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The Dumbest Investment in the World Was Better Than Owning Safe Treasurys

Argentina's century bond defaulted but ended up a winner, an important lesson for investors

By James Mackintosh Follow

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Argentina's central bank in Buenos Aires. PHOTO: FRANCISCO LOUREIRO/REUTERS

Investors who bought Argentina's 100-year dollar bond were laughed at in 2017 for their naiveté in buying such a long bond from a serial defaulter. Sure enough, the country failed to pay after just three years.

But investors who stuck with the country are having the last laugh. The bonds they were given in the default, plus the fat coupons on the original century bond, are now worth more than the original investment. Not just that: They are worth far more than if the dollars had been invested in "safe" U.S. Treasurys.

The turnaround in the Argentina bonds was due to President Javier Milei taking a chain saw to the bloated Argentine state, while managing to maintain his popularity.

The eventual profit was also down to the high yield. The coupons investors receive have more than made up for the fall in the price of the bonds, down by a quarter. If the coupons had been reinvested in the same bonds, an investor would have made well above 50%, against a loss of about 10% for U.S. 30-year bonds and a slight gain for the U.S. Treasury index.

The money made on what was widely regarded as the dumbest of dumb places should remind us of three important lessons: When risks are obvious, they are often well-rewarded; even when risks are hard to see, they are still there; radical political change is hard to predict. Let’s go through each:

Obvious risks don't come much more glaring than Argentina. It first defaulted only 11 years after declaring independence from Spain in 1816 and has defaulted on average every couple of decades since, nine times in total. Why, you could reasonably ask, does anyone ever lend it money? Do investors never learn? The answer is the same as it is for troubled borrowers everywhere: There is money in subprime. Charge a high enough interest rate and it makes up for the defaults.

Academic research has shown how well this works. Josefin Meyer and Christoph Trebesch of the Kiel Institute for the World Economy and Carmen Reinhart of Harvard showed a few years ago that since 1816 the bonds of almost every risky country had long-run returns higher than the U.S. or U.K., despite frequent defaults. Just as with stocks or junk bonds, there is reward for risk, and the average return works out better than for the safest assets, U.S. Treasurys.

"Average" is doing a lot of work here. Investors have to be ready to take significant pain on particular bonds, just as they would on individual stocks—sometimes a lot of pain. Losses can be huge: At its 2020 low, the price of Argentina's century bond was down 75%. Likewise, losses can hit many investments at once, leaving a portfolio in the red for a long time. Diversify across enough high-yielding assets and hold for the long run, though, and the high yield has compensated for the risk, despite the volatility.

Hidden risks are the true problem for investors. Sometimes these are hiding in plain sight, as with Greece before the 2007 financial crisis. Its bonds were treated like other eurozone sovereign bonds, despite Greece having too much debt in a currency it didn't control. That ended badly when Greece's inability to pay collided with the European Central Bank's unwillingness to provide a backstop (though after default, an ECB policy reversal and years of fierce austerity, Greece has recovered its investment-grade rating).

Safe assets became particularly risky when yields reached zero, or in some cases went negative. Investors were willing to lend for long periods to the U.S., Japan or European countries for virtually no reward, so when the return of inflation led bond yields to rise to more normal levels after the pandemic, the prices of their bonds were crushed.

Those who held 40-year Japanese government bonds from when yields were at their lows in 2019 have lost half their money, even if they reinvested the paltry coupons—and 65% in dollar terms as the yen's fall added to the losses. British 50-year gilts have done even worse, while the U.S. 30-year Treasury has lost 45% from the pandemic low in yields.

The absolute worst: Austria's 100-year zero-coupon bond issued in 2019, which is down more than 90% in the past five years. Being "safe" against a default doesn't mean being safe against loss.

Politics is a minefield for investors. Understanding it is hard, and even those who understand it often can't predict it. Milei has achieved what seemed impossible in any country, let alone in a country dominated for so long by left-wing populism: Voters supported him through a recession while he cut spending to bring down inflation. Argentina might even be able to start issuing bonds again soon.

Argentina's President Javier Milei has maintained voters' support while hacking back public spending.
PHOTO: SAMUEL CORUM/PRESS POOL

"It's certainly feasible that at some point this year they will regain market access and that will really change the story," said Lucas Martin, head of Latin American fixed-income strategy at Bank of America. "If they can roll over some of the debt on their own [without the International Monetary Fund] then that will relax the fiscal constraints."

Few would predict that Milei's approach will allow Argentina to escape forever its cycle of debt buildup and default. But at least investors go in with their eyes open. When developed countries go through radical political change there is no cushion in the form of a higher bond yield, because investors think such risks don't apply to them.

"Quality of governance, failure to enforce the law, lack of fiscal capacity may be the sort of thing that Treasury investors want to read up on," said Paul McNamara, an emerging-market bond fund manager at GAM Investments.

Some in President Trump's administration have already discussed the prospect of imposing a "user fee" on U.S. debt held by foreign governments, something likely to be classed as a default, or pressure them to swap their bonds for 100-year debt with a low interest rate in a "Mar-a-Lago" accord. The lessons from Argentina aren't just for Argentina.

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