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Enabling poor rural people
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Report on IFAD's investment portfolio for the third quarter of 2010

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For: Information

Report on IFAD's investment portfolio for the third quarter of 2010

I. Executive summary

1. During the third quarter of 2010, IFAD's investment policy and high-quality instruments continued to protect the investment portfolio from any turmoil in the global financial markets while providing a robust rate of return.
2. The value of the investment portfolio in United States dollar terms increased by US\$93,322,000 equivalent, from US\$2,481,962,000 equivalent at 30 June 2010 to US\$2,575,284,000 equivalent at 30 September 2010. The main factors for this increase were net investment income and foreign exchange movements, offset in part by net cash outflows.
3. The year-to-date investment portfolio's rate of return is 3.50 per cent, which translates into a year-to-date investment income amount of US\$86,136,000 equivalent, net of all fees and including income from securities lending cash collateral activities.

II. Introduction

4. This report on IFAD's investment portfolio¹ presents final data on the third quarter of 2010. It consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio by currency; securities lending cash collateral; liquidity level in IFAD's investment portfolio; and risk measurement.

III. Market conditions

5. Throughout the third quarter of 2010, fixed-income markets were generally positive, with all of IFAD's asset classes generating positive returns. IFAD's government bonds asset class benefited from the portfolio's concentration in safe and high-quality issuers. The performance of the latter was supported in part by investors' continued demand for safety, but mainly by the slowdown in the pace of the economic recovery and the resulting expectations of central bank interventions in the form of quantitative easing. This lowered bond yields, which had a direct positive impact on pricing. The diversified fixed-interest asset class continued to perform very strongly as these assets benefited from a continued recovery and investors' renewed appetite for non-government assets. The inflation-indexed bonds asset class also benefited from demand for safe, high-quality government debt, as well as from an increase in inflation expectations, driven by the expected increase in stimulus spending.
6. Concerns regarding the creditworthiness of some European Union peripheral countries abated during the period. IFAD's portfolio has little or no exposure to the countries most affected by these concerns.
7. During the same period, the United States dollar depreciated against all the SDR currencies, specifically the euro (-10.28 per cent), British pound sterling (-5.06 per cent) and Japanese yen (-5.59 per cent).

¹ This quarterly report presents IFAD-only investment information, while financial information involving non-IFAD entities, including Supplementary Funds, the Belgian Fund for Food Security (BFFS), the Heavily Indebted Poor Countries (HIPC) Initiative and the After-Service Medical Coverage Scheme (ASMCS) is presented to the Executive Board in the annual consolidated financial statements. The Annual Report for the Credit Union of IFAD employees is published separately.

IV. Asset allocation

8. Table 1 shows the movements affecting the investment portfolio's major asset classes during the third quarter of 2010 and compares the portfolio's asset allocation at the end of the quarter with the investment policy allocation.
9. During the period, there was a cash outflow of US\$54,462,000 equivalent from the internally managed operational cash portfolio, representing disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member States' contributions.
10. The depreciation of the United States dollar against all the SDR currencies resulted in an increase in the portfolio balance in United States dollar terms of US\$121,032,000 equivalent during the third quarter of 2010.
11. The above movements, combined with investment income of US\$26,752,000² equivalent, increased the overall investment portfolio value by US\$93,322,000 equivalent for the period.

Table 1

Movements affecting the asset allocation within the portfolio, third quarter 2010

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
Opening balance (1 July 2010)	184 741	383 815	1 011 453	456 698	445 255	2 481 962
Investment income ^b	155	4 296	6 434	9 329	6 538	26 752
Transfers due to allocation	8 426	(4 544)	-	-	(3 882)	-
Transfers due to expenses/income	(1 084)	28	507	267	282	-
Net disbursement ^c	(54 462)	-	-	-	-	(54 462)
Movements on exchange	10 854	19 042	62 285	(7)	28 858	121 032
Closing balance by portfolio (30 September 2010)	148 630	402 637	1 080 679	466 287	477 051	2 575 284
Actual asset allocation (percentage)	5.8	15.6	42.0	18.1	18.5	100.0
Investment policy asset allocation ^d (percentage)	5.5	15.6	43.6	15.3	20.0	100.0
Difference in asset allocation (percentage)^e	0.3	-	(1.6)	2.8	(1.5)	-

^a Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.

