Document:	EB 2012/105/R.35	E
Agenda:	12(e)(i)	
Date:	1 March 2012	
Distribution:	Public	
Original:	English	

IFAD

Enabling poor rural people to overcome poverty

Report on IFAD's investment portfolio for 2011

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Executive Board — 105th Session
Rome, 3-4 April 2012

For: **Information**

Report on IFAD's investment portfolio for 2011

I. Executive summary

1. During 2011, IFAD's prudent investment strategy contributed to protecting the investment portfolio from turmoil in the global financial markets. IFAD's high-quality investments, especially United States denominated securities, benefited from the flight-to-quality which affected investors worldwide. IFAD proactively responded to the European sovereign downgrades that marginally affected the global government bonds and inflation-indexed bonds asset classes by following market developments on country-by-country level and instructing investment managers in accordance with the Fund's prudent and conservative investment approach. The aim was to remain within the allowable investment universe, thereby avoiding to relax the credit rating requirements, but at the same time to avoid the realization of market losses. IFAD's approach proved to be a successful one, as evidenced by the solid portfolio return reported further below.

2. The value of the investment portfolio in United States dollar terms decreased by US$67,237,000 equivalent, from US$2,522,753,000 equivalent at 31 December 2010 to US$2,455,516,000 equivalent at 31 December 2011. The main factors for this decrease were the disbursement outflows and foreign exchange movements, which were partially offset by the net investment income.

3. The investment portfolio's net rate of return for 2011 was 3.82 per cent and this translates into an annual investment income of US$93,909,000 equivalent net of all investment related fees.

II. Introduction

4. This report on IFAD's investment portfolio covers the year ended 31 December 2011 and includes comparative figures, where applicable, for the year ended 31 December 2010.

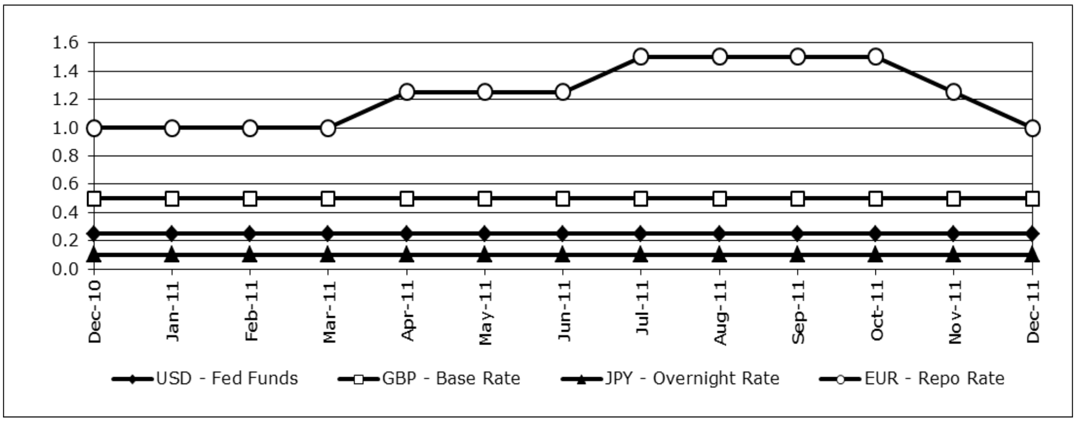
5. The report consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio (by instrument, currency, maturity/duration and credit rating); liquidity level in IFAD's investment portfolio; and risk measurement.

III. Market conditions

6. The following charts illustrate financial trends for the countries whose currencies make up the valuation basket for special drawing rights (SDRs): Eurozone countries, Japan, the United Kingdom and the United States.

7. Chart 1 shows the evolution of central bank interest rates for SDR countries for 2011. All central banks, except for the European Central Bank (ECB), maintained their central bank target rates unchanged in 2011, to continue supporting the economy in its recovery phase. Specifically, the Federal Reserve Bank of the United States maintained its discount rate at 0.25 per cent; the Bank of England bank rate was kept unchanged at 0.50 per cent; and the Bank of Japan kept the overnight rate at 0.10 per cent. The ECB raised the refinancing rate by 0.25 per cent in April and again in July 2011. During the last quarter of 2011 the rate was decreased twice and returned to a level of 1.00 per cent.

