

Document: EB 2014/111/R.24
Agenda: 16
Date: 25 February 2014
Distribution: Public
Original: English

E



Investing in rural people

Report on IFAD's investment portfolio for 2013

Note to Executive Board representatives

Focal points:

Technical questions:

Iain Kellet

Chief Financial Officer and Head
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: i.kellet@ifad.org

Natalia Toschi

Team Leader
Financial Planning and Analysis Unit
Tel.: +39 06 5459 2653
e-mail: n.toschi@ifad.org

Robin Anthony Rocco

Portfolio Analytics Officer
Financial Planning and Analysis Unit
Tel.: +39 06 5459 2342
e-mail: r.rocco@ifad.org

Dispatch of documentation:

Deirdre McGrenra

Head, Governing Bodies Office
Tel.: +39 06 5459 2374
e-mail: gb_office@ifad.org

Executive Board — 111th Session
Rome, 8-9 April 2014

For: **Information**

Report on IFAD's investment portfolio for 2013

I. Executive summary

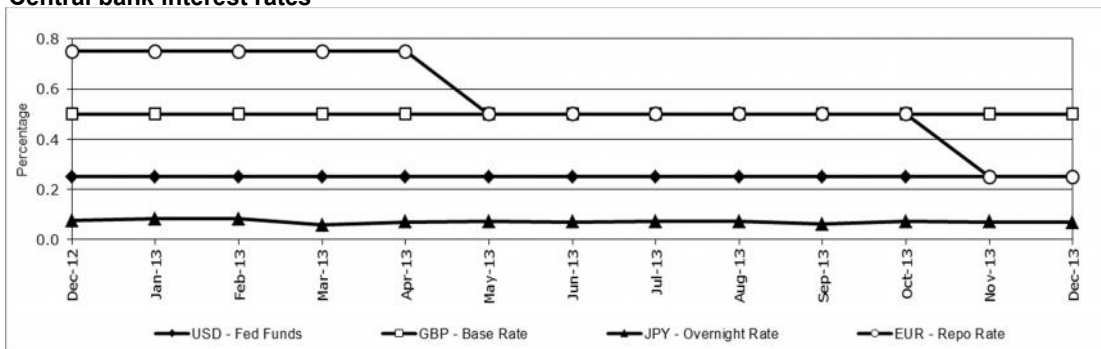
1. The value of the investment portfolio in United States dollar terms decreased by US\$291.8 million, from US\$2,269.6 million at 31 December 2012 to US\$1,977.8 million at 31 December 2013. The main factors for this decrease were net outflows, negative investment income and foreign exchange movements.
2. In October 2013, IFAD implemented some changes to its investment portfolio as recommended by a study on mitigating the prospects of negative performance in the medium term (see section III). These were presented to the Executive Board in December 2013¹ in the context of the yearly review of the Investment Policy Statement (IPS).
3. In 2013, IFAD's investment portfolio was impacted by the overall negative trend of global fixed-income markets. The investment portfolio's net rate of return for 2013 was a negative 1.11 per cent, translating into an investment loss of US\$24.0 million, net of all investment-related fees.

