

# BORDERLANDS

## ON THE ROAD IN MEXICO (AND TEXAS)

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Mexico stands to be one of the chief beneficiaries of the geopolitical shifts reshaping global trade. With the country in the midst of a nearshoring boom, investment manager Tom Miedema spent a week there to find out more.

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In his 2015 book *Prisoners of Geography*, Tim Marshall considered the impact of geography on international affairs and the fate of nations. On Mexico, Marshall offered a rather gloomy assessment. Lamenting the harsh terrain of much of the country, he argued that jungle, mountains and desert have all served to inhibit Mexico's economic growth.

Compounding this misfortune, proximity to the world's largest market for illegal drugs has facilitated the growth of powerful criminal gangs, rendering much of the country ungovernable. Beset by its seemingly immutable disadvantages, Mexico, Marshall concluded, was "destined to live in the shadow of the United States".

But nearly a decade on from this downbeat prognosis, rather than a hindrance, geography would appear to be working in Mexico's favour. The proximity to the US that Marshall deemed a handicap to economic progress is today attracting scores of businesses keen to shift production away from China and closer to the world's largest economy. In the eyes of many, this nearshoring trend is a once-in-a-generation opportunity with transformative potential for the long-term trajectory of the Mexican economy.

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To dig deeper into the nearshoring story and the wider economic backdrop in Mexico, I visited the country in May. In the capital Mexico City and the northern industrial heartlands, I spoke with company management teams across a diverse range of sectors, from real estate and capital goods, to airports and mining. Many of the firms I met with are held in our emerging markets strategy, and several are taking advantage of nearshoring to enhance already impressive long-term growth stories. Walter Scott's experience of investing in Mexico over the past three decades has strengthened our belief that, despite its challenges, the country offers opportunities for a long-term investment approach centred on company fundamentals.

## PROFITING FROM PROXIMITY

Perhaps counterintuitively, I began my trip not in Mexico but over the border in Texas. For investors wanting to better understand what's going on in the Mexican economy, a few days in the Lone Star State is time well spent.

Texas and Mexico are deeply interconnected. In 2022, trade between the two totalled US$286 billion, the highest for any US state. Over three-quarters of the land trade between both countries crosses through Texas ports of entry, whilst exports to Texas are estimated to support over one million Mexican jobs.

As the Dallas Federal Reserve points out, so-called 'sister cities' on either side of the border are "tied to one another" in "trade, jobs and private investment". Economically at least, what's good for Texas is typically good for Mexico, and vice versa.

Today, Texas is thriving – even by the impressive standards of the US economy. Individuals and families are flocking to its towns and cities, attracted by lower taxes, cheaper housing and plentiful employment. Companies are relocating too, most notably Tesla, tempted by the state's business-friendly environment and skilled workforce. Meanwhile, spurred by the CHIPS and Inflation Reduction acts, private sector investment is flowing into the semiconductor and clean energy industries, fuelling a construction and infrastructure boom.

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Since the CHIPS Act was signed into law in 2022, companies across the semiconductor ecosystem have announced nearly $450 billion of new investment in the US. Some 20% of that figure is being deployed in Texas. At the same time, the fossil-fuel powerhouse has emerged as a clean energy giant, generating more power from renewables than any other US state.

For the visitor, it is impossible not be struck by the dynamism of Texas. At every company I visited, from tech leaders and industrials in Dallas to construction services firms and oil producers in Houston, management teams were looking to the future with optimism and confidence. And with good reason. Durable tailwinds look set to support this economic boom for some time to come.

## BRINGING IT ALL BACK HOME

Much of the trade that happens between Mexico and Texas takes place in what are sometimes referred to as "mega-regions", clusters of economic activity revolving around sister cities, such as "los dos Laredos" (Laredo and Nuevo Laredo), McAllen and Reynosa or Brownsville and Matamoros. Along with the broader Monterrey region, these areas are also at the heart of the nearshoring trend.

