Mexico: A Case Study for International Investing

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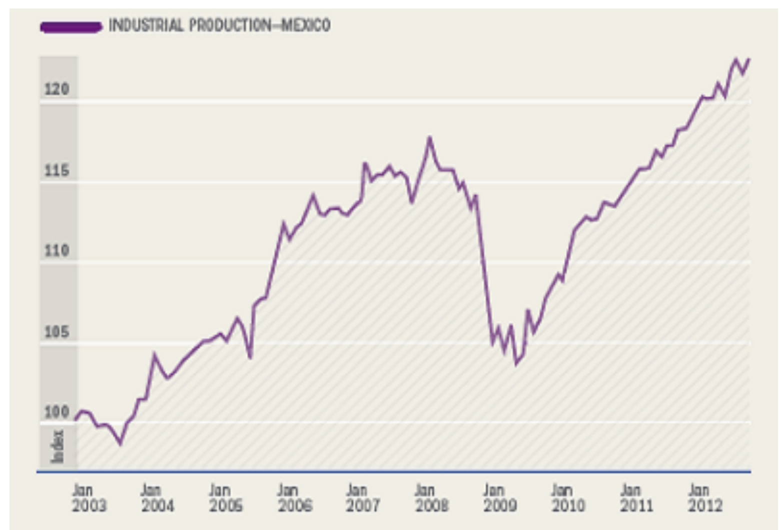
A young, educated workforce in Singapore. Rising household income in Brazil. Export growth in Mexico.

These are just some of the factors driving global growth, and if you're only investing domestically, you could be missing out on growth opportunities. In fact, investing solely in the United States amounts to excluding three-fourths of the global economy[1] and more than half of the world's stock market value.[2]

Plus, a range of factors—younger populations, abundance of natural resources, export strength, differences in household income—provide some international markets with growth opportunities that may not be available in the United States.

Using Mexico as a case study, let's take a look at some of the key factors to consider when researching international investments.

Manufacturing in Mexico Continues to Grow



Export Prospects

Mexico's stock market surged 20% in 2012,[3] and its geographical proximity to the United States may have had something to do with that. Manufacturers in Mexico are gaining market share, benefitting from "near-shoring," the global trend of placing plants closer to end-consumer markets like the United States.

Mexico has also benefitted from a changing cost equation. Rising labor costs, as well as increases in transportation and real estate costs, are undermining China's competitive advantage. In 2000, Mexican factory workers earned more than four times as much as Chinese workers, according to the Boston Consulting Group (BCG).[4] By 2010, Mexican workers earned only 1.5 times as much as Chinese workers, largely a result of China's double-digit wage increases in recent years. BCG estimates that by 2015, the total cost—including benefits, taxes and indirect costs—of hiring Chinese workers may be 25% higher than that of hiring Mexican workers.

Roughly 80% of Mexico's exports went to the United States in 2011,[5] and exports constitute more than 30% of Mexican gross domestic product (GDP), meaning the United States generates a quarter of Mexico's economic activity. If growth in the United States continues, Mexico will likely benefit from it.

Ability for Consumers to Spend

Mexico's increased market share brings with it the need for workers with advanced skills, such as those required to produce telecom and aerospace equipment. Due to Mexico's strength in

manufacturing, the number of private sector jobs has grown 4.6% annually for the past two years, and real wages have increased 0.4% during the same time.[6]

Meanwhile, inflation has stabilized despite rising food costs during 2012, and consumer confidence is strong. Consumers' access to credit has improved, with consumer lending growing at a fast clip during the past two years, driven in part by banks reducing interest rates and collateral requirements.

Consumer-related sectors account for more than 50% of Mexico's stock market, so these factors all combine to foster a potentially bright outlook for Mexico's economy.[7]

Monetary and Fiscal Policy

It's useful to compare Mexico to the rest of Latin America. After initial cuts in 2009, Mexico's central bank has been one of the few from emerging markets able to avoid raising rates in response to inflation risks, which has bolstered the peso. Additionally, Mexico's new government has promised reforms to open up markets to competition, revive growth and reduce government interference.

Brazil's monetary policy, on the other hand, has been quite volatile. Its central bank raised rates by 3.75 percentage points between January 2010 and August 2011, and then cut rates by 5.25 percentage points. The rate hikes were in response to inflation and currency upside risks, but contributed to inflation volatility, as well as consumer and investor uncertainty. Brazil's new government has also increased its interference in certain companies in the energy and materials sectors, reducing their profitability.

Unique Risks

Overall, investing internationally carries risks, including political instability and limited access to timely and accurate information. In addition, each country also comes with its own unique risks that you should be aware of before making an investment decision.

For example, with 80% of its exports destined for the United States, Mexico's economy may slow if the US economy lags. Another risk factor is that one stock constitutes about 20% of Mexico's main stock index, so the performance of that stock could have a large influence on the overall market. Mexico's stock market rose 20% in local currency in 2012, and 29% when factoring in a gain in the peso for US dollar investors. As a result, the stock market appears somewhat expensively valued. However, we like Mexico's long-term story and investors may want to take advantage of market volatility to buy on dips.

Overall, investors should approach international investing as a way to diversify away from US-only holdings and tap into potential growth opportunities. We believe investors should have some international exposure, though how much exposure will depend on your risk tolerance. Allocating between 5% (for conservative investors) and 25% (for more aggressive investors) of your total portfolio to international stocks is a good rule of thumb.

Source: FactSet and National Institute of Statistics and Geography, as of November 30, 2012.

1. International Monetary Fund, December 2011.
2. S&P Global Broad Market Index, May 2012.
3. Mexico IPC Index, Bloomberg, as of December 31, 2012.
4. Boston Consulting Group, "Made in America, Again," August 2011.
5. Mexico's National Institute of Statistics and Geography (INEGI).
6. "Mexico Economic Outlook, Third Quarter 2012," BBVA Research, August 2, 2012.
7. Bloomberg, January 15, 2013.