II. Market conditions

4. Chart 1 shows the evolution of central bank interest rates for special drawing rights (SDR) countries for 2013.

Chart 1

Central bank interest rates



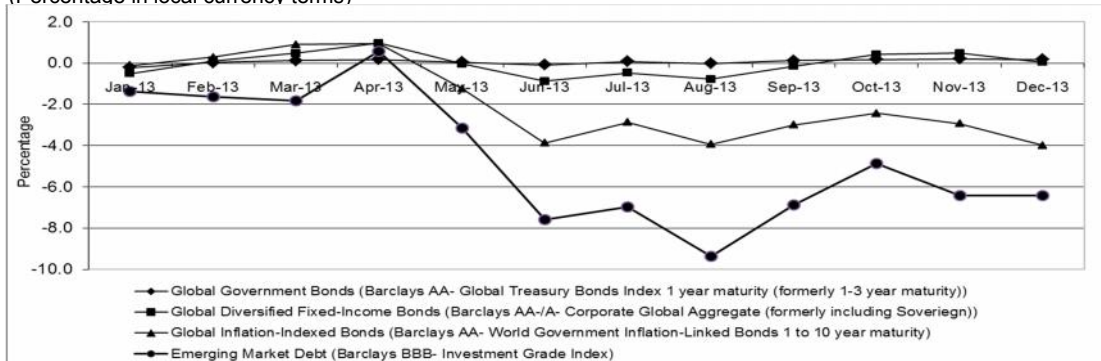
Source: Bloomberg

Chart 2 shows the cumulative performance for 2013 of benchmark indices applied to IFAD's externally managed asset classes.

Chart 2

Fixed-interest market developments in 2013

(Percentage in local currency terms)



Source: Barclays

5. The **global government bond asset class** performed positively, supported by the restated support of main central banks, which maintained their accommodative policies. Government bonds with long durations were generally

¹ EB 2013/110/R.41

negatively affected by rising yields, impacted by the foreseen tapering of quantitative easing by the Federal Reserve of the United States, which remained the focal discussion throughout the year. IFAD's government bonds were protected by their relatively shorter duration, which was further reduced in October 2013.

6. The **global diversified fixed-income asset class** also performed positively, as investors sought instruments to increase investment returns. This asset class benefited from very strong performance in corporate and government mortgage-backed bonds.
7. The **global inflation-indexed asset class** registered a negative performance, as inflation expectations in developed markets fell, contributing to the underperformance of inflation-indexed bond markets against their nominal counterparts.
8. The **emerging market government bond asset class** registered the weakest performance among the asset classes, as it came under pressure from the uncertainty that dominated developed markets and the substantial yield increases on government bonds of long duration, including emerging market bonds.
9. In 2013, the United States dollar depreciated against the British pound sterling (-2.46 per cent) and the euro (-4.05 per cent) and appreciated against the Japanese yen (+22.08 per cent). These trends resulted in combined slightly negative foreign exchange movement in IFAD's investment portfolio (see table 1).
10. It must be noted that the currency fluctuations affecting IFAD's assets are offset by similar fluctuations for IFAD's liabilities and are therefore neutralized on an asset liability level. Consequently, the income and performance of IFAD's investment portfolio are reported in local currency terms.

III. Investment policy statement review

11. The yearly review of the IPS was presented and approved at the 110th session of the Executive Board in December 2013.
12. In 2013, IFAD carried out a study on mitigating the prospects of negative performance while supporting IFAD's growing demand for liquidity in the light of increasing disbursements over the coming years.
13. The following recommendations of the review were implemented in October 2013:
 - (a) Reduce effective duration in the global government bond portfolio to one year to reduce sensitivity to interest rate movements;
 - (b) Increase investment policy asset allocation to emerging market debt from 7.0 to 10.0 per cent, in view of its more favourable medium-term outlook, by reducing the global diversified fixed-income portfolio allocation from 13.0 to 10.0 per cent (see table 1);
 - (c) Eliminate global government bond exposure in the global diversified fixed-income portfolio to streamline this asset class.

IV. Asset allocation

14. During 2013, the value of the investment portfolio in United States dollar terms decreased by US\$291.8 million. This was the result of net outflows of US\$263.4 million, negative investment income of US\$24.0 million and foreign exchange movements of US\$4.4 million.

