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Report on IFAD's investment portfolio for the second quarter of 2012

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For: **Information**

Report on IFAD's investment portfolio for the second quarter of 2012

I. Executive summary

1. This report consists of the following sections and subsections: progress in implementation of the investment policy; market conditions; asset allocation; investment income; rate of return and risk measurements. The latter includes subsections in relation to duration; conditional value-at-risk; ex ante tracking error; credit rating analysis; currency composition analysis and minimum liquidity requirement.

2. During the second quarter of 2012, IFAD's investment portfolio showed a positive performance due to the continued flight-to-quality to United States and core European government bond markets.

3. The value of the investment portfolio in United States dollar terms decreased by US$25,647,000 equivalent, from US$2,396,781,000 equivalent at 1 April 2012 to US$2,371,134,000 equivalent at 30 June 2012. The main factors for this decrease were negative foreign exchange movements and the net disbursement outflows, which were partially offset by the net investment income.

4. The investment portfolio's net rate of return for the second quarter of 2012 was 0.77 per cent, and this translates into a net investment income amount of US$17,574,000 equivalent.

5. On a year-to-date basis, the net rate of return for the first half of 2012 was 1.31 per cent, which translates into a net investment income amount of US$31,285,000 equivalent.

6. During the second quarter of 2012, IFAD completed all steps necessary to implement the revised investment policy in accordance with the Investment Policy Statement approved by the Executive Board in December 2011.[1] The progress in implementation is reported in section II below.

II. Progress in implementation of the investment policy

7. IFAD's Investment Policy Statement (IPS) was approved by the Executive Board at its 104th session held in December 2011. As stated in the IPS,[2] "the implementation status of the IPS will be reported to the Executive Board at its regular meetings".

8. By the end of June 2012, all tenders for the external portfolio managers for management of the global government bond, global diversified fixed-income and emerging market debt asset classes[3] were completed. The new managers were appointed and the new portfolios were funded during the month of July 2012 according to schedule. Applicable benchmarks were constructed for the new global diversified fixed-income and emerging market debt asset classes and were applied from July.

9. The in-house enhanced risk monitoring system was implemented ahead of schedule and by 30 June 2012 all relevant staff were trained on the new system. The system will be used from July 2012 onwards to monitor and report the risk levels of asset classes (both benchmarks and actual portfolios) in line with the risk budget parameters.[4] Alignment of IFAD's monitoring system with the external managers' system took place in June 2012. Section VII of this report presents the risk

[1] EB 2011/104/R.43.
[2] IPS Section II, A.
[3] IPS Section III, D.
[4] IPS Section II, I. and section IV.

measures of the portfolio in place as at 30 June 2012 and 31 March 2012 (see annex), i.e. on the portfolio before the funding of the restructured and new mandates.

10. The first review of the IPS will be submitted to the Executive Board at its December 2012 session, as stated in IPS section II, B., paragraph 8.

III. Market conditions

11. Market conditions during the second quarter of 2012 resulted in a favourable outcome for IFAD's investment portfolio. The global government bonds asset class ended the period positively, supported by the flight-to-quality to United States and core European government bond markets, due to continuing debt concerns in several peripheral euro-zone countries. The United States Treasury bond prices increased, especially for longer-dated maturities, as the United States Federal Reserve announced that it will extend its "Operation Twist" quantitative easing programme. The diversified fixed-income asset class yielded the highest level of returns in the portfolio, with United States Treasury bonds being the chief contributor to performance, together with United States agency mortgage pass-through securities, the other main component of the asset class. Inflation-indexed bond prices also increased, as investors sought refuge in safe havens such as the United States, United Kingdom and core European issuers, but with performance somewhat dampened by a fall in expected inflation.

12. Bond yields in most markets represented in IFAD's investment portfolio have now fallen to extremely low levels. This might reduce the portfolio's income-earning potential going forward. Some diversification benefits are expected through the funding of the emerging market bonds and the global diversified fixed-income asset class (currently a United States-based asset class) from the third quarter of 2012, in line with IPS implementation.

13. During the second quarter of 2012, the volatile foreign exchange markets saw an overall appreciation of the United States dollar against the euro (+4.94 per cent) and the British pound sterling (+1.87 per cent), while there was an overall depreciation of the United States dollar against the Japanese yen (-3.04 per cent).

14. IFAD's reporting currency is the United States dollar. Therefore, the overall appreciation of the United States currency against the euro and the British pound sterling, which has a high weight in the investment portfolio, resulted in a net negative foreign exchange movement, as evidenced in table 1. It must be noted that the currency fluctuations affecting IFAD's assets are balanced by similar fluctuations for IFAD's liabilities and are therefore neutralized on an asset liability level. For this reason, the income and performance of IFAD's portfolio are reported in local currency terms.

