the lift follows the size of the bond problem. Japan, with the deepest bond loss, gained most (+0.43). China, whose bond leg was already low-volatility and positive, gained least (+0.02). The United States stays first under either construction, at 0.95, but the order behind it changes: Switzerland (0.68), Canada (0.65) and Japan (0.62), against Canada then Switzerland with bonds. France gets a full 60/40-style line for the first time, at 0.50.

05 What the swap gives up

Three limits matter as much as the result.

The decade was a hard one for bonds. The sample includes the 2021 to 2023 rise in yields and 2022, when bonds and equities fell together. Government bonds earn their place in a different crisis: a deflationary crash with falling rates. Market neutral is built to ignore market direction; it is not built to rally when equities collapse. This test does not contain that crisis, so it cannot show what the swap would cost in one.

One market neutral leg replaces nine bond legs. The same composite stands in for every market, so the cross-country rates diversification of the bond build disappears by construction. Each blend's character now comes from its equity leg alone. China's low equity correlation is the one diversification channel that survives the swap.

The composite is nine funds, not an index. A different selection of market neutral managers would move the 4.34% and 3.72% reference point. Manager selection is part of the result, and part of the work.

06 What we would do with the book

Separate the two jobs of the 40. The bond sleeve is asked to provide income, low volatility and crash protection at once. Over this decade, for a dollar investor, it delivered little of the first two. Decide which job each part of the sleeve is for, and size it to that job.

Hold market neutral as a stabiliser, keep duration as the crash hedge. A blend of both keeps protection against a deflationary shock while capturing the steadier return this decade rewarded. The split is a dial, not a switch.

State the currency of the result. In dollar terms, Japan's bond leg lost 3.98% a year. A yen-based investor lived a different decade. Any cross-market 60/40 comparison is a currency decision before it is an asset allocation one.

Treat manager selection as the allocation. With market neutral, the strategy label tells you little; the managers inside it are the exposure. Build the sleeve from a defined, monitored set.

SO WHAT FOR ALLOCATORS

The question is not whether the 60/40 is dead. It is what the 40 is for. Over this decade, for a dollar investor, the equity half held up and the bond half did not. Ask what the stabilising sleeve is meant to do, in which crisis, and in which currency.

07 What we measured

Portfolios. For each of ten markets: 100% government bonds, 100% equities, and 60% equities with 40% bonds, rebalanced monthly. Then the same 60/40 with the bond leg replaced by market neutral, also rebalanced monthly.

Series. Broad country equity indices and country government bond total-return indices, all stated in US dollars, February 2016 to August 2026 (126 to 128 months). Germany's bond leg is derived from 10-year Bund yields (monthly return of prior yield over twelve, less eight times the change in yield), a cruder approximation than the priced indices used elsewhere. Market neutral: nine funds from the Morningstar Equity Market Neutral category, equal-weighted, in US dollars, May 2016 to September 2026; blended samples run 123 to 125 months.

Measures. Annualised return is the compound annual growth rate over the sample. Sharpe ratios use the 2016 to 2026 average US three-month bill yield, 2.34%, for every market, consistent with a dollar-based allocator's funding cost.

Limits. All figures embed each market's currency move against the dollar and are not comparable with local-currency charts. No transaction costs. The market neutral composite is one equal-weighted basket of nine funds, not an index. A record of one decade, not a forecast.

Prepared by Three Horizons Capital from its own data platform. For professional investors. Not investment advice.

If this is useful

We build this kind of look-through, across markets, currencies and sleeves, for portfolio teams deciding what each part of a portfolio is for. If that is the question in front of you, it is the work we do.