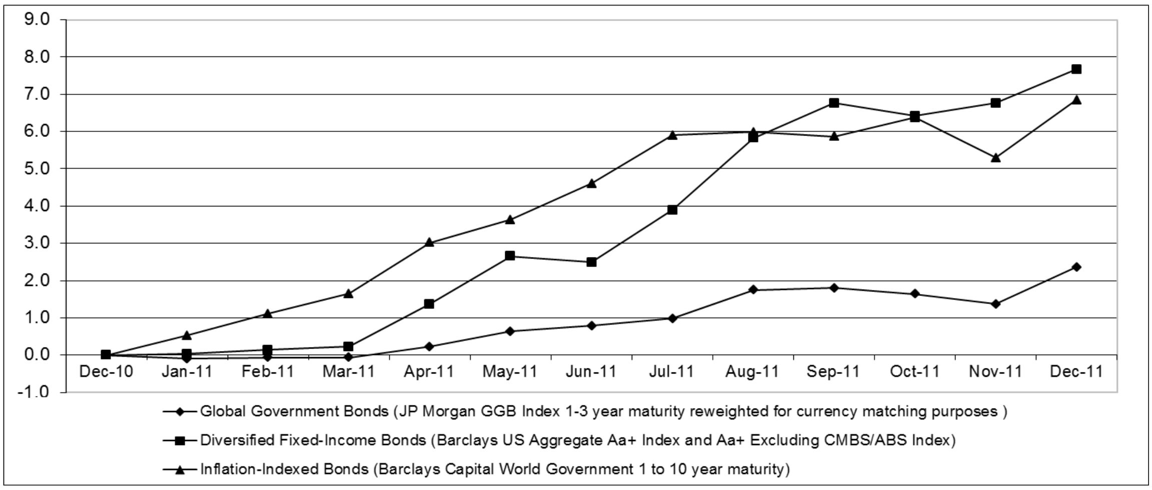
Chart 1
Central Bank interest rates



Source: Bloomberg

8. Chart 2 shows the cumulative performance for 2011 of the benchmark indices applied to IFAD's externally managed asset classes, i.e. global government bonds, the diversified fixed-income bonds and the inflation-indexed bonds. The global government bonds started the year with a slightly negative quarter, but performance improved towards the mid-to-latter stages of the year due to a worsening of the global growth prospects, which led to an increase in demand for high-quality securities. The diversified fixed-income benchmark also started the year with a weak performance, but recovered significantly after the first quarter and ended the year as the highest performing benchmark. This was mainly due to the positive impact of the central banks' stimuli on US denominated bonds. The inflation-indexed bonds benchmark showed a positive performance throughout the year, mainly due to the benchmark's sovereign constituents status of 'safe havens', together with their perceived additional benefit of providing protection against inflation.

Chart 2
Fixed-interest market developments in 2011
(Percentage in local currency terms)



9. In 2011, the volatile foreign exchange markets saw an overall depreciation of the United States dollar against the Japanese yen (-5.88 per cent) and the British pound sterling (-0.97 per cent), while there was an overall appreciation of the United States dollar against the euro (+2.31 per cent)

10. IFAD's reporting currency is the United States dollar. Therefore, the appreciation of the United States currency against the euro, which has a relevant weight in the investment portfolio, resulted in net negative foreign exchange movements as evidenced in table 1 and described in paragraph 12. However, it must be noted that the currency fluctuations affecting IFAD's assets are balanced by similar fluctuations on IFAD's liabilities and therefore neutralized on an asset liability level (please refer to section VII B). For this reason, the performance of IFAD's portfolio is reported in local currency terms (please refer to section VI).

IV. Asset allocation

11. Table 1 shows the movements affecting the portfolio by asset class in 2011 and compares the portfolio's year-end asset allocation with the policy allocation.