IV. Asset allocation

15. Table 1 shows the movements affecting the portfolio by asset class during the second quarter of 2012 and compares the portfolio's asset allocation with the policy allocation.

Table 1
Movements affecting the asset allocation within the portfolio during the second quarter of 2012
(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 (1 April 2012)	**183 207**	**374 723**	**917 152**	**413 578**	**508 121**	**2 396 781**
Investment income[b]	51	1 737	3 227	8 027	4 532	17 574
Transfers due to allocation	34 720	15 208	(49 934)	-	6	-
Transfers due to expenses and income allocation	(943)	31	425	251	236	-
Net disbursement[c]	(7 476)	-	-	-	-	(7 476)
Movements on exchange	(2 335)	(9 486)	(21 049)	(3)	(2 872)	(35 745)
Closing balance by portfolio (30 June 2012)	**207 224**	**382 213**	**849 821**	**421 853**	**510 023**	**2 371 134**
Actual asset allocation (percentage)	8.7	16.1	35.9	17.8	21.5	100.0
Investment policy asset allocation[d] (percentage)	5.5	16.1	43.4	15.0	20.0	100.0
Difference in allocation (percentage)	**3.2**	**-**	**(7.5)**	**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, loan reflows and encashment of Member State contributions.
[d] The investment policy allocation for the held-to-maturity portfolio is set to match the current 16.1 per cent asset allocation in the investment portfolio.

16. During the second quarter of 2012, the overall investment portfolio value in United States dollar terms decreased by US$25,647,000 equivalent. This decrease was the net result of the following flows:

- Negative foreign exchange movements of US$35,745,000 equivalent;
- Net outflows of US$7,476,000 equivalent representing disbursements for loans, grants and administrative expenses net of cash receipts, loan reflows and encashment of Member State contributions; and
- Investment income of US$17,574,000 equivalent.

17. During the second quarter period, US$15,208,000 equivalent was transferred from the operational cash portfolio back into the held-to-maturity portfolio. This represented accumulated funds pertaining to recently matured/sold bonds from the held-to-maturity portfolio that were pending reinvestment.

18. In order to cover projected disbursement needs in the operational cash portfolio, US$49,934,000 equivalent was transferred from the global government bonds portfolio.

19. The actual allocation shows some deviations relative to the policy allocation, whereby an underallocation in the global government bonds asset class is counterbalanced by an overallocation in the other asset classes. This is mainly due to an initial decision in 2011 to provide cash for disbursements by liquidating funds from the global government bonds portfolio. This was the lowest performing asset class within the portfolio in 2011 and has continued to be the lowest performing mandate in 2012 (see table 3).

V. Investment income

20. In the first half of 2012, the net investment income amounted to US$31,285,000 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 second quarter

of 2012 investment income broken down by asset class, together with a year-to-date summary.

Table 2
Breakdown of investment income by asset class for the second quarter of 2012
(Thousands of United States dollars equivalent)

	Operational cash	*Held-to-maturity*	*Global government bonds*	*Diversified fixed-income bonds*	*Inflation-indexed bonds*	*Subtotal second quarter 2012*	*Total year-to-date 2012*
Interest from fixed-income investments and bank accounts	69	2 874	5 136	2 449	3 766	14 294	28 321
Realized market gains/(losses)	-	(919)	207	2 213	(453)	1 048	12 199
Unrealized market gains/(losses)	-	-	(1 691)	3 616	1 455	3 380	(6 800)
Amortization[a]	-	(187)	-	-	-	(187)	(362)
Investment income before fees	**69**	**1 768**	**3 652**	**8 278**	**4 768**	**18 535**	**33 358**
Investment manager fees	-	-	(341)	(209)	(194)	(744)	(1 600)
Custody fees/bank charges	(18)	(2)	(19)	(10)	(3)	(52)	(121)
Financial advisory and other investment-related fees	-	(29)	(65)	(32)	(39)	(165)	(352)
Investment income after fees	**51**	**1 737**	**3 227**	**8 027**	**4 532**	**17 574**	**31 285**

[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 in accordance with International Financial Reporting Standards (IFRS).

21. In order to align the investment portfolio with the minimum credit quality requirements specified in IFAD's IPS and investment guidelines, Spanish and Italian government bonds, which were downgraded below the minimum credit rating floor of AA-, were divested from the internally managed held-to-maturity portfolio.