Table 1
Movements affecting asset allocation within the portfolio in 2013
 (Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Global strategic portfolio</i>	<i>Global government bonds</i>	<i>Global diversified fixed-income bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt bonds</i>	<i>Total</i>
Opening balance (1 January 2013)	194 806	373 555	762 797	318 681	459 430	160 355	2 269 624
Net investment income ^b	32	7 271	1 169	(1 107)	(18 366)	(13 011)	(24 012)
Transfers due to allocation	233 910	(86 885)	(87 025)	(60 000)	(60 000)	60 000	-
Transfers due to expense allocation	(3 363)	155	1 134	629	923	522	-
Net outflows ^c	(263 438)	-	-	-	-	-	(263 438)
Movements on exchange	936	8 931	150	(6 489)	(8 263)	315	(4 420)
Closing balance (31 December 2013)	162 883	303 027	678 225	251 714	373 724	208 181	1 977 754
Actual asset allocation (percentage)	8.2	15.3	34.4	12.7	18.9	10.5	100.0
Investment policy asset allocation (percentage)	7.0	17.0	36.0	10.0	20.0	10.0	100.0
Difference in allocation (percentage)	1.2	(1.7)	(1.6)	2.7	(1.1)	0.5	-

^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 Net outflows consist of disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

15. In October 2013, US\$60.0 million was transferred from the global diversified fixed-income portfolio to the emerging market debt portfolio, reflecting the outcome of IFAD's asset class study (see section III).
16. Other transfers throughout 2013 included liquidating US\$60.0 million from the global inflation-indexed bond portfolio, US\$87.0 million from the global government bond portfolio and US\$86.9 million from the global strategic portfolio to cover disbursements in the operational cash portfolio.

V. Investment income

17. Net investment income in 2013 amounted to a negative US\$24.0 million, inclusive of all investment-related fees. Table 2 presents a summary of 2013 investment income broken down by asset class.

Table 2
Breakdown of investment income by asset class in 2013
 (Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic portfolio</i>	<i>Global government bonds</i>	<i>Global diversified fixed-income bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt bonds</i>	<i>Total</i>
Interest from fixed-income investments and bank accounts	124	8 362	14 195	8 859	4 328	8 160	44 028
Realized market gains/(losses)	-	-	(5 332)	(2 416)	(1 213)	(2 834)	(11 795)
Unrealized market gains/(losses)	-	-	(6 560)	(6 921)	(20 558)	(17 815)	(51 854)
Amortization*	-	(936)	-	-	-	-	(936)
Investment income before fees	124	7 426	2 303	(478)	(17 443)	(12 489)	(20 557)
Investment manager fees	-	-	(776)	(483)	(702)	(435)	(2 396)
Custody fees/bank charges	(92)	(36)	(123)	(46)	(86)	(35)	(418)
Financial advisory & other investment-related fees	-	(119)	(235)	(100)	(135)	(52)	(641)
Investment income after fees	32	7 271	1 169	(1 107)	(18 366)	(13 011)	(24 012)

* A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value for the global strategic portfolio which is reported at amortized cost.

VI. Rate of return

18. 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 VIII. E.).

Table 3
Quarterly performances for 2013 together with annual performance versus benchmark
 (Percentages in local currency terms)

	<i>2013 quarterly and year-to-date performances and benchmark</i>						
	<i>Fourth quarter</i>	<i>Third quarter</i>	<i>Second quarter</i>	<i>First quarter</i>	<i>Annual 2013</i>	<i>Benchmark 2013</i>	<i>Difference</i>
Operational cash	0.03	0.01	0.01	0.03	0.07	0.07	-
Global strategic portfolio	0.42	0.48	0.55	0.57	2.13	1.94	0.19
Global government bonds	0.22	0.17	(0.20)	0.15	0.34	0.16	0.18
Global diversified fixed-income bonds	0.62	0.94	(1.84)	0.27	(0.04)	0.32	(0.36)
Global inflation-indexed bonds	(1.04)	0.59	(4.72)	0.97	(4.23)	(3.99)	(0.24)
Emerging market debt bonds	0.39	0.66	(6.42)	(2.17)	(7.49)	(6.54)	(0.95)
Net rate of return	0.00	0.40	(1.69)	0.18	(1.11)	(0.99)	(0.12)