Table 1
Movements affecting the asset allocation within the portfolio in 2011
(Thousands of United States dollars equivalent)

	Operational cash[a]	*Held-to-maturity*	*Global government bonds*	*Diversified fixed- income bonds*	*Inflation-indexed bonds*	*Total*
Opening balance by portfolio (31 December 2010)	**182 583**	**397 662**	**1 013 674**	**444 234**	**484 600**	**2 522 753**
Investment income[b]	1 094	11 172	21 183	27 793	32 667	93 909
Transfers due to allocation	155 760	(15 896)	(76 247)	(59 004)	(4 613)	-
Transfers due to expenses and income allocation	(3 930)	89	1 792	918	1 131	-
Net disbursement[c]	(134 881)	-	-	-	-	(134 881)
Movements on exchange	(682)	(9 138)	(9 922)	(56)	(6 467)	(26 265)
Closing balance by portfolio (31 December 2011)	**199 944**	**383 889**	**950 480**	**413 885**	**507 318**	**2 455 516**
Actual asset allocation (percentage)	8.1	15.6	38.7	16.9	20.7	100.0
Investment policy asset allocation[d] (percentage)	5.5	15.6	43.5	15.4	20.0	100.0
Difference in allocation (percentage)[e]	**2.6**	**-**	**(4.8)**	**1.5**	**0.7**	**-**

[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 values of portfolios and foreign exchange movements.

12. During 2011, the overall investment portfolio value in United States dollar terms decreased by US$67,237,000 equivalent. This decrease was the net result of the following flows:

- Outflow of US$134,881,000 equivalent representing disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions;
- Investment income of US$93,909,000 equivalent; and
- Negative foreign exchange movements of US$26,265,000 equivalent.

13. During 2011, US$155,760,000 equivalent were transferred from the four bond portfolios into the operational cash portfolio to cover disbursement needs.

14. The actual allocation shows some deviations compared to the policy allocation whereby an under allocation in the global government bonds asset class is counterbalanced by an over allocation in the other asset classes. This is mainly due to the decision to provide cash for disbursement by liquidating funds from the global government bonds, which was the lowest performing asset class within the portfolio.

V. Investment income

15. In 2011, the net investment income amounted to US$93,909,000 equivalent, inclusive of all realized and unrealized market gains and losses and net of all investment related fees. Table 2 presents a summary of the 2011 investment income broken down by asset class.

Table 2
Breakdown of investment income by asset class in 2011
(Thousands of United States dollars equivalent)

	Operational cash	*Held-to-maturity*[b]	*Global government bonds*	*Diversified fixed-income bonds*	*Inflation-indexed bonds*	*Total*
Interest from fixed-income investments and bank accounts	1 175	15 079	27 342	11 277	12 040	66 913
Realized market gains/(losses)	-	-	(9 824)	6 250	20 220	16 646
Unrealized market gains/losses[b]	-	(3 423)	5 457	11 184	1 538	14 756
Amortization[a]	-	(395)	-	-	-	(395)
Investment income before fees	**1 175**	**11 261**	**22 975**	**28 711**	**33 798**	**97 920**
Investment manager fees	-	-	(1 489)	(813)	(1 007)	(3 309)
Custody fees/bank charges	(81)	(11)	(115)	(29)	(30)	(266)
Financial advisory and other investment related fees	-	(78)	(188)	(76)	(94)	(436)
Investment income after fees	**1 094**	**11 172**	**21 183**	**27 793**	**32 667**	**93 909**

[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 (IFRS).

[b] The held-to-maturity portfolio contains an unrealized loss of US$3,423,000 equivalent which pertains to an impairment of one security. IFAD management is in the process of confirming whether or not the security will be liquidated and in the meantime has decided to conservatively recognize the security at its fair (market) price and therefore report this potential loss.

VI. Rate of return

16. 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 of IFAD's assets and IFAD's liabilities to the SDR currency ratios (see section VII. B.).

17. The investment portfolio returned a positive 3.82 per cent in 2011, including all realized and unrealized market gains and losses and net of investment expenses.