22. The sale of US$35,297,000 equivalent of Spanish bonds generated a realized loss of US$285,000 equivalent, while the sale of US$25,951,000 equivalent of Italian bonds generated a loss of US$634,000 equivalent, thereby creating a total realized loss of US$919,000 equivalent in the held-to-maturity portfolio.

23. As presented in table 2, the held-to-maturity portfolio realized losses of US$919,000 equivalent in the second quarter. Reinvestments were made in short-term bank instruments based on IFAD's stringent bank eligibility criteria. IFAD's externally managed global government and inflation-indexed bond portfolios divested from the same bond markets also in the fourth quarter of 2011 and first quarter of 2012.

VI. Rate of return

24. 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.

25. The investment portfolio returned a positive 0.77 per cent for the second quarter of 2012, contributing to the first quarter performance of 0.54 per cent and achieving a year-to-date return of 1.31 per cent for the first six months of 2012. This

included all realized and unrealized market gains and losses and is net of investment expenses.

26. In the first half of 2012, the inflation-indexed bond portfolio was the best performing mandate and was complemented by a solid performance from the diversified fixed-income, held-to-maturity and, to a lesser extent, global government bond portfolios.

Table 3
Second quarter 2012 and year-to-date 2012 rates of return and applicable benchmark comparison
(Percentages in local currency terms)

	Second quarter 2012 performance			*Year-to-date 2012 performance*		
	Actual	*Benchmark*	*Over/(under) performance*	*Actual*	*Benchmark*	*Over/(under) performance*
Operational cash	0.04	0.04	-	0.07	0.07	-
Held-to-maturity	0.51	0.78	(0.27)	1.73	1.63	0.10
Global government bonds	0.44	0.33	0.11	0.92	1.00	(0.08)
Diversified fixed-income bonds	2.00	1.95	0.05	1.91	1.69	0.22
Inflation-indexed bonds	0.98	1.36	(0.38)	2.05	3.43	(1.38)
Net rate of return	**0.77**	**0.82**	**(0.05)**	**1.31**	**1.57**	**(0.26)**

VII. Risk measurements

27. In accordance with the IPS, the risk measures used for risk budgeting purposes are the conditional value-at-risk (CVaR) for the overall portfolio and single asset classes, and the ex ante tracking error for single managers within the respective asset classes.

28. The in-house enhanced risk monitoring system was implemented ahead of schedule by 30 June 2012. Ahead of the full implementation of the revised mandates in accordance with the Fund's IPS (refer to section II), IFAD is monitoring and reporting the risk levels of existing portfolios and asset classes to ensure compliance with risk budget levels. The current CVaR and ex ante tracking error levels are reported in sections B and C below. In addition, other main risk indicators are reported in sections A, D, E and F.

A. Market risk: Duration

29. Within the fixed-income investment universe, one of the most important measures of market risk is a bond's duration.[5] The duration indicates the effective maturity and represents the time needed to recuperate the initial investment through the cash flows expected by the bond (coupons and principal). The longer the duration, the more the bond's price is sensitive to movements of market interest rate, because the investment will be exposed to market fluctuations for a longer time period. Thus a longer duration is normally associated with higher risk. IFAD assesses the optimal asset class duration in line with risk budget levels, and IFAD's investment guidelines set duration limits versus benchmarks.

[5] The measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows. Duration is measured in years.

Table 4
IFAD's investment portfolio and benchmark effective duration as at 30 June 2012
(Duration in number of years)

	Portfolio	*Benchmark*
Global government bonds	1.77	1.89
Diversified fixed-income bonds	3.97	4.26
Inflation-indexed bonds	5.17	5.01
Total portfolio (including held-to-maturity and operational cash)	**2.33**	**2.34**

Note: The total portfolio duration is lowered by the operational cash and held-to-maturity portfolios, which are not subject to fluctuations in prices.

30. Table 4 shows the actual and benchmark durations for the single asset classes and the overall portfolio. The overall portfolio duration was 2.33 years, which is an overall conservative positioning. The inflation-indexed bonds asset class has the longest duration, in line with the nature of the issuances of inflation-indexed securities. The global government bonds have the shortest duration, thereby lowering the overall portfolio risk level.

