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Enabling poor rural people  
to overcome poverty

## **Report on IFAD's investment portfolio for the first quarter of 2011**

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**For: Information**

# Report on IFAD's investment portfolio for the first quarter of 2011

## I. Executive summary

1. During the first quarter of 2011, the value of IFAD's investment portfolio in United States dollar terms decreased by US\$28,833,000 equivalent, from US\$2,522,753,000 equivalent at 31 December 2010 to US\$2,493,920,000 equivalent at 31 March 2011. The main factors for this decrease were net disbursement outflows, which were partially offset by foreign exchange movements and the net investment income.
2. The investment portfolio's net rate of return for the three-month period is 0.36 per cent, which translates into a net investment income of US\$9,663,000 equivalent. Subject to the Executive Board's endorsement, IFAD will revise its current investment policy so as to address challenges associated with risk management and the current weakening performance in the investment portfolio.

## II. Introduction

3. This report on IFAD's investment portfolio presents information on the first quarter of 2011. It consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio by currency; liquidity level in IFAD's investment portfolio; composition of the investment portfolio by credit rating; and risk measurement.

## III. Market conditions

4. Fixed-income markets began the year on a marginally positive note, with most of IFAD's asset classes ending the first quarter positive. Volatility impacted all asset classes, but especially the global government bonds, which experienced a slightly negative return during the first quarter of 2011. This was partly due to core European government bonds, as the market started to price in possible increases in interest rates, on the back of increasing inflation concerns.
5. The diversified fixed-interest asset class performed positively, due to a temporary demand for higher-yielding quality assets. The inflation-indexed bonds asset class performed positively throughout the quarter, although it still remained volatile, mostly because of investors' demand for inflation protection.
6. In the currency market, the United States dollar depreciated against the euro (-6.41 per cent) and the British pound sterling (-3.98 per cent) while slightly appreciating against the Japanese yen (+1.39 per cent).

## IV. Asset allocation

7. Table 1 shows the movements affecting the investment portfolio's asset classes during the first quarter of 2011 and compares the portfolio's asset allocation at the end of the quarter with the investment policy allocation.
8. During the period, there was a net cash outflow of US\$82,577,000 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.
9. The depreciation of the United States dollar against the euro and British pound sterling resulted in an increase in the portfolio balance in United States dollar terms by US\$44,081,000 equivalent during the first quarter of 2011.

10. The above movements, combined with a net investment income of US\$9,663,000 equivalent, decreased the overall investment portfolio value by US\$28,833,000 equivalent for the period.

Table 1

**Movements affecting the asset allocation within the portfolio, first quarter 2011**

(Thousands of United States dollars equivalent)

	<i>Operational cash<sup>a</sup></i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
<b>Opening balance (31 December 2010)</b>	<b>182 583</b>	<b>397 662</b>	<b>1 013 674</b>	<b>444 234</b>	<b>484 600</b>	<b>2 522 753</b>
Investment income <sup>b</sup>	200	3 926	(1 754)	688	6 603	9 663
Transfers due to allocation	102 259	(5 679)	(56 576)	(40 004)	-	-
Transfers due to expenses/income	(1 149)	44	529	267	309	-
Net disbursement <sup>c</sup>	(82 577)	-	-	-	-	(82 577)
Movements on exchange	7 672	10 349	27 798	(26)	(1 712)	44 081
<b>Closing balance by portfolio (31 March 2011)</b>	<b>208 988</b>	<b>406 302</b>	<b>983 671</b>	<b>405 159</b>	<b>489 800</b>	<b>2 493 920</b>
Actual asset allocation (percentage)	8.4	16.3	39.5	16.2	19.6	100.0
Investment policy asset allocation <sup>d</sup> (percentage)	5.5	16.3	43.3	14.9	20.0	100.0
<b>Difference in asset allocation (percentage)<sup>e</sup></b>	<b>2.9</b>	<b>-</b>	<b>(3.8)</b>	<b>1.3</b>	<b>(0.4)</b>	<b>-</b>

<sup>a</sup> Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.

