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Investing in rural people

Report on IFAD's investment portfolio for 2014

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Report on IFAD's investment portfolio for 2014

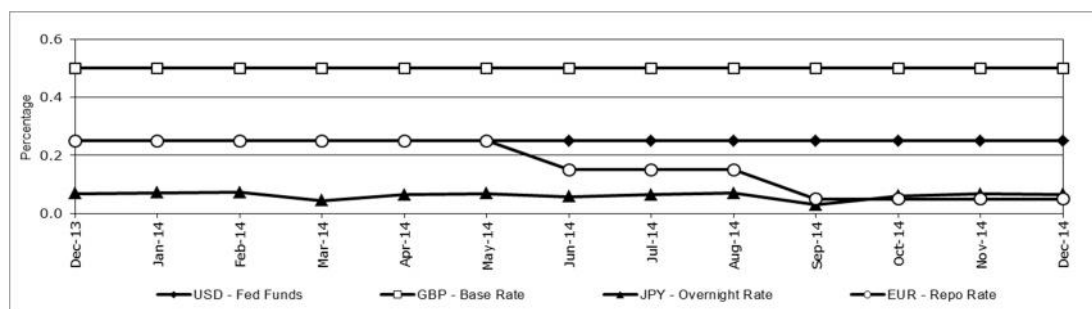
I. Executive summary

1. The value of IFAD's investment portfolio in United States dollar terms decreased by US\$292.5 million, from US\$1,977.8 million at 31 December 2013 to US\$1,685.3million at 31 December 2014. The main factors for this decrease were net outflows and foreign exchange movements, which were slightly offset by positive investment income.
2. In 2014, IFAD's investment portfolio generated a positive net rate of return of 2.58 per cent (versus a benchmark of 2.08 per cent), translating into an investment income of US\$48.7 million, net of all investment-related fees.

II. Market conditions

3. Chart 1 shows the evolution of central bank interest rates for special drawing rights (SDR) countries in 2014.

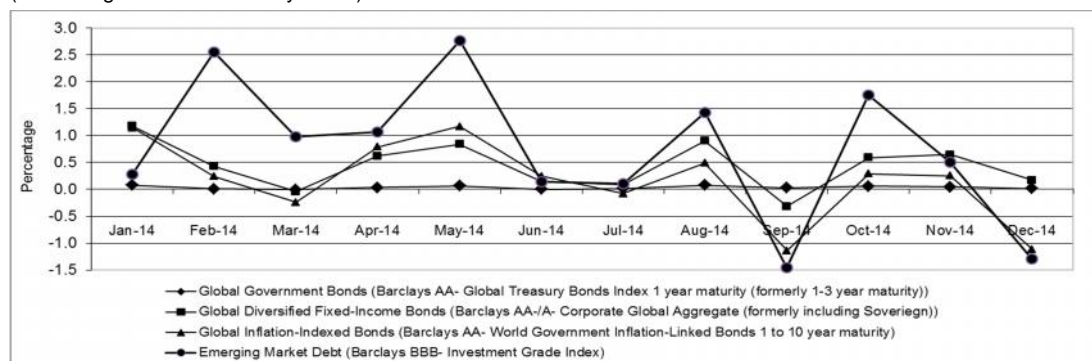
Chart 1
Central bank interest rates in 2014



Source: Bloomberg.

4. Chart 2 shows the monthly performance of benchmark indices applied to IFAD's externally managed asset classes in 2014.

Chart 2
Fixed-interest market developments in 2014
(Percentages in local currency terms)



Source: Barclays.

5. The global government bond asset class performed positively, with 2014 generally remaining a good year for fixed-income investors. Geopolitical tensions, global economic slowdown, continued support from central banks and renewed weakness in the euro zone dampened investors' risk appetite and fostered safe-haven investments. While the United States Federal Reserve completed its quantitative easing tapering programme, market sentiment remained contained as it was acknowledged that interest rates in the United States would remain low for some time.

6. The global diversified fixed-income asset class benefited from continued tightening of credit spreads, particularly in the investment grade space (IFAD's universe), responding to strong investor demand, continued central bank support and stabilizing economic data in the United States.
7. The global inflation-indexed asset class registered a positive performance, benefiting from the general appetite for fixed income rather than inflation pressure.
8. The emerging market debt bond asset class registered the strongest performance among IFAD's fixed-income asset classes. Although adverse market sentiment towards riskier assets, geopolitical tensions and fears of higher United States Treasury yields were present, they were more than offset by accommodative monetary policy action by a number of emerging market countries. The portfolio also benefited from having a hard currency mandate.
9. In 2014, the United States dollar appreciated against the euro (+14.16 per cent), the Japanese yen (+14.15 per cent) and the British pound sterling (+5.99 per cent). This resulted in large foreign exchange movements 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 in its liabilities and are therefore neutralized at the 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 IFAD's Investment Policy Statement (IPS) was presented and approved at the 113th session of the Executive Board in December 2014.
12. The main changes recommended in the 2014 IPS review related to consolidating the policy provisions by introducing a single credit rating floor for all asset classes, unless otherwise specified.

IV. Asset allocation

13. During 2014, the value of the investment portfolio in United States dollar terms decreased by US\$292.5 million. This was the result of net outflows of US\$237.0 million and foreign exchange movements of US\$104.2 million, which were slightly offset by positive investment income of US\$48.7 million.

Table 1

Movements affecting IFAD's asset allocation within the portfolio in 2014

(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>	Total
Opening balance (1 January 2014)	162 883	303 027	678 225	251 714	373 724	208 181	1 977 754
Net investment income ^b	95	4 918	3 049	14 276	7 629	18 808	48 775
Internal transfers	136 402	(11 402)	(125 000)	-	-	-	-
Transfers due to expense allocation	(3 282)	135	1 019	566	869	693	-
Net flows ^c	(236 999)	-	-	-	-	-	(236 999)
Foreign exchange movements	(3 252)	(15 929)	(42 061)	(12 398)	(26 921)	(3 685)	(104 246)
Closing balance (31 December 2014)	55 847	280 749	515 232	254 158	355 301	223 997	1 685 284
Actual asset allocation (percentage)	3.3	16.7	30.5	15.1	21.1	13.3	100.0
Investment asset allocation (percentage)	7.0	17.0	36.0	10.0	20.0	10.0	100.0
Difference in allocation (percentage)	(3.7)	(0.3)	(5.5)	5.1	1.1	3.3	-

^a Cash held with banks, readily available for disbursing loans, grants and administrative expenses.^b Investment income is detailed further in table 2.^c Net flows consist of outflows for disbursements for loans, grants and administrative expenses and inflows from loan reflows and encashment of Member State contributions.

14. Internal transfers during 2014 included the liquidation of US\$125.0 million from the global government bond portfolio and US\$11.4 million from the global strategic portfolio, to cover disbursement needs in the operational cash portfolio.

V. Investment income

15. Net investment income in 2014 amounted to US\$48.7 million, inclusive of all investment-related fees. Table 2 presents a summary of