31. All portfolios are well within the duration limits versus the benchmark established in IFAD's investment guidelines.

B. Market risk: Conditional value-at-risk (CVaR)

32. The one-year CVaR at 95 per cent is a measure of the potential average expected loss of a portfolio under extreme conditions (the so-called "left tail"). It gives an indication of how much value a portfolio could lose, on average, over a forward-looking one-year horizon with a 95-per-cent confidence level in highly adverse scenarios. To derive this measure, the portfolio is revalued (stressed) assuming a large number of market condition scenarios affecting its value. For example, a CVaR of 4.0 per cent on a portfolio of US$1,000,000 means there is a 5-per-cent chance that the average loss of the portfolio will be US$40,000.

Table 5
Conditional value-at-risk (CVaR) of current asset classes
(Confidence level at 95 per cent, percentages, based on historical simulations over 5-year history)

	Actual investment portfolio	*IPS budget level*
	1-year CVaR	*1-year CVaR*
Global government bonds	1.92	4.00
Diversified fixed-income bonds	8.84	15.00
Inflation-indexed bonds	7.07	9.00
Total portfolio (including held-to-maturity and operational cash)	**2.94**	**10.00**

33. As shown in table 5, the CVaR of single asset classes and of the overall portfolio were currently well below the risk budget levels.

C. Market risk: Ex ante tracking error

34. The ex ante tracking error is calculated based on the expected portfolio and benchmark returns over a forward-looking one-year horizon. It gives an indication of how different an active strategy is from its benchmark. The more a portfolio differs from the benchmark upon which it is based, the more likely it is to under- or outperform that same benchmark. For example, a one-year forward-looking ex ante tracking error of 0.2 per cent means that, over the coming year, the portfolio excess return over the benchmark is expected to be in the range of +/- 0.2 per cent of its mean value.

Table 6
IFAD's investment portfolio ex ante tracking error as at 30 June 2012
(Percentages)

	Investment portfolio	*IPS budget level*
Global government bonds	0.31	1.50
Diversified fixed-income bonds	0.82	3.00
Inflation-indexed bonds	0.48	2.50

35. As shown in table 6, the current levels of ex ante tracking error are well below the budget levels. This indicates a close resemblance of the portfolio strategy to the benchmark indices.

D. Credit risk: Credit rating analysis

36. IFAD's IPS establishes credit rating floors for all eligible asset classes. Credit risk is managed through the monitoring of securities in accordance with the investment guidelines. Should a security be downgraded below IFAD's minimum credit rating, procedures are in place to limit market losses through monitoring and divestment.

37. As at 30 June 2012, over 85 per cent of IFAD's fixed-income investments were rated AAA; over 13 per cent were rated between AA+ and AA- and under 1 per cent were rated between A+ and A.

Table 7
Composition of the investment portfolio by credit ratings[a] as at 30 June 2012
(Thousands of United States dollars equivalent)

	Operational cash	*Held-to-maturity*	*Global government bonds*	*Diversified fixed-income bonds*	*Inflation-indexed bonds*	*Total*	*Percentage*
AAA	-	165 542	734 594	314 629	419 792	1 634 557	85.5
AA+	-	60 740	-	16 563	-	77 303	4.0
AA	-	47 322	22 367	16 246	-	85 935	4.5
AA-	-	10 082	44 765	23 702	20 402	98 951	5.2
A+	-	-	7 904	6 491	-	14 395	0.8
A	-	-	-	273	-	273	0.0
Cash[b]	207 224	2 406	38 999	43 721	65 121	357 471	n/a
Time deposits	-	96 121	-	-	-	96 121	n/a
Pending sales and purchases[c]	-	-	1 192	228	4 708	6 128	n/a
Total	**207 224**	**382 213**	**849 821**	**421 853**	**510 023**	**2 371 134**	**100.0**

[a] In accordance with 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), Moody's or Fitch ratings. The held-to-maturity portfolio is more conservative and reports the lowest credit rating of the three above-mentioned agencies.
[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.

38. In preparation for the upcoming transition of various managers and funding of the new emerging market debt portfolio, there is a high level of cash in the investment portfolio that is pending reinvestment in July 2012.

E. Currency risk: Currency composition analysis

39. 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.

40. 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.

41. The applicable SDR units, together with their percentage weights as at 30 June 2012, are shown in table 8.

Table 8
Units and weights applicable to SDR valuation basket as at 30 June 2012

Currency	*Units*	*Percentage weight*
United States dollar	0.6600	43.4
Euro	0.4230	35.3
Yen	12.1000	10.0
Pound sterling	0.1110	11.3
Total		**100.0**

42. At 30 June 2012, assets in the form of cash, investments, promissory notes and contribution receivables from Member States under the Sixth, Seventh, Eighth and Ninth Replenishments, net of provisions, amounted to US$2,665,829,000 equivalent, as summarized in table 9.

