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By Ben Bain and Newley Purnell

June 21 (Bloomberg) -- Foreign investors led by Bill Gross that boosted holdings of Mexican debt to a record as the Federal Reserve suppressed interest rates are now suffering the worst rout since the depths of the financial crisis.

Yields on Mexico's benchmark peso bonds due in 2024 jumped 0.67 percentage point in the past week, the most since November 2008 in the aftermath of Lehman Brothers Holdings Inc.'s failure and more than triple the 0.21 percentage point rise on emerging-market local debt. Gross's Pacific Investment Management Co., the world's largest bond fund manager, is the biggest holder of the securities, according to filings data compiled by Bloomberg.

The swoon in Mexican bonds, part of a global selloff, deepened yesterday after Fed Chairman Ben S. Bernanke said the central bank may pare bond purchases this year and end them in mid-2014 if the U.S. achieves its growth objectives. Yields on Mexico's 2024 bonds are now at a one-year high of 5.93 percent, 0.01 percentage point more than in June 18, 2012, when Gross said he favored the notes over German bunds. The peso, which Gross called a "great currency" on Feb. 5, has tumbled 5.5 percent in the past week, exacerbating losses in dollars.

Foreigners 'Panicking'

"There are a lot of foreigners in the paper," Mindaugas Lepeska, an analyst at Threadneedle Asset Management, which oversees $3 billion in emerging-market fixed-income assets including Mexican local-currency bonds, said in a telephone interview from London. "If the country has very high foreign participation in the capital markets, then the foreigners, who would be panicking, would be selling first."

He declined to comment on if Threadneedle had bought or sold Mexican bonds amid the rout.

Mark Porterfield, a spokesman at the Newport Beach, California-based Pimco, said company officials weren't available to comment on the company's Mexico holdings.

Gross's flagship $285 billion Pimco Total Return Fund is the biggest holder of the 2024 peso securities, according to filing data compiled by Bloomberg. The world's biggest mutual fund has lost 2.2 percent this year, the most among of 19 U.S. total return funds with at least $2 billion in assets, data compiled by Bloomberg show. Gross said in the fund's monthly report in May that the fund's exposure to Mexico was the biggest detractor of its performance.

Mexico also has the highest allocation among countries in Pimco's $14.5 billion Emerging Local Bond Fund, with 15.7 percent, according to its May monthly report.

Favored Bonds

Ramin Toloui, global co-head of emerging-markets portfolio management at Pimco, said on May 20 that the firm is favoring local bonds from Mexico, Brazil and South Africa.

Bernanke will cut the Fed's $85 billion in monthly bond purchases by $20 billion at the Sept. 17-18 policy meeting, according to 44 percent of economists in a Bloomberg survey released yesterday.

That compares with just 27 percent who said policy makers would start tapering in September in a June 4-5 poll.

Alejandro Urbina, a money manager who helps oversee about $800 million in emerging-market assets including Mexican debt at Silva Capital Management, says that liquidity for longer-term Mexican bonds has "dried up" as the securities are more vulnerable to increases in global interest rates.

'Very Scared'

"There's quite a bit of pain out there," Urbina said in a telephone interview from Chicago. "Locals and foreigners right now are very scared of duration and so the market ceases to have a bid because nobody wants to be left holding the bag on bonds that may be falling in price."

Pablo Cisilino, who helps manage $60 billion of emerging-market debt at Stone Harbor Investment Partners in New York, says he's buying Mexican peso bonds as the debt is "cheap" at current price levels. He said improved outlook for the U.S., Mexico's biggest trading partner, helps make the peso attractive as the Latin American country's government pushes ahead with reforms to boost growth.

President Enrique Pena Nieto said in an interview with Bloomberg News in London on June 17 that his administration will send a bill to congress to open the state-owned oil industry to private investment by September along with a tax proposal.

He has said the overhauls will boost growth in Latin America's second-biggest economy to as much 6 percent per year, compared with 3.9 percent in 2012.

'Question of Time'

"The fundamental story hasn't changed in Mexico" Cisilino said in a telephone interview from New York. "It's a question of time only."

The peso rose 0.1 percent to 13.3470 per dollar at 12:44 p.m. in Mexico City, after dropping 0.9 percent yesterday to the weakest closing level in almost 11 months.

Mexico's stability council, which includes officials from the Finance Ministry and the central bank, said yesterday it was analyzing the market volatility.

Central bank Governor Agustin Carstens said in April that volatility in capital flows may spur an "overreaction" in the exchange rate.

The extra yield that investors demand to hold Mexican dollar bonds over U.S. Treasuries dropped two basis points, or 0.02 percentage point, to 228 basis points, according to JPMorgan Chase & Co.'s EMBI Global index.

The cost to protect Mexican debt against non-payment for five years with credit-default swaps fell three basis points to 162 basis points, according to data compiled by Bloomberg.

Yields on Mexican interbank rate futures contracts due in December, known as TIIE, jumped 18 basis points yesterday to 4.58 percent.

‘Crowded Trade’

Yields on Mexico’s peso bonds due in 2024 touched a record low 4.48 percent on May 9, less than two weeks before Bernanke said the Fed may reduce the pace of asset purchases if there was sustainable improvement in U.S. employment. Today yields on the debt rose seven basis points to 6 percent.

Mexico has “become probably a favorite crowded trade, and to that extent, the technicals are less robust because simply more people own it,” Jeremy Brewin, who oversees more than $5 billion of fixed-income assets as the head of emerging-market debt at Aviva Investors, said in a telephone interview in London. “When people get outflows from their portfolios, they look around for the most liquid asset they’ve got and one that they are probably overweight within their portfolio structure.”

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