<sup>b</sup> Investment income is further detailed in table 2.

<sup>c</sup> Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

<sup>d</sup> The investment policy allocation for the held-to-maturity portfolio is set to match the current 16.3 per cent asset allocation in the investment portfolio.

<sup>e</sup> 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.

11. During the first quarter of 2011, transfers of US\$56,576,000 equivalent from the global government bonds portfolio and US\$40,004,000 equivalent from the diversified fixed-interest bonds portfolio were made to the operational cash portfolio to cover disbursement needs.
12. Similarly, an amount of US\$5,679,000 of coupon income generated from the held-to-maturity portfolio was progressively transferred to the operational cash portfolio during the first quarter of 2011.

## V. Investment income

13. In the first quarter of 2011, net investment income amounted to US\$9,663,000 equivalent. Table 2 presents a summary of the first quarter 2011 investment income broken down by asset class.

Table 2

**Breakdown of investment income by asset class, first quarter 2011**

(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>Total</i>
Interest from fixed-interest investments and bank accounts	223	4 072	7 819	3 000	2 467	17 581
Realized capital gains/(losses)	-	-	(1 874)	(3 485)	5 216	(143)
Unrealized capital gains/(losses)	-	-	(7 170)	1 440	(771)	(6 501)
Amortization/accretion <sup>a</sup>	-	(102)	-	-	-	(102)
<b>Investment income before fees</b>	<b>223</b>	<b>3 970</b>	<b>(1 225)</b>	<b>955</b>	<b>6 912</b>	<b>10 835</b>
Investment manager fees	-	-	(393)	(219)	(251)	(863)
Custody fees/bank charges	(23)	(3)	(36)	(7)	(8)	(77)
Financial advisory and other investment management fees	-	(41)	(100)	(41)	(50)	(232)
<b>Investment income after fees</b>	<b>200</b>	<b>3 926</b>	<b>(1 754)</b>	<b>688</b>	<b>6 603</b>	<b>9 663</b>

<sup>a</sup> 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 0.36 per cent net of fees (0.41 per cent gross of fees) for the first quarter of 2011.

Table 3

**Rates of return and relevant benchmarks on IFAD's investments for the first quarter of 2011 together with rates of return for previous quarters in 2010**

(Percentages in local currency terms)

	<i>2010 rate of return in local currency</i>				<i>1st quarter 2011 rate of return/benchmark</i>		
	<i>1<sup>st</sup> quarter</i>	<i>2<sup>nd</sup> quarter</i>	<i>3<sup>rd</sup> quarter</i>	<i>4<sup>th</sup> quarter</i>	<i>1<sup>st</sup> quarter</i>	<i>1<sup>st</sup> quarter benchmark</i>	<i>Over/ (under) performance</i>
Operational cash	0.04	0.04	0.08	0.09	0.11	n.a.	n.a.
Held-to-maturity	0.97	0.91	1.08	0.97	0.99	0.91	0.08
Government bonds	0.99	0.80	0.54	(0.19)	(0.11)	(0.06)	(0.05)
Diversified fixed-interest bonds	1.75	3.75	2.10	(1.56)	0.12	0.23	(0.11)
Inflation-indexed bonds	1.05	1.72	1.36	(0.11)	1.39	1.65	(0.26)
<b>Gross rate of return</b>	<b>1.10</b>	<b>1.45</b>	<b>1.02</b>	<b>(0.23)</b>	<b>0.41</b>	<b>0.49</b>	<b>(0.08)</b>
Less expenses	(0.03)	(0.04)	(0.04)	(0.03)	(0.05)	(0.05)	n.a.
<b>Net rate of return</b>	<b>1.07</b>	<b>1.41</b>	<b>0.98</b>	<b>(0.26)</b>	<b>0.36</b>	<b>0.44</b>	<b>(0.08)</b>

Note: n.a.: not applicable

16. The inflation-indexed portfolio performed the best within the portfolio with a gross rate of return of 1.39 per cent, while the government bonds portfolio had the lowest return with a gross rate of return of negative 0.11 per cent for the three-month period.
17. The differences between the rates of return among the mandates are due to the different characteristics of asset classes and demonstrate the positive impact of portfolio diversification.