Table 9
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]	1 067 207	94 908	120 087	1 282 202
Euro group[c]	819 088	25 698	14 510	859 296
Yen	204 424	39 950	-	244 374
Pound sterling	279 957	-	-	279 957
Total	**2 370 676**	**160 556**	**134 597**	**2 665 829**

[a] The difference in the cash and investments balance compared with other tables derives from the exclusion of assets in non-convertible currencies of US$460,000 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.

43. The alignment of assets by currency group against the SDR valuation basket as at 30 June 2012 is shown in table 10. The balance of commitments denominated in United States dollars at 30 June 2012 amounted to US$171,415,000 equivalent, composed of the General Reserve (US$95,000,000) and commitments for grants denominated in United States dollars (US$76,415,000).

Table 10
Alignment of assets by currency group with the SDR valuation composition as at 30 June 2012
(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	1 282 202	(171 415)	1 110 787	44.5	43.4	1.1
Euro group	859 296	-	859 296	34.5	35.3	(0.8)
Yen	244 374	-	244 374	9.8	10.0	(0.2)
Pound sterling	279 957	-	279 957	11.2	11.3	(0.1)
Total	**2 665 829**	**(171 415)**	**2 494 414**	**100.0**	**100.0**	**0.0**

44. As at 30 June 2012 there was a shortfall in the euro currency group of 0.8 per cent, the Japanese yen of 0.2 per cent and the British pound sterling of 0.1 per cent. This was offset by an excess allocation in the United States dollar currency group of 1.1 per cent.

F. Liquidity risk: Minimum liquidity requirement

45. IFAD's liquidity risk is addressed through the minimum liquidity requirement. IFAD's liquidity policy[6] states that the amount of highly liquid assets in IFAD's investment portfolio should remain above 60 per cent of the projected annual gross disbursement level, including the impact of liquidity shocks. This translates into a minimum liquidity requirement of US$518,000,000 equivalent over the Eighth Replenishment period.

46. Highly liquid assets in IFAD's investment portfolio as at 30 June 2012 amounted to US$1,057,045,000 equivalent, which comfortably clears the minimum liquidity requirement (table 11).

Table 11
Liquidity level in IFAD's investment portfolio as at 30 June 2012
(Thousands of United States dollars equivalent)

	Actual	*Percentage*
Highly liquid assets	**1 057 045**	**44.6**
Short-term	207 224	8.7
Government securities	849 821	35.9
Fairly liquid assets	**931 876**	**39.3**
Non-government securities	931 876	39.3
Partially liquid assets	**382 213**	**16.1**
Held-to-maturity	382 213	16.1
Total portfolio	**2 371 134**	**100.0**

[6] EB 2006/89/R.40.

Report on IFAD's investment portfolio for the first quarter of 2012

I. Executive summary

1. This report consists of the following sections and subsections: asset allocation; investment income; rate of return and risk measurements. The latter includes subsections in relation to duration; conditional value-at-risk; ex ante tracking error; credit rating analysis; currency composition analysis and minimum liquidity requirement.

2. During the first quarter of 2012, IFAD's investment portfolio performed positively. The investment portfolio's net rate of return for the first quarter of 2012 was 0.54 per cent and this translates into a net investment income amount of US$13,711,000 equivalent.

3. The value of the investment portfolio in United States dollar terms decreased by US$58,735,000 equivalent, from US$2,455,516,000 equivalent at 31 December 2011 to US$2,396,781,000 equivalent at 31 March 2012. The main factors for this decrease were the net disbursement outflows, which were partially offset by the net investment income and positive foreign exchange movements.

II. Asset allocation

4. Table 1 shows the movements affecting the portfolio by asset class during the first quarter of 2012 and compares the portfolio's asset allocation with the policy allocation.

Table 1
Movements affecting the asset allocation within the portfolio during the first quarter of 2012
(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 (1 January 2012)	**199 944**	**383 889**	**950 480**	**413 885**	**507 318**	**2 455 516**
Investment income/(loss)[b]	68	4 547	4 254	(564)	5 406	13 711
Transfers due to allocation	69 427	(19 115)	(50 312)	-	-	-
Transfers due to expenses and income allocation	(1 089)	35	480	256	318	-
Net disbursement[c]	(86 525)	-	-	-	-	(86 525)
Movements on exchange	1 382	5 367	12 250	1	(4 921)	14 079
Closing balance by portfolio (31 March 2012)	**183 207**	**374 723**	**917 152**	**413 578**	**508 121**	**2 396 781**
Actual asset allocation (percentage)	7.6	15.6	38.3	17.3	21.2	100.0
Investment policy asset allocation[d] (percentage)	5.5	15.6	43.6	15.3	20.0	100.0
Difference in allocation (percentage)	**2.1**	**-**	**(5.3)**	**2.0**	**1.2**	**-**

[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, loan reflows 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.