^b Investment income is further detailed in table 2.

^c Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

^d The investment policy allocation for the held-to-maturity portfolio is set to match the current 15.6 per cent asset allocation in the investment portfolio.

^e The differences between policy and actual asset allocations are impacted by fluctuations in market prices and currencies. The asset allocation is reviewed and realigned from time to time.

² This figure does not include the impact of the unrealized gain/loss on the securities lending cash collateral reinvestment shown in table 2. The reason is that the security lending cash collateral is not directly related to any asset classes within the investment portfolio and therefore its market value change does not affect the portfolio's asset allocation.

12. Table 1 reflects IFAD's actual asset allocation as well as the current investment policy asset allocation. In October 2010, IFAD's Management finalized a review of the investment policy and the related minimum liquidity requirement. Resulting policy changes will be presented for information to the Audit Committee at its 117th meeting and to the Executive Board at its 101st session (EB 2010/101/R.42).

V. Investment income

13. During the first three quarters of 2010, the aggregate investment income amounted to US\$86,136,000 equivalent. All realized and unrealized gains and losses are included in the investment income. Table 2 presents a summary of the third quarter 2010 investment income broken down by asset class.

Table 2

Breakdown of investment income by asset class and the impact of the reinvested securities lending cash collateral, third quarter and year-to-date 2010

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Subtotal third quarter 2010</i>	<i>Subtotal year-to-date 2010</i>	<i>Year-to-date securities lending cash collateral impact</i>	<i>Total year-to-date 2010</i>
Interest from fixed-interest investments and bank accounts	141	4 512	8 665	3 218	2 222	18 758	54 222	-	54 222
Realized capital gains	26	-	762	3 462	4 877	9 127	18 382	-	18 382
Unrealized capital gains (losses)	-	-	(2 486)	2 929	(279)	164	16 638	918	17 556
Amortization/accretion ^a	-	(188)	-	-	-	(188)	(613)	-	(613)
Income from securities lending	-	11	30	13	13	67	188	-	188
Investment income before fees and taxes	167	4 335	6 971	9 622	6 833	27 928	88 817	918	89 735
Investment manager fees	-	-	(421)	(242)	(244)	(907)	(2 651)	-	(2 651)
Custody fees/bank charges	(12)	(1)	(13)	(6)	(5)	(37)	(258)	-	(258)
Financial advisory and other investment management fees	-	(38)	(103)	(45)	(46)	(232)	(696)	-	(696)
Taxes recoverable	-	-	-	-	-	-	6	-	6
Investment income after fees and taxes	155	4 296	6 434	9 329	6 538	26 752	85 218	918	86 136

^a A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments as per the International Financial Reporting Standards.

VI. Rate of return

14. The rate of return of IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements, which is neutralized through the currency alignment.
15. The investment portfolio returned a positive 3.50 per cent in the first three quarters of 2010, net of all fees and including income from securities lending cash collateral activities.

Table 3
Quarterly rate of return on IFAD's investments for 2009 and 2010
 (Percentages in local currency terms)

	Quarterly rates of return in local currency						
	1 st quarter 2009	2 nd quarter 2009	3 rd quarter 2009	4 th quarter 2009	1 st quarter 2010	2 nd quarter 2010	3 rd quarter 2010
Operational cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Held-to-maturity	0.99	1.12	1.11	1.07	0.97	0.91	1.08
Government bonds	1.14	(0.28)	0.96	0.34	0.99	0.80	0.54
Diversified fixed-interest bonds	0.54	0.81	3.54	0.28	1.75	3.75	2.10
Inflation-indexed bonds	2.26	1.06	2.57	1.63	1.05	1.72	1.36
Quarterly net return^a	1.38	0.61	1.73	0.66	1.07	1.41	0.98
Year-to-date return^a	1.38	1.99	3.76	4.45	1.07	2.50	3.50

^a Net of all securities lending cash collateral activities

Note: n.a.: not applicable

16. The differences between quarterly returns are due to the different characteristics of asset classes and highlight the positive impact of portfolio diversification on the stability and safety of the overall portfolio return.