There has been talk of a nearshoring dividend for Mexico since US-China trade relations started to deteriorate in the mid-2010s. Having proved something of a slow burn to begin with, it has now gained serious momentum. Last year, foreign direct investment into Mexico hit a record US$36 billion. Companies looking to relocate manufacturing away from China are being lured to border cities by low labour costs, a skilled workforce and the beneficial trade terms conferred by the USMCA (US-Mexico-Canada Trade Agreement).

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Speaking with management teams in Mexico, you quickly get a sense of the scale of the nearshoring opportunity. Prologis, a real estate investment trust, is dealing with huge demand for industrial and logistics space along the border, with automotive and electronics firms leading the way. Whilst expecting growth to stabilise over time, the business anticipates the current acceleration continuing for another three-to-five years.

One company increasing its real estate footprint is WEG, which is building capacity to meet growing demand for its industrial equipment on both sides of the border. Established in Brazil in the 1960s, WEG started out as a manufacturer of electric motors. Since then, it has expanded its product range to cover the complete energy conversion cycle, from the generation of electricity through to its conversion into mechanical power. Its customer base is similarly wide ranging.

Having entered the Mexican market in 2000, WEG now has extensive operations across the country, employing more than 4,000 people. Most recently, the acquisition of the industrial electric motors and generators businesses of Regal Rexnord brought with it operations in Monterrey.

During a tour of one of WEG's three Mexican industrial parks, we discussed the current surge in demand from US construction and infrastructure spending. A large chunk of this investment is focused on renewable energy and electricity distribution, which plays directly to WEG's strengths in GTD (generation, transmission and distribution) equipment. The business has earmarked Mexico's nearshoring boom as the next big opportunity for its GTD technology.

Airport operator OMA is another beneficiary of the increase in economic activity in the north of the country. Despite their country's mountainous terrain and generally poor road infrastructure, Mexicans still make many more long-distance journeys by bus than by plane. However, with the combination of economic growth, the advent of more low-cost airlines and an increased number of routes, this is starting to change.

At the company's Mexico City offices, management shared details of OMA's plans to expand some of its smaller, more regional operations, as well as the significant investment in Monterrey International Airport close to the Texas border. Reflecting management's bullish view on the long-term outlook for the region, the five-year expansion programme will increase Monterrey's passenger service capacity by 50%.

**ALL EYES ON SHEINBAUM**

Amidst the enthusiasm, however, there was a widespread acknowledgement that more work needs to be done if Mexico is to fully grasp its nearshoring opportunity. Water scarcity and a tight labour market are near-term bottle necks, whilst the country's energy infrastructure is in urgent need of an upgrade. Drug-related organised crime is a constant background worry (according to some estimates, Mexico's drug cartels control one-third of the country).

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Tasked with addressing these challenges is Mexico's new president Claudia Sheinbaum, a former head of Mexico City and close ally of outgoing president Andrés Manuel López Obrador. Having been comfortably ahead in the polls for many months, Sheinbaum's victory in June's election came as no surprise. Less expected, however, was an historic electoral landslide.

With around 60% of the vote, Sheinbaum's left-wing Morena party and its allies crushed their nearest rivals, stoking fears that she would have the parliamentary votes necessary to push through controversial constitutional reforms drawn up by her predecessor. Critics believe the proposed reforms, which include an overhaul of pensions, environmental regulations, electoral procedures and the judiciary, will undermine the integrity of Mexico's civic and democratic institutions whilst ushering in a less market-friendly environment.

Jolted by the result, investors moved swiftly to dump Mexican assets, with equities, bonds and the peso all selling off sharply in the immediate aftermath. Markets have since steadied, as investors watch closely for signs of how Sheinbaum might govern.

Will she choose to emulate the approach of her predecessor who, despite his occasional anti-business rhetoric and regulatory meddling, sought a broadly pragmatic relationship with the private sector? Or will a huge majority embolden her to pursue a less conciliatory line? With Mexico on the cusp of a generational economic opportunity, there is a great deal riding on her decision.




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