



EM bonds: sorting the wheat from the chaff

The similar fortunes of Mexican and South African debt belie the differences between them.

Emerging markets haven't started 2016 well.

Investors have sold off holdings in the asset class indiscriminately and not necessarily for reasons that have anything to do with fundamentals. What's happening to South African and Mexican debt reflects that.

Both countries have sold off in recent months. The South African rand has been declining against the dollar for some time but has fallen off a cliff in the last month. The Mexican peso hasn't fared much better. Having settled somewhat towards the end of last year it has sold off ever since. The same goes for the country's bonds and those of the state-owned petroleum company Pemex.

South African assets are being sold for good reason. Its investment grade credit rating is under threat as investors fret about whether its administration can deal with a number of challenges from the collapse in commodity prices and an economy stymied by structural flaws. Employment is stuck at 25%, the Central Bank will probably be forced to raise interests from their current level of 6.25% if they're to keep to their inflation target. And the economy is barely going to manage growth of 1.5% this year. Low commodity prices is part of the economic problem but there are also big infrastructure bottlenecks (the country's businesses regularly have to deal with electricity black outs) holding the country back.

Mexico, however, is another matter. Enrique Peña Nieto, its President, has certainly had a torrid time of late. His approval ratings fell to the lowest level of any recent president after he failed to respond adequately to the disappearance of 43 students and allegations of wrongdoing connected to a house purchase by his wife.

Then came the escape of "El Chapo", one of the country's most formidable drug dealers, which was a nadir for the President. But El Chapo's recent recapture could be a turning point in the President's fortunes. The structural reforms which he enacted early in his tenure are starting to take effect. Increased competition in the telecoms market means mobile-phone charges have dropped over 12% and continue to fall. Furthermore, reforms to the financial sector, including new legislation aimed at allowing failing businesses to be more easily wound up (which has already been used) and measures to improve credit growth, are starting to take effect. In a country that has had very small levels of credit since the Tequila Crisis, these new rules should help growth.

International investors also tend to have a lot of time for countries who simply let their central banks do their job and do it well. After all, meddling in central bank affairs is as sure a sign as any that panic isn't far off, especially in emerging markets.

In terms of oil price pressures, the government managed to sell 100% of the recent oil exploration and extraction licenses which were auctioned – a big vote of confidence for a country during an oil price rout.

So why are investors selling Mexico seemingly as readily as South Africa?

The short answer: fear. Investors are taking fright at anything with an emerging market label. When fear sets in, irrationality follows and bargains are left behind. Long-term investors would do well to look through the noise and try to focus on what is really going on in these countries.

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