Bill Gross’s I-Told-You-So Moment Gets Added Lift: Mexico Credit

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Sept. 20 (Bloomberg) -- Bill Gross’s prediction that the Federal Reserve would unwind its unprecedented stimulus slowly at a time when bond traders were bracing for a quicker reduction is paying some of the biggest dividends south of the border.

Mexico’s peso-denominated notes due 2024 surged this week, reducing yields by the most in 15 months, as the Fed on Sept. 18 refrained from curbing its $85 billion of monthly bond buying. The 0.34 percentage point drop is more than the 0.22 percentage point average decline in borrowing costs for emerging-market debt and halted a jump in peso bond yields since May as the Fed debated paring purchases. Gross’s Pacific Investment Management Co., which runs the largest bond fund, is also the biggest holder of the 2024 notes.

Gross said one day before the Fed’s decision that investors should buy short-maturity Treasuries because the bank was likely to continue favoring monetary stimulus after Lawrence Summers quit the race this week to replace Chairman Ben S. Bernanke. The Fed’s move spurred a rally in emerging-market assets, while peso bonds also jumped as the rebound in the local currency bolstered speculation Mexico’s central bank will lower interest rates to revive the economy, Nomura Holdings Inc. said.

“Both the external and the domestic point to a flatter and tighter curve” in Mexico, Alejandro Urbina, who helps oversee $800 million at Silva Capital Management LLC, said in a telephone interview from Chicago. “We get this relief rally due to the no-taper, and then you have this other side of it, which is Banco de Mexico.”

‘Increasingly Dovish’

When Gross recommended in a Sept. 16 tweet that investors buy the “front end” of the Treasury bond curve, he said he still expected the Fed to taper bond buying.

“Not braggin’ but what did we tell you,” Gross wrote on Twitter on Sept. 18 after the Fed kept the pace of stimulus.

Yields on two-year U.S. Treasury notes dropped five basis points, or 0.05 percentage point, to a one-month low of 0.32 percent on the day of the Fed’s decision.

Summers’s decision made Fed Vice Chairman Janet Yellen the top candidate, a sign to Gross that the central bank will maintain its easy-money policies.

“What we got was an increasingly dovish handoff from Chairman Bernanke to Janet Yellen,” Gross said yesterday in an interview on Bloomberg Radio’s “Bloomberg Surveillance” with Tom Keene and Michael McKee. “Bernanke has metaphorically left the building. We are living in a Yellen world. And Yellen is a dove with a capital D.”

Bond Returns

Mexico’s peso bonds have returned 16.8 percent in dollars since Gross wrote June 19, 2012, on his Twitter account that the country’s notes bonds were an obvious choice, versus 6.3 percent for local-currency emerging-market government debt tracked by

Bank of America Corp.

He said Mexico's lower debt levels and higher yields make investing in the country's bonds instead of German notes a decision so obvious that he ended his comments on the Pimco Twitter account with the word "duh."

Andrew Balls, the head of European portfolio management at Newport Beach, California-based Pimco, said in a Bloomberg Television interview on Sept. 16 that he sees value in local Mexican and Brazilian bonds.

"We have been pretty realistically constructive about the prospects for Mexican fixed income," Michael Gomez, managing director and co-head of emerging markets at Pimco, said in a telephone interview. "We've seen a market that is backed by a set of policy makers who are fairly proactive, whose fundamentals are very strong." Gomez said "the view that the Fed is anchored in the front end provides a constructive backdrop for the value and the strength of the fundamentals of Mexico to be realized."

Mexico's Policy

Mexico's central bank cut its target lending rate by 0.25 percentage point to a record low 3.75 percent on Sept. 6 after the economy posted its weakest first-half growth since the end of a recession in 2009. It has trimmed rates by 0.75 percentage point this year. Interest-rate swaps reflect a 52 percent likelihood that the bank will lower borrowing costs by 0.25 percentage point in the next three months.

Mexico's peso rallied 2.1 percent against the dollar after the Fed decision on Sept. 18, the most since June and boosting speculation the central bank may cut rates as stronger currency helps tame inflation by reducing the cost of imports.

"It improves the chances for a cut given the impact it's had on" the peso, Edwin Gutierrez, a fund manager who oversees $10 billion at Aberdeen Asset Management Plc, said in an e-mailed response to questions.

'Temporary' Bounce

Roberto Ivan Garcia Castellanos, a bond trader at Casa de Bolsa Finamex SAB, said that Fed will eventually have to reduce its stimulus measures, making the rally in Mexican bonds short-lived.

"The data in the U.S. hasn't been so bad as to justify a decision like this," Garcia Castellanos said by telephone from Guadalajara, Mexico. "This is going to be temporary."

The peso fell 1.5 percent to 12.9010 per dollar at 2:40 p.m. in New York.

The extra yield investors demand to own Mexican government dollar bonds instead of Treasuries widened two basis points to 184 basis points, according to JPMorgan Chase & Co. Mexico's five-year credit default swaps, contracts that protect holders of the nation's debt from non-payment, climbed eight basis points to 106 basis points.

Yields on Mexico's bonds due 2024 soared as much as 1.1 percentage points since the end of May to a 17-month high of 5.81 percent on concern the Fed would pare back stimulus, according to data compiled by Bloomberg.

“Given the selloff that we had in emerging markets, there is some value here,” Henry Stipp, who oversees $3 billion as co-head of emerging-market fixed-income at Threadneedle Asset Management, said in a telephone interview from London. “They are more dovish. There is no doubt about it.”