19. The investment portfolio returned a negative 1.11 per cent in 2013, net of all investment-related expenses.

VII. Composition of the portfolio by instrument

20. Table 4 shows the composition of the investment portfolio by instrument as at 31 December 2012 and 2013.

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

	<i>31 December 2012</i>	<i>31 December 2013</i>
Cash ^a	246 892	183 056
Time deposits and other obligations of banks ^b	110 610	95 394
Global government bonds/government agencies	1 657 952	1 428 519
Commercial mortgage-backed securities ^c	15 424	-
Government mortgage-backed securities ^c	77 866	23 705
Corporate bonds	186 196	244 299
Unrealized market gain/(loss) on forward contracts	(8 785)	(3 297)
Unrealized gain/(loss) on futures	6 575	11 914
Subtotal: cash and investments	2 292 730	1 983 590
Receivables for investments sold	1 385	3 197
Payables for investments purchased	(24 491)	(9 033)
Total	2 269 624	1 977 754

^a Includes cash in non-convertible currencies amounting to US\$46,000 equivalent (US\$50,000 in 2012).

^b Includes time deposits in non-convertible currencies amounting to US\$367,000 equivalent (US\$397,000 in 2012).

^c Mortgage backed securities in IFAD's investment portfolio require a AAA rating by at least two credit rating agencies.

VIII. Risk measurements

21. In accordance with the IPS, the risk measures used for risk-budgeting purposes are conditional value-at-risk (CVaR) and the ex ante tracking error, which are reported in subsections B and C below. In addition, other risk indicators are reported in subsections A, D, E and F.

A. Market risk: Duration

22. Duration² is defined as the weighted average of the time to each coupon and principal payment of a bond. As a result, the longer the duration, the more the bond's price is sensitive to movements of market interest rates. 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.

² 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 5
IFAD's investment portfolio and benchmark effective duration as at 31 December 2012 and 2013
 (Duration in number of years)

	31 December 2012		31 December 2013	
	Portfolio	Benchmark	Portfolio	Benchmark
Global government bonds	1.71	1.86	0.92	0.99
Global diversified fixed-income bonds	4.10	4.16	4.42	4.35
Global inflation-indexed bonds	6.25	5.38	5.42	5.11
Emerging market debt bonds	7.61	6.77	6.54	6.31
Total portfolio (including global strategic portfolio and operational cash)	2.95	2.76	2.59	2.44

Note: The total portfolio duration is lowered by the global strategic and operational cash portfolios, which are not subject to fluctuations in price.

23. The overall portfolio duration was 2.59 years (2.95 years in 2012), which is an overall conservative positioning.

B. Market risk: Conditional value-at-risk

24. 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. 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 95 per cent chance that the average loss of the portfolio will not exceed US\$40,000 in one year.

Table 6
CVaR of current asset classes as at 31 December 2012 and 2013
 (Confidence level at 95 per cent, percentages, based on historical simulations over five-year history)

	Actual investment portfolio one-year CVaR		One-year CVaR IPS budget level
	31 December 2012	31 December 2013	
Global government bonds	1.50	1.07	4.00
Global diversified fixed-income bonds	6.56	5.73	15.00
Global inflation-indexed bonds	6.85	6.87	9.00
Emerging market debt bonds	12.70	10.69	27.00
Total portfolio (including global strategic portfolio and operational cash)	2.72	2.76	6.00

25. The CVaR of single asset classes and of the overall portfolio were all below risk budget levels. Despite a CVaR decrease in all mandates compared with the last year-end, except for a slight increase in the global inflation-indexed bond portfolio, the overall CVaR increased slightly due to the decrease in cash and the global strategic portfolio, which are not subject to market price volatility (see tables 4 and 8 respectively).