VII. Composition of the investment portfolio by currency

17. The majority of IFAD's commitments are expressed in special drawing rights (SDRs). Consequently, the Fund's overall assets are maintained in such a way as to ensure that commitments for undisbursed loans and grants denominated in SDRs are matched, to the extent possible, by assets denominated in the currencies and ratios of the SDR valuation basket. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in the same currency.
18. The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be included in the basket and what their percentage weight should be at the date of reweighting of the basket.
19. The current units for each of the four currencies making up the SDR valuation basket were determined on 30 December 2005 in such a way that the value of the SDR was precisely US\$1.42927, in terms of both the old units and the new units, which became effective on 1 January 2006. The applicable units, together with their weights as at 1 January 2006 and 30 September 2010, are shown in table 4.

Table 4
Units and weights applicable to SDR valuation basket

Currency	1 January 2006		30 September 2010	
	Units	Percentage weight	Units	Percentage weight
United States dollar	0.6320	43.7	0.6320	40.6
Euro	0.4100	34.3	0.4100	36.0
Yen	18.4000	10.9	18.4000	14.2
Pound sterling	0.0903	11.1	0.0903	9.2
Total		100.0		100.0

20. At 30 September 2010, assets in the form of cash, investments, promissory notes and contributions receivable from Member States under the Fifth, Sixth, Seventh and Eighth Replenishments, net of provisions, amounted to US\$3,238,284,000

equivalent, as summarized in table 5 (compared with US\$2,998,309,000 equivalent at 30 June 2010).

Table 5

Currency composition of assets in the form of cash, investments and other receivables

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Cash and investments^a</i>	<i>Promissory notes^a</i>	<i>Contributions receivable from Member States</i>	<i>Total</i>
United States dollar group ^b	1 103 529	181 525	135 466	1 420 520
Euro group ^c	829 807	92 205	167 114	1 089 126
Yen	389 992	87 194	-	477 186
Pound sterling	251 452	-	-	251 452
Total	2 574 780	360 924	302 580	3 238 284

^a Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US\$504,000 equivalent for cash and investments, and US\$1,399,000 equivalent for promissory notes.

^b Includes assets in Australian, Canadian and New Zealand dollars.

^c Includes assets in Swiss francs, Swedish kronor, and Danish and Norwegian kroner.

21. The alignment of assets by currency group against the SDR valuation basket as at 30 September 2010 is shown in table 6. The balance of commitments denominated in United States dollars at 30 September 2010 amounted to US\$155,212,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$60,212,000).

Table 6

Alignment of assets per currency group with the SDR valuation composition as at 30 September 2010

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Asset amount</i>	<i>Less: commitments denominated in US dollars</i>	<i>Net asset amount</i>	<i>Net asset amount (percentage)</i>	<i>SDR weights (percentage)</i>	<i>Difference (percentage)</i>
US dollar group	1 420 520	(155 212)	1 265 308	41.0	40.6	0.4
Euro group	1 089 126	-	1 089 126	35.3	36.0	(0.7)
Yen	477 186	-	477 186	15.5	14.2	1.3
Pound sterling	251 452	-	251 452	8.2	9.2	(1.0)
Total	3 238 284	(155 212)	3 083 072	100.0	100.0	0.0

22. As at 30 September 2010, there was a shortfall in the euro currency group holdings (-0.7 per cent) and in pound sterling (-1.0 per cent), which was offset by an excess allocation in the United States dollar currency group holdings (+0.4 per cent) and in the Japanese yen (+1.3 per cent).
23. Temporary deviances from SDR weights at a specific point in time are due to the fluctuation in values of IFAD assets and the underlying currencies (i.e. cash, investments and Member contribution payments and receivables).

VIII. Securities lending cash collateral

24. The market value including accrued income of cash collateral reinvested against securities lent as at 30 September 2010 was US\$147,402,000³ equivalent, with a corresponding liability to the borrowers for US\$147,712,000 equivalent. The asset

³ This figure does not include an income distribution payable/liability of US\$47,161 equivalent.

class as well as credit quality compositions of the cash collateral reinvested against securities lent are shown in table 7. The difference in the collateral reinvested and the corresponding liability as at 30 September 2010 shrank to US\$310,000 equivalent from US\$1,228,000 equivalent as at 31 December 2009, thus bringing an unrealized gain including movement in accrued income of US\$918,000 for the first three quarters of 2010, as shown in table 2.

