# Mexico set to become a rising investment honeypot

By **Stirling Larkin**

LAST week a private sovereign wealth fund, considered one of the original China bulls, made a large move into new geography and in so doing flagged to us where the smart money is looking in 2015.

The success of China can clearly be attributed to its masterful export-led engagement with the West since 1978, when Deng Xiaoping brought his country closer to the world.

Since then, the US has been the prime benefactor of this relationship and astute ultra-high net worth global investors have found numerous ways of investing alongside this growth story, particularly in sectors such as retail, logistics and consumer staples.

The New York listing of China's largest e-commerce juggernaut, Alibaba, late last month epitomised this super trend.

Over time, however, China's currency, labour force and pricing power have also risen, leaving some to ask whether new engagements offer better yields in the years ahead, at least in the export-led industries.

These calls have been seconded by those voicing geopolitical reservations surrounding the rise in Asian nationalism, the stalled status of globalisation and questions concerning maritime and aviation security in an age of heightened uncertainty.

The large sovereign wealth fund investment last week was made in Mexico — an economy thought to be a new contender and whose rejuvenated export-led market represents a China hedge for the US consumer and global investors next year.

Mexico now rivals China as a near sourcing alternative for the US, providing cheaper unit labour costs and existing continental transport infrastructure, and is increasingly viewed by US pension funds as the US's back door play and obvious China hedge.

Under Enrique Pena Nieto's presidency, Mexico has turned an important corner and caught the attention of astute global investors for all the right reasons.

While other emerging markets fell by the wayside late last year, Mexico, now known as the Aztec Tiger, cleverly aligned itself with the post-global financial crisis recovery of its greatest interdependent market, the US, where 87 per cent of its exports went last year.

UHNW global investors saw that this new alignment provided Mexico with a geostrategic advantage and an ace in the hole over China and other rivals such as South Korea, Turkey and Poland.

It allowed itself the opportunity to demonstrate its position as an irreplaceable stakeholder in the increasingly integrated North American value chain.

This was witnessed by increasing trade activity between not only the US and Mexico but with Canada, as well, in 2012 and last year.

After the 20-year success of the North Atlantic Free-Trade Agreement, this compact trading bloc is looking to roll into new regional economic agreements, such as the Trans-Pacific Partnership and the Pacific Alliance, through which Mexico can also look to broaden its export reach to Pacific countries, including Australia, in the decade ahead.

Australian investment communities, all of whom have been heavily tilted towards China in recent years, have considered Mexico as a new, viable and independent investment alternative and one that would provide them with a direct path to the North American consumer.

Especially during a time when the Australian dollar remains relatively high and domestic growth prospects appear tepid, global investments exposed to new areas of growth present as compelling.

Australian superannuation funds could consider investments made by their US pension peers who have invested in the MSCI Mexico IMI 25/50 Index, which enjoyed a five-year annualised net return of 12.8 per cent, as at August 29.

This index can also be readily accessed by retail investors via the iShares MSCI Mexico Capped ETF (EWW: US).

The Mexico Equity & Income Fund (MXE: US) — which consists of equity and convertible debt securities issued by Mexican companies and then commingled with tranches of debt securities — has also demonstrated strong returns and provided investment access across the entire capital stack.

Mr Nieto and the members of the newly allied Pact for Mexico — a coalition of all three major Mexican parties — have made incredible inroads towards fixing the fault lines in the Mexican economy and social fabric.

Allowing, for the first time in nearly 80 years, for foreign energy companies such as BHP Billiton to bid to develop deepwater petroleum reserves in the Gulf of Mexico, has been seen by many as a critical step forward and a sign that foreign investment is finally welcome, once again.

Mr Nieto's PRI party has driven through important fiscal reforms and, in so doing, has created an increasing fiscal impulse while also tackling the over-unionisation of labour.

This had been a pressing concern for the global investor considering Mexico as an alternative to China in years gone by.

Mr Nieto and his coalition have even confronted the business monopolies and drug syndicates, while also modernising key infrastructure assets such as roads, rail and ports.

An investment in OHL Mexico (OHLMEX*: MM) over the past three years would have reflected this experience, whereby Mexico's infrastructure has been rapidly modernised and contracts have been awarded to public entities for the first time in decades.

A more level playing field is arising and several key industries, previously disrupted by prior regimes' monopolistic pricing, are rejuvenating and providing global investors with rewarding opportunities.

Importantly for the global investor, Mexican industry has also embraced the regional shale gas revolution and welcomed the unconventional petroleum exploration expertise of their Texan neighbours.

Further still, this has allowed the nation to finally begin recapturing manufacturing and services contracts that were being lost to China.

The US consumer has now received a viable alternative to Made in China.

Kohlberg Kravis Roberts recently told investors in New York that “Mexico is not a pure-play urbanisation story, nor is it a low GDP-per-capita story that has the potential to double overnight”.

But it may in fact be “inversely linked to China’s success” and “much more of an open-economy investment story than many of the other emerging-markets countries many investors know”.

With pressure from US rates likely to persist, Chinese export-led growth softening and thus affecting commodity prices, and emerging-market risk premiums continuing to compress, following the smart money seems wiser than ever.

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