This Emerging Nation Bond Trades Like G-7 Debt. It Pays More Too

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By Ben Bain and Sebastian Boyd

(Bloomberg) -- Not all emerging markets are created equal.

Amid extreme swings in developing-country debt from Brazil to South Africa, Mexico's market for government bonds is enjoying a period of relative tranquility. While the 1.8 percent that Mexico's fixed-rate peso bonds have returned in the past six months is hardly a windfall, the Mbonos are outperforming other local-currency notes in Latin America's main markets, as well as all but one developed country, after adjusting for volatility.

Mexico can thank institutional investors for helping to mute the effects from a selloff that's rocked other developing nations. About 60 percent of Mbonos are now held by foreigners, including BlackRock, Pimco and Chilean pensions, the highest in 15 years, data compiled by Bloomberg show. In 2004, they held less than 5 percent. The bonds now trade more like developed- market debt than emerging-market securities, making their 4 percentage-point premium versus U.S. Treasuries an attractive offer, according to Bank of Nova Scotia.

"Without a doubt Mexico is very much above other markets" in the developing world, said Gerardo Rodriguez, a former deputy finance minister for Mexico, who now works as a money manager at BlackRock in New York. "It offers a good combination of risk- adjusted returns and, above all, liquidity."

That's not to say Mexico isn't without its problems. Like the rest of the region, the plunge in commodities prices has weighed on growth. Economists surveyed by Bloomberg now forecast an expansion of 2.4 percent. In December, they expected 3.4 percent. But through it all - from conflict-of-interest allegations dogging top government officials to the high-profile escape this summer of the world's most-famous drug trafficker - foreign bond investors have remained steadfast.

Mexican debt "has been remarkably steady," Eduardo Suarez, a Latin America strategist at Scotia, said in a note to clients this month. He estimates about a third of foreign-owned Mbonos are held by long-term investors including sovereign wealth funds.

Benchmark peso debt now has a lower standard deviation as measured by a z-score interval than similar 10-year bonds from all G-7 countries. Standard deviation measures swings in returns relative to the average over a given time period. A score close to zero indicates less volatility.

While the peso's plunge - 10 percent this year - threatens to erode gains for foreign holders, it's much easier to hedge in Mexico than other emerging markets, which also reduces volatility, Suarez said. The peso fell 0.2 percent to 16.4141 per dollar at 3:11 p.m. in Mexico City.

As a low-risk asset, Mbonos are "not yet up there with Treasuries or Canadian bonds, but it's getting there," he said from Mexico City. "There are a lot of factors behind it. The first one is who the holders are."

Alejandro Urbina, a money manager at Chicago-based Silva Capital Management LLC, **said his firm has been boosting Mbono holdings** among its $180 million in assets. **A greater foreign presence in the market brings "a more stable hand,"** he said.

That in addition to the nation's economic outlook "makes Mexico a compelling investment story despite all the volatility that exists," he said by phone from Cedar Rapids, Iowa. **"It comes with an interesting economic story and all you've got to do is put up with some volatility - however, less volatility than you face in other emerging markets."**