## VII. Composition of the investment portfolio by currency

18. 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.
19. The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be part of the basket and what their percentage weight should be at the date of reweighting of the basket.
20. The units for each of the four currencies making up the SDR valuation basket were determined on 30 December 2010 in such a way that the value of the SDR was precisely US\$1.54003, in terms of both the old units and the new units, which became effective on 1 January 2011. The applicable units, together with their weights as at 1 January 2011 and 31 March 2011, are shown in table 4.

Table 4  
Units and weights applicable to SDR valuation basket

Currency	1 January 2011		31 March 2011	
	Units	Percentage weight	Units	Percentage weight
United States dollar	0.6600	41.9	0.6600	41.8
Euro	0.4230	37.4	0.4230	37.9
Yen	12.1000	9.4	12.1000	9.2
Pound sterling	0.1110	11.3	0.1110	11.1
<b>Total</b>		<b>100.0</b>		<b>100.0</b>

21. At 31 March 2011, assets in the form of cash, investments, promissory notes and contribution receivables from Member States, net of provisions, amounted to US\$3,053,446,000 equivalent, as summarized in table 5 (compared with US\$3,116,479,000 equivalent at 31 December 2010).

Table 5  
Currency composition of assets in the form of cash, investments and other receivables<sup>a</sup>  
(Thousands of United States dollars equivalent)

Currency	Cash and investments	Promissory notes	Contribution receivables from Member States	Total
United States dollar group <sup>b</sup>	1 023 872	179 735	105 506	1 309 113
Euro group <sup>c</sup>	844 421	108 101	109 001	1 061 523
Yen	393 190	57 692	-	450 882
Pound sterling	231 928	-	-	231 928
<b>Total</b>	<b>2 493 411</b>	<b>345 528</b>	<b>214 507</b>	<b>3 053 446</b>

<sup>a</sup> Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US\$509,000 equivalent for cash and investments, and US\$1,399,000 equivalent for promissory notes.

<sup>b</sup> Includes assets in Australian, Canadian and New Zealand dollars.

<sup>c</sup> Includes assets in Swiss francs, Swedish kronor, and Danish and Norwegian kroner.

22. The alignment of assets by currency group against the SDR valuation basket as at 31 March 2011 is shown in table 6. The balance of commitments denominated in United States dollars at 31 March 2011 amounted to US\$172,286,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$77,286,000).

Table 6

**Alignment of assets per currency group with the SDR valuation composition as at 31 March 2011**  
(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	1 309 113	(172 286)	1 136 827	39.4	41.8	(2.4)
Euro group	1 061 523	-	1 061 523	36.8	37.9	(1.1)
Yen	450 882	-	450 882	15.7	9.2	6.5
Pound sterling	231 928	-	231 928	8.1	11.1	(3.0)
<b>Total</b>	<b>3 053 446</b>	<b>(172 286)</b>	<b>2 881 160</b>	<b>100.0</b>	<b>100.0</b>	<b>0.0</b>

23. As at 31 March 2011, there was a shortfall in the euro currency group of 1.1 per cent, in the United States dollar currency group of 2.4 per cent and in the British pound sterling of 3.0 per cent. This was offset by an excess allocation in Japanese yen of 6.5 per cent.
24. The above misalignment is mainly due to the changes that became effective on 1 January 2011 in the relative weights of the four currencies in the SDR basket together with the depreciation of the United States dollar against the Japanese yen in 2010.
25. IFAD is in the process of rebalancing the currency composition of the investment portfolio so as to reduce the misalignment with the four currencies in the SDR basket.

## VIII. Liquidity level in IFAD's investment portfolio

26. As at 31 March 2011, highly liquid assets in IFAD's investment portfolio amounted to US\$1,192,700,000 equivalent (table 7).