Table 7

Composition and credit ratings of the cash collateral reinvested against securities lent as at 30 September 2010

(Thousands of United States dollars equivalent)

	AAA	AA	A	BBB	Total	Percentage
Cash	81 356	-	-	-	81 356	55.2
Corporate bonds	-	14 153	-	-	14 153	9.6
Mortgage-backed securities	6 334	-	-	500	6 834	4.6
Asset-backed securities	41 044	1 895	-	2 120	45 059	30.6
Total	128 734	16 048	-	2 620	147 402	100.0
Composition weight	87.3	10.9	-	1.8	100.0	-

25. The maturity structure of the cash collateral reinvested against securities lent is shown in table 8 below.

Table 8

Maturity structure of the cash collateral reinvested against securities lent, as at 30 September 2010^a

(Thousands of United States dollars equivalent)

<i>Period due</i>	<i>30 September 2010</i>		<i>31 December 2009</i>	
	<i>Amount</i>	<i>Percentage</i>	<i>Amount</i>	<i>Percentage</i>
Due in one year or less	127 648	86.6	163 407	75.7
Due after one year through two years	14 752	10.0	36 589	17.0
Due after two years through three years	2 959	2.0	13 113	6.1
Due after three years through four years	2 043	1.4	2 671	1.2
Total	147 402	100.0	215 780	100.0

^a The maturity structure represents the financial maturities of the reinvested cash collateral, not the legal maturities.

26. As evident from tables 7 and 8, the reinvested cash collateral maintains a high level of quality with over 87 per cent in triple A, while being fairly liquid – reflecting over 55 per cent in cash and over 86 per cent to be redeemed through maturity within one year.
27. Following the downsizing of the securities lending cash collateral activities to a target of US\$350 million in August 2009 and the continued downsizing through maturing securities subsequently, the Audit Committee, at its 113th meeting in April 2010, requested an assessment of IFAD's continued involvement in such activities. In conjunction with finalizing a review of IFAD's investment policy and minimum liquidity requirement in October 2010, Management also reviewed the return and risk profile of this activity as well as available exit options. As a result, Management decided to exit completely from the programme in an orderly manner by the end of 2010.

IX. Liquidity level in IFAD's investment portfolio

28. Highly liquid assets in IFAD's investment portfolio as at 30 September 2010 amounted to US\$1,229,300,000 equivalent (table 9).

Table 9

Liquidity level in IFAD's investment portfolio, as at 30 September 2009

(Thousands of United States dollars equivalent)

	<i>Actuals</i>	<i>Percentage</i>
Highly liquid assets	1 229.3	47.8
Short-term instruments	148.6	5.8
Government securities	1 080.7	42.0
Fairly liquid assets	943.3	36.6
Non-government securities	943.3	36.6
Partially liquid assets	402.7	15.6
Held-to-maturity	402.7	15.6
Total portfolio	2 575.3	100.0

X. Risk Measurement

29. With the exception of operational cash and held-to-maturity investments, the investment portfolio performance is subject to market movements. Historically, different asset classes have shown different levels of volatility, often referred to as "risk". Volatility is measured in terms of standard deviation of returns from their mean. At 30 September 2010, the standard deviation of IFAD's investment portfolio was 1.38 per cent, identical to 1.38 per cent for the investment policy.⁴
30. Value-at-Risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount that the portfolio could lose in value over a three-month forward time horizon, with a 95 per cent confidence level.⁵ Table 10 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 30 September 2010 and for previous periods.

Table 10

Value-at-risk (VaR)

(Forecast horizon of three months, confidence level at 95 per cent)

<i>Date</i>	<i>Investment portfolio</i>		<i>Investment policy</i>	
	<i>VaR (percentage)</i>	<i>Amount (thousands of United States dollars)</i>	<i>VaR (percentage)</i>	<i>Amount (thousands of United States dollars)</i>
30 September 2010	1.15	29 716	1.15	29 628
30 June 2010	1.17	29 090	1.26	31 256
31 March 2010	1.18	29 611	1.28	32 162
31 December 2009	1.23	32 080	1.31	33 987
30 September 2009	1.27	33 245	1.31	34 272

⁴ The security lending cash collateral programme is not factored into this volatility measurement.

⁵ The security lending cash collateral programme is not factored into this VaR measurement.

31. At 30 September 2010, the investment portfolio's VaR was 1.15 per cent, a decrease from the end of the previous quarter and identical to the investment policy VaR of 1.15 per cent. It should be noted that the investment policy VaR is based on the policy asset allocation (see table 1).