5. During the first quarter period of 2012, the overall investment portfolio value in United States dollar terms decreased by US$58,735,000 equivalent. This decrease was the net result of the following flows:

- Net outflows of US$86,525,000 equivalent, representing disbursements for loans, grants and administrative expenses net of cash receipts, loan reflows and encashment of Member State contributions;
- Net investment income of US$13,711,000 equivalent; and
- Positive foreign exchange movements of US$14,079,000 equivalent.

6. During the quarter US$19,115,000 equivalent was transferred from the held-to-maturity portfolio into the operational cash portfolio. This represented accumulated coupon income, together with funds pertaining to recently matured/sold bonds from the held-to-maturity portfolio pending reinvestment.

7. In order to cover projected disbursement needs in the operational cash portfolio, US$50,312,000 equivalent was transferred from the global government bonds portfolio.

8. The actual allocation shows some deviations relative to the policy allocation, whereby an underallocation in the global government bonds asset class is counterbalanced by an overallocation in the other asset classes. This is mainly due to the decision in 2011 to provide cash for disbursements by liquidating funds from the global government bonds portfolio, which was the lowest performing asset class within the portfolio in 2011 as well as being the most liquid asset class.

III. Investment income

9. During the first quarter of 2012, the net investment income amounted to US$13,711,000 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 first quarter of 2012 investment income broken down by asset class.

Table 2
Breakdown of investment income by asset class for the first quarter of 2012
(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	91	3 463	6 277	2 587	1 609	14 027
Realized market gains/(losses)	-	1 294	(641)	2 275	8 223	11 151
Unrealized market gains/(losses)[a]	-	-	(902)	(5 170)	(4 108)	(10 180)
Amortization[b]	-	(175)	-	-	-	(175)
Investment income before fees	**91**	**4 582**	**4 734**	**(308)**	**5 724**	**14 823**
Investment manager fees	-	-	(377)	(211)	(268)	(856)
Custody fees/bank charges	(23)	(3)	(26)	(10)	(7)	(69)
Financial advisory and other investment-related fees	-	(32)	(77)	(35)	(43)	(187)
Investment income after fees	**68**	**4 547**	**4 254**	**(564)**	**5 406**	**13 711**

[a] The held-to-maturity portfolio contains a realized gain of US$1,294,000 equivalent, which pertains to the sale of an impaired security in February 2012.
[b] 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 in accordance with International Financial Reporting Standards (IFRS).

IV. Rate of return

10. 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.

11. The investment portfolio returned a positive 0.54 per cent for the first quarter of 2012, including all realized and unrealized market gains and losses and net of investment expenses.

12. The internally managed held-to-maturity portfolio was the best performing portfolio and was complemented by a solid performance from the inflation-indexed bond and global government bond portfolios. The overall rate of return was slightly offset by the negative performance in the diversified fixed-income bond portfolio (see table 3).

Table 3
First quarter 2012 and annual 2011 rates of return and applicable benchmark comparison
(Percentages in local currency terms)

	Performance for the first quarter 2012			*Annual performance for 2011*		
	Actual	*Benchmark*	*Over/(under) performance*	*Actual*	*Benchmark*	*Over/(under) performance*
Operational cash	0.03	0.03	-	0.56	0.56	-
Held-to-maturity	1.22	0.84	0.38	2.91	3.56	(0.65)
Global government bonds	0.48	0.67	(0.19)	2.42	2.36	0.06
Diversified fixed-income bonds	(0.09)	(0.25)	0.16	7.28	7.67	(0.39)
Inflation-indexed bonds	1.06	2.09	(1.03)	6.97	6.84	0.13
Net rate of return	**0.54**	**0.75**	**(0.21)**	**3.82**	**3.94**	**(0.12)**

V. Risk measurements

13. In accordance with the IPS, the risk measures used for risk budgeting purposes are the CVaR for the overall portfolio and single asset classes, and the ex ante tracking error for single managers within the respective asset classes.

14. The in-house monitoring of risk budget levels will start as soon as the enhanced risk management system is fully implemented. In the meantime, in close collaboration with the Global Custodian, IFAD is monitoring and reporting on a monthly basis the risk levels of existing portfolios and asset classes to ensure compliance with risk budget levels. The current CVaR and ex ante tracking error levels are reported in sections B and C below. In addition, other main risk indicators are reported in sections A, D, E and F.