Table 7

**Liquidity level in IFAD's investment portfolio, as at 31 March 2011**  
(Thousands of United States dollars equivalent)

	<i>Actuals</i>	<i>Percentage</i>
<b>Highly liquid assets</b>	<b>1 192.7</b>	<b>47.8</b>
Short-term instruments	209.0	8.4
Government securities	983.7	39.4
<b>Fairly liquid assets</b>	<b>894.9</b>	<b>35.9</b>
Non-government securities	894.9	35.9
<b>Partially liquid assets</b>	<b>406.3</b>	<b>16.3</b>
Held-to-maturity	406.3	16.3
<b>Total portfolio</b>	<b>2 493.9</b>	<b>100.0</b>

## IX. Composition of the investment portfolio by credit rating

27. The credit ratings used in this report are primarily issued by Standard and Poor's (S&P); however, some investments where the S&P rating was not available have been rated by either Moody's Investors Services or Fitch Ratings, two other major credit rating agencies.
28. As at 31 March 2011, over 80 per cent of IFAD's fixed-income investments had a rating of AAA, almost 11 per cent were rated between AA+ and AA- and almost 8 per cent between A+ and A-. Cash and cash equivalents together with pending trade sales and purchases are not directly rated by credit rating agencies and are therefore excluded from the analysis (see table 8).

Table 8

### Composition of the investment portfolio by credit ratings, as at 31 March 2011

(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>Total</i>	<i>Percentage (%)</i>
AAA	-	288 828	799 146	350 984	431 146	1 870 104	80.5
AA+ to AA-	-	80 734	81 205	50 065	39 867	251 871	10.9
A+ to A-	-	20 577	88 067	20 119	49 946	178 709	7.7
BBB+ to BBB-	-	16 163	-	179	-	16 342	0.9
B+ <sup>a</sup>	-	-	-	283	-	283	0.0
CCC <sup>a</sup>	-	-	-	412	-	412	0.0
Cash and cash equivalents <sup>b</sup>	208 988	-	15 253	14 164	165	238 570	n.a.
Pending trade sales and purchases <sup>c</sup>	-	-	-	(31 047)	(31 324)	(62 371)	n.a.
<b>Total</b>	<b>208 988</b>	<b>406 302</b>	<b>983 671</b>	<b>405 159</b>	<b>489 800</b>	<b>2 493 920</b>	<b>100.0</b>

Note: n.a.: not applicable

<sup>a</sup> Investments that fall below investment grade are legacy securities downgraded during the global financial crisis. They will be redeemed at the earliest opportunity in an attempt to minimize the realization of losses.

<sup>b</sup> Cash and cash equivalents consist of cash with central banks and corporate banks, cash held by external portfolio managers and pending foreign exchange purchases and sales used for foreign exchange hedging purposes. These amounts are not directly rated by credit rating agencies.

<sup>c</sup> Pending trade sales and purchases are investment trades in the process of being finalized by the external portfolio managers for investment purposes, and do not have an applicable credit rating attached to them.

29. Investments that fall below the credit rating floor of the current investment policy are monitored carefully so as to be redeemed at the earliest opportunity without realizing any significant losses.

## X. Risk measurement

30. 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 31 March 2011, the standard deviation of IFAD's investment portfolio was 1.17 per cent, compared with 1.40 per cent for the investment policy.
31. 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. Table 9 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 31 March 2011 and for previous quarterly periods.

Table 9  
**Value-at-risk**  
 (Forecast horizon of three months, confidence level at 95 per cent)

	<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>
31 March 2011	0.98	24 338	1.17	29 190
31 December 2010	1.11	27 986	1.19	29 946
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

32. At 31 March 2011, the investment portfolio's VaR was 0.98 per cent, a decrease from the end of the previous quarter and well below the investment policy VaR of 1.17 per cent. It should be noted that the investment policy VaR is based on the policy allocation (see table 1).