18. The diversified fixed-income bonds portfolio was the highest contributor to the 2011 net rate of return (for the second consecutive year) and was complemented by a solid performance from the inflation-indexed portfolio and to a lesser extent from the held-to-maturity and global government bonds portfolios.

Table 3
Annual rates of return on IFAD's investments for 2008, 2009, 2010, 2011 and benchmark comparison for 2011
(Percentages in local currency terms)

	Annual rates of return and benchmark in local currency terms					
	Portfolio Performance				*Benchmark*	*Over/(under) performance*
	2008	*2009*	*2010*	*2011*	*2011*	*2011*
Operational cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Held-to-maturity	4.30	4.36	4.00	2.91	3.56	(0.65)
Global government bonds	8.70	2.17	2.19	2.42	2.36	0.06
Diversified fixed-income bonds	4.70	5.23	6.10	7.28	7.67	(0.39)
Inflation-indexed bonds	3.62	7.73	4.07	6.97	6.84	0.13
Net rate of return	**5.41**	**4.45**	**3.26**	**3.82**	**3.94**	**(0.12)**

Note: n.a.: not applicable.

VII. Composition of the portfolio

A. Composition of the investment portfolio by instrument

19. Table 4 shows the composition of the investment portfolio by instrument as at 31 December 2011 in comparison with 31 December 2010.

Table 4
Composition of investment portfolio by instrument
(Thousands of United States dollars equivalent)

	31 December 2010	*31 December 2011*
Cash[a]	238 671	233 704
Time deposits and other obligations of banks[b]	66 078	122 179
Global government bonds/government agencies	1 869 920	1 737 474
Mortgage-backed securities (MBS)[c]	176 832	181 813
Government guaranteed asset-backed securities (ABS)[c]	11 301	20 366
Corporate bonds	215 056	201 787
Unrealized market gain/(loss) on forward contracts	13 207	(503)
Unrealized gain/(loss) on futures	(226)	(3 955)
Options	-	2
Subtotal: cash and investments	**2 590 839**	**2 492 867**
Receivables for investments sold	70 781	120 479
Payables for investments purchased	(138 867)	(157 830)
Total	**2 522 753**	**2 455 516**

[a] Includes cash in non-convertible currencies amounting to US$54,000 equivalent (US$56,000 in 2010).
[b] Includes time deposits in non-convertible currencies amounting to US$430,000 equivalent (US$452,000 in 2010).
[c] MBS and ABS in IFAD's investment portfolio require a AAA rating by at least two credit rating agencies (CRAs). Over 98 per cent of the MBS allocation is related to government MBS.

B. Composition of the investment portfolio by currency

20. The majority of IFAD's commitments pertain to undisbursed loans and grants and are expressed in special drawing rights (SDRs). In order to immunize IFAD's balance sheet against currency fluctuations, the Fund's assets are maintained, to the extent possible, in the same currencies and ratios of the Fund's commitments, i.e. in SDR. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in the same currency.

21. 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 the basket.

22. The applicable SDR units together with their percentage weights as at 31 December 2011 are shown in table 5.

Table 5
Units and weights applicable to SDR valuation basket

	31 December 2011	
Currency	*Units*	*Percentage weight*
United States dollar	0.6600	42.9
Euro	0.4230	35.7
Yen	12.1000	10.3
Pound sterling	0.1110	11.1
Total		**100.0**

23. At 31 December 2011, assets in the form of cash, investments, promissory notes and contribution receivables from Member States under the Fifth, Sixth, Seventh and Eighth Replenishments, net of provisions, amounted to US$2,778,248,000 equivalent, as summarized in table 6.