C. Market risk: Ex ante tracking error

26. The ex ante tracking error gives an indication of how different an active strategy is from its benchmark. The more a portfolio differs from the benchmark on 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 7
IFAD's investment portfolio ex ante tracking error as at 31 December 2012 and 2013
 (Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>31 December 2012</i>	<i>31 December 2013</i>	
Global government bonds	0.34	0.37	1.50
Global diversified fixed-income bonds	0.57	0.94	3.00
Global inflation-indexed bonds	0.43	0.45	2.50
Emerging market debt bonds	1.01	1.19	4.00

27. The current levels of ex ante tracking error are below budget levels, indicating a close resemblance of the portfolio strategy to the benchmark indices.

D. Credit risk: Credit rating analysis

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

Table 8
Investment portfolio composition by credit ratings^a as at 31 December 2012 (total) and 2013
 (Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic portfolio</i>	<i>Global government bonds</i>	<i>Global diversified fixed-income bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt</i>	<i>Total</i>	<i>Percentage</i>
AAA	-	72 241	445 918	31 781	270 688	1 808	822 436	41.6
AA+/-	-	133 982	219 887	57 898	101 135	42 936	555 838	28.1
A+/-	-	-	-	158 652	-	5 575	164 227	8.3
BBB+/-	-	-	-	-	-	154 023	154 023	7.8
Cash ^b	162 883	1 410	13 493	4 900	6 550	5 733	194 969	9.9
Time deposits	-	95 394	-	-	-	-	95 394	4.8
Pending sales and purchases ^c	-	-	(1 073)	(1 517)	(4 649)	(1 894)	(9 133)	(0.5)
Total 2013	162 883	303 027	678 225	251 714	373 724	208 181	1 977 754	100.0
Total 2012	194 806	373 555	762 797	318 681	459 430	160 355	2 269 624	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 the Standard and Poor's (S&P), Moody's or Fitch rating agencies. The global strategic portfolio is more conservative and reports the lowest credit rating of the three above-mentioned agencies.

^b Consists of cash equivalents and 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.

E. Currency risk: Currency composition analysis

29. The majority of IFAD's commitments pertain to undisbursed loans and grants and are expressed in 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 as the Fund's commitments, i.e. in SDR.
30. At 31 December 2013, the net asset amount consisting of cash, investments, promissory notes and contribution receivables from Member States (net of provisions) less commitments denominated in United States dollars amounted to US\$2,516.5 million.

Table 9

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

<i>Currency</i>	<i>United States dollar group^a</i>	<i>Euro group^c</i>	<i>Yen</i>	<i>Pound sterling</i>	<i>Total</i>
Cash and investments ^a	956 694	653 884	129 608	237 155	1 977 341
Promissory notes	139 236	87 770	71 584	-	298 590
Contribution receivables from Member States	139 368	207 178	-	84 689	431 235
Less: commitments denominated in US dollars	(190 692)	-	-	-	(190 692)
Net asset amount	1 044 606	948 832	201 192	321 844	2 516 474
Net asset amount (percentage)	41.5	37.7	8.0	12.8	100.0
SDR weights (percentage)	42.9	37.8	7.5	11.8	100.0
Difference (percentage)	(1.4)	(0.1)	0.5	1.0	0.0

^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\$413,000 equivalent (cash and investments).

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

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

F. Liquidity risk: Minimum liquidity requirement

31. IFAD's liquidity risk is addressed through the minimum liquidity requirement (MLR). IFAD's liquidity policy,³ together with the revised Ninth Replenishment period (2013-2015) MLR, states that IFAD's investment portfolio should remain above 60 per cent of the projected annual gross disbursement level (outflows), including potential additional requirements due to liquidity shocks.
32. IFAD's latest financial model assumptions, incorporating 2013 resources available for commitment under the sustainable cash flow approach, calculate an MLR of US\$595.0 million,⁴ which is comfortably cleared by IFAD's investment portfolio balance of US\$1,977.8 million (see table 1).

³ EB 2006/89/R.40

⁴ EB 2013/110/R.15