A. Market risk: Duration

15. Within the fixed-income investment universe, one of the most important measures of market risk is a bond's duration.[7] The duration indicates the effective maturity and represents the time needed to recuperate the initial investment through the cash flows expected by the bond (coupons and principal). The longer the duration, the more the bond's price is sensitive to movements of market interest rate, because the investment will be exposed to market fluctuations for a longer time period. Thus a longer duration is normally associated with higher risk. IFAD assesses the optimal asset class duration in line with risk budget levels, and IFAD's investment guidelines set duration limits versus benchmarks.

[7] The measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows. Duration is measured in years.

Table 4
IFAD's investment portfolio and benchmark effective duration as at 31 March 2012
(Duration in number of years)

	Portfolio	*Benchmark*
Global government bonds	1.96	2.01
Diversified fixed-income bonds	4.59	4.47
Inflation-indexed bonds	5.32	5.03
Total portfolio (including held-to-maturity and operational cash)	**2.55**	**2.45**

Note: The total portfolio duration is lowered by the operational cash and held-to-maturity portfolios, which are not subject to fluctuations in prices.

16. Table 4 shows the actual and benchmark durations for the single asset classes and the overall portfolio. The overall portfolio duration was 2.55 years, which is an overall conservative positioning. The inflation-indexed bonds asset class has the longest duration, in line with the nature of the issuances of inflation-indexed securities. The global government bonds have the shortest duration, thereby lowering the overall portfolio risk level.

17. All portfolios are well within the duration limits versus the benchmark established in IFAD's investment guidelines.

B. Market risk: Conditional value-at-risk (CVaR)

18. The one-year CVaR at 95 per cent is a measure of the potential average expected loss of a portfolio under extreme conditions (the so-called "left tail"). It gives an indication of how much value a portfolio could lose, on average, over a forward-looking one-year horizon with a 95-per-cent confidence level in highly adverse scenarios. To derive this measure, the portfolio is revalued (stressed) assuming a large number of market condition scenarios affecting its value. For example, a CVaR of 4.0 per cent on a portfolio of US$1,000,000 means there is a 5-per-cent chance that the average loss of the portfolio will be US$40,000.

Table 5
Conditional value-at-risk (CVaR) of current asset classes as at 31 March 2012
(Confidence level at 95 per cent, percentages, based on historical simulations over a 5-year history)

	Actual investment portfolio	*IPS budget level*
	1-year CVaR	*1-year CVaR*
Global government bonds	2.40	4.00
Diversified fixed-income bonds	11.35	15.00
Inflation-indexed bonds	7.57	9.00
Total portfolio (including held-to-maturity and operational cash)	**3.44**	**10.00**

19. As shown in table 5, the CVaR of single asset classes and of the overall portfolio are currently well below the risk budget levels.

C. Market risk: Ex ante tracking error

20. The ex ante tracking error is calculated based on the expected portfolio and benchmark returns over a forward-looking one-year horizon. It gives an indication of how different an active strategy is from its benchmark. The more a portfolio differs from the benchmark upon which it is based, the more likely it is to under- or outperform that same benchmark. For example, a one-year forward-looking ex ante tracking error of 0.2 per cent means that, over the coming year, the portfolio excess return over the benchmark is expected to be in the range of +/- 0.2 per cent of its mean value.

Table 6
IFAD's investment portfolio ex ante tracking error as at 31 March 2012
(Percentages)

	Investment portfolio	*IPS budget level*
Global government bonds	0.61	1.50
Diversified fixed-income bonds	0.81	3.00
Inflation-indexed bonds	1.02	2.50

21. As shown in table 6, the current levels of ex ante tracking error are well below the budget levels. This indicates a close resemblance of the portfolio strategy to the benchmark indices.

D. Credit risk: Credit rating analysis

22. IFAD's IPS establishes credit rating floors for all eligible asset classes. Credit risk is managed through the monitoring of securities in accordance with the investment guidelines. Should a security be downgraded below IFAD's minimum credit rating, procedures are in place to limit market losses through monitoring and divestment.

23. As at 31 March 2012, over 87 per cent of IFAD's fixed-income investments were rated AAA (compared with 85 per cent as at 31 December 2011); over 10 per cent were rated between AA+ and AA- (compared with 9 per cent as at 31 December 2011) and over 2 per cent were rated between A+ and A- (compared with 4 per cent as at 31 December 2011). Investments rated below BBB+ were reduced to 0.02 per cent (compared with 0.3 per cent as at 31 December 2011).