Table 6
Currency composition of assets in the form of cash, investments and other receivables
(Thousands of United States dollars equivalent)

Currency	*Cash and investments*[a]	*Promissory notes*[a]	*Contribution receivables from Member States*	*Total*
United States dollar group[b]	1 084 541	125 775	45 695	1 256 011
Euro group[c]	807 984	54 720	55 596	918 300
Yen	244 308	41 430	-	285 738
Pound sterling	318 199	-	-	318 199
Total	**2 455 032**	**221 925**	**101 291**	**2 778 248**

[a] The difference in the cash and investments balance compared to other tables derives from the exclusion of assets in non-convertible currencies of US$484,000 equivalent (cash and investments).
[b] Includes assets in Australian, Canadian and New Zealand dollars.
[c] Includes assets in Swiss francs, Swedish kronor, Danish kroner and Norwegian kroner.

24. The alignment of assets by currency group against the SDR valuation basket as at 31 December 2011 is shown in table 7. The balance of commitments denominated in United States dollars at 31 December 2011 amounted to US$186,675,000 equivalent, composed of the General Reserve (US$95,000,000) and commitments for grants denominated in United States dollars (US$91,675,000).

Table 7
Alignment of assets per currency group with the SDR valuation composition as at 31 December 2011
(Thousands of United States dollars equivalent)

Currency	*Asset amount*	*Less: commitments denominated in US dollars*	*Net asset amount*	*Net asset amount (percentage)*	*SDR weights (percentage)*	*Difference (percentage)*
US dollar group	1 256 011	(186 675)	1 069 336	41.3	42.9	(1.6)
Euro group	918 300	-	918 300	35.4	35.7	(0.3)
Yen	285 738	-	285 738	11.0	10.3	0.7
Pound sterling	318 199	-	318 199	12.3	11.1	1.2
Total	**2 778 248**	**(186 675)**	**2 591 573**	**100.0**	**100.0**	**0.0**

25. As at 31 December 2011, there was a shortfall in the United States dollar currency group of 1.6 per cent and in the Euro currency group of 0.3 per cent. This was offset by an excess allocation in the Pound Sterling of 1.2 per cent and Japanese yen of 0.7 per cent.

C. Composition of the investment portfolio by maturity and duration

26. Table 8 provides details on the composition of the overall investment portfolio by maturity as at 31 December 2011 and compares this with the maturity composition at 31 December 2010.

27. The effective average duration was 2.6 years as at 31 December 2011, slightly higher than the previous year-end (2.5 years at 31 December 2010).

Table 8
Composition of the investment portfolio by maturity
(Thousands of United States dollars equivalent)

	31 December 2010		*31 December 2011*	
Period	*Amount*	*Percentage*	*Amount*	*Percentage*
Due in one year or less	479 650	19.0	617 461	25.2
Due after one year through five years	1 628 385	64.6	1 316 517	53.6
Due from five to ten years	205 454	8.1	278 118	11.3
Due after ten years	209 264	8.3	243 420	9.9
Total	**2 522 753**	**100.0**	**2 455 516**	**100.0**
Weighted average duration		**2.5 years**		**2.6 years**

D. Composition of the investment portfolio by credit rating

28. As at 31 December 2011, over 85 per cent of IFAD's fixed income investments was rated AAA (compared to 79 per cent as at 30 September 2011); approximately 9 per cent was rated between AA+ and AA- (compared to 20 per cent as at 30 September 2011) and about 4 per cent was rated A+ (there were no investments rated between A+ and A- as at 30 September 2011). Investments rated below BBB+ remained constant at 0.3 per cent (compared to 0.5 per cent as at 30 September 2011).

Table 9
Composition of the investment portfolio by credit ratings[a] as at 31 December 2011
(Thousands of United States dollars equivalent)

	Operational cash	*Held-to-maturity*	*Global government bonds*	*Diversified fixed-income bonds*	*Inflation-indexed bonds*	*Total*	*Percent age (%)*
AAA	-	291 138	783 347	384 938	481 667	1 941 090	85.7
AA+	-	30 539	21 279	14 247	5 453	71 518	3.2
AA	-	-	-	19 424	-	19 424	0.9
AA-	-	28 595	66 116	28 593	3 590	126 894	5.6
A+	-	27 991	57 570	-	13 006	98 567	4.3
BBB+ and below	-	5 626	-	501	-	6 127	0.3
Cash and cash equivalents[b]	199 944	-	23 640	4 604	4 002	232 190	n.a.
Pending sales and purchases[c]	-	-	(1 472)	(38 422)	(400)	(40 294)	n.a.
Total	**199 944**	**383 889**	**950 480**	**413 885**	**507 318**	**2 455 516**	**100.0**

