BLOG POST
The Reflation Trade
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Reflation is defined as an anticipated period of growth. Investors typically respond by rotating in to risk assets, namely equities. Recently, this is in response to relaxed Fed policy and the expected impact the vaccine has on economic recovery. Within equities, small caps and growth-oriented companies tend to do well. The rotation in to risk assets is occurring in coordination with a sell off in treasuries. The chart below shows the spread between the 10 year Treasury yield and S&P 500 earnings yield. A wide spread indicates investors are compensated for taking on the additional risk in holding stocks versus treasury bonds. The chart shows that the current spread continues to be greater than the long-term trend going back to 2000.

- The spread between the 10-year Treasury yield and S&P 500 earnings is about 2%, down from over 5% at the start of 2020 (Bloomberg).
- In addition to a rotation to risk assets, a sell off in Treasuries may be a result of inflation expectations.
- A reflationary trade coupled with improved economic expectations and risking rates may benefit the bank sector and commodities.
- The reflation trade is having an impact on sovereign bond yields globally. The 30 year Japanese Government Bond rose to .745% as of February 26th, the highest the yield has been in two years (Reuters).