Table 7
Composition of the investment portfolio by credit ratings[a] as at 31 March 2012
(Thousands of United States dollars equivalent)

	Operational cash	*Held-to-maturity*	*Global government bonds*	*Diversified fixed-income bonds*	*Inflation-indexed bonds*	*Total*	*Percentage*
AAA	-	256 375	807 378	388 997	463 737	1 916 487	87.6
AA+	-	21 323	-	15 078	-	36 401	1.7
AA	-	39 155	28 760	17 389	-	85 304	3.9
AA-	-	10 147	43 006	28 475	19 289	100 917	4.6
A	-	19 154	-	-	-	19 154	0.9
A-	-	28 569	-	-	-	28 569	1.3
BBB+ and below	-	-	-	499	-	499	0.0
Cash and cash equivalents[b]	183 207	-	22 768	11 113	25 614	242 702	n/a
Pending sales and purchases[c]	-	-	15 240	(47 973)	(519)	(33 252)	n/a
Total	**183 207**	**374 723**	**917 152**	**413 578**	**508 121**	**2 396 781**	**100.0**

[a] In accordance with 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 ratings. 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.

E. Currency risk: Currency composition analysis

24. 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.

25. 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.

26. The applicable SDR units, together with their percentage weights as at 31 March 2012, are shown in table 8.

Table 8
Units and weights applicable to SDR valuation basket as at 31 March 2012

Currency	*Units*	*Percentage weight*
United States dollar	0.6600	42.7
Euro	0.4230	36.4
Yen	12.1000	9.5
Pound sterling	0.1110	11.4
Total		**100.0**

27. At 31 March 2012, assets in the form of cash, investments, promissory notes and contribution receivables from Member States under the Sixth, Seventh, Eighth and Ninth Replenishments, net of provisions, amounted to US$2,772,108,000 equivalent, as summarized in table 9.

Table 9
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]	1 065 796	163 946	86 866	1 316 608
Euro group[c]	804 219	46 143	40 118	890 480
Yen	218 900	38 734	-	257 634
Pound sterling	307 386	-	-	307 386
Total	**2 396 301**	**248 823**	**126 984**	**2 772 108**

[a] The difference in the cash and investments balance compared with other tables derives from the exclusion of assets in non-convertible currencies of US$480,000 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.

28. The alignment of assets by currency group against the SDR valuation basket as at 31 March 2012 is shown in table 10. The balance of commitments denominated in United States dollars at 31 March 2012 amounted to US$172,350,000 equivalent, composed of the General Reserve (US$95,000,000) and commitments for grants denominated in United States dollars (US$77,350,000).

Table 10
Alignment of assets by currency group with the SDR valuation composition as at 31 March 2012
(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	1 316 608	(172 350)	1 144 258	44.0	42.7	1.3
Euro group	890 480	-	890 480	34.3	36.4	(2.1)
Yen	257 634	-	257 634	9.9	9.5	0.4
Pound sterling	307 386	-	307 386	11.8	11.4	0.4
Total	**2 772 108**	**(172 350)**	**2 599 758**	**100.0**	**100.0**	**0.0**

29. As at 31 March 2012 there was a shortfall in the euro currency group of 2.1 per cent. This was offset by an excess allocation in the United States dollar currency group of 1.3 per cent, the British pound sterling of 0.4 per cent and the Japanese yen of 0.4 per cent.

F. Liquidity risk: Minimum liquidity requirement

30. IFAD's liquidity risk is addressed through the minimum liquidity requirement. IFAD's liquidity policy[8] states that the amount of highly liquid assets in IFAD's investment portfolio should remain above 60 per cent of the projected annual gross disbursement level, including the impact of liquidity shocks. This translates into a minimum liquidity requirement of US$518,000,000 equivalent over the Eighth Replenishment period.

31. Highly liquid assets in IFAD's investment portfolio as at 31 March 2012 amounted to US$1,100,359,000 equivalent, which comfortably clears the minimum liquidity requirement (table 11).

Table 11
Liquidity level in IFAD's investment portfolio as at 31 March 2012
(Thousands of United States dollars equivalent)

	Actual	*Percentage*
Highly liquid assets	**1 100 359**	**45.9**
Short-term	183 207	7.6
Government securities	917 152	38.3
Fairly liquid assets	**921 669**	**38.5**
Non-government securities	921 699	38.5
Partially liquid assets	**374 723**	**15.6**
Held-to-maturity	374 723	15.6
Total portfolio	**2 396 781**	**100.0**

[8] EB 2006/89/R.40.