[a] As per IFAD's current Investment Guidelines, the credit ratings used in this report are based on the best credit ratings available from either Standard and Poor's (S&P) or Moody's credit rating agencies. The diversified fixed-income bonds portfolio also applies Fitch Ratings.
[b] Consists of cash with central banks, corporate banks and cash held by external portfolio managers. These amounts are not rated by credit rating agencies.
[c] Pending foreign exchange purchases and sales used for hedging purposes and trades pending settlement. These amounts do not have an applicable credit rating.

Note: n.a.: not applicable

29. During 2011 and in particular the latter half of the year, credit rating agencies downgraded a number of sovereign issuers included in the global government and inflation-indexed bonds asset class. As a result, the investment portfolio shows some exposure to securities rated below AA-. IFAD proactively responded to the European sovereign downgrades that marginally affected the global government bonds and inflation-indexed bonds asset classes by following market developments on country-by-country level and instructing investment managers in accordance with the Fund's prudent and conservative investment approach. The AAA credit rating exposure increased to over 85 per cent of the investment portfolio, due to external managers shifting allocation from the downgraded bonds into higher credit quality issuers.

VIII. Liquidity level in IFAD's investment portfolio

30. Highly liquid assets in IFAD's investment portfolio as at 31 December 2011 amounted to US$1,150,400,000, equivalent or more than 46 per cent of the total investment portfolio (table 10).

Table 10
Liquidity level in IFAD's investment portfolio as at 31 December 2011
(Million of United States dollars equivalent)

	Actuals	*Percentage*
Highly liquid assets	**1 150.4**	**46.8**
Short-term	199.9	8.1
Government securities	950.5	38.7
Fairly liquid assets	**921.2**	**37.6**
Non-government securities	921.2	37.6
Partially liquid assets	**383.9**	**15.6**
Held-to-maturity	383.9	15.6
Total portfolio	**2 455.5**	**100.0**

IX. Risk measurement[1]

31. With the exception of operational cash and held-to-maturity investments, the investment portfolio performance is subject to market movements. Different asset classes show different levels of volatility, often referred to as "risk". Volatility is measured in terms of standard deviation of returns from their mean. At 31 December 2011, the standard deviation of IFAD's investment portfolio was 1.59 per cent, compared with 1.53 per cent for the investment policy.

32. 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-looking time horizon, with a 95 per cent confidence level. Table 11 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 31 December 2011 and for previous periods.

Table 11
Value-at-risk (VaR)
(Forecast horizon of three months, confidence level at 95 per cent)

	Investment portfolio		*Investment policy*[a]	
Date	*VaR (Percentage)*	*Amount (Thousands of US dollars)*	*VaR (Percentage)*	*Amount (Thousands of US dollars)*
31 December 2011	1.33	32 871	1.28	31 490
30 September 2011	1.25	30 884	1.21	29 979
30 June 2011	1.19	29 411	1.22	30 027
31 March 2011	0.98	24 338	1.17	29 190
31 December 2010	1.11	27 986	1.19	29 946

[a] The investment policy VaR is based on policy allocation (see table 1).

[1] More comprehensive information pertaining to the Fund's risk management is provided in the 2011 consolidated financial statements in note 4 (document EB 2012/105/R.40).

33. At 31 December 2011, the investment portfolio's VaR was 1.33 per cent, thereby remaining very low in absolute terms. During the year, the VaR showed a decreasing trend in the first quarter in line with shorter portfolio duration at that time. During the remainder of the year, the VaR slightly increased due to marginally longer portfolio duration.

34. The investment portfolio's VaR of 1.33 per cent was slightly higher than the investment policy VaR of 1.28 per cent as at 31 December 2011. The main reason for this was a lower portfolio allocation to the less risky asset class of global government bonds when compared to the policy (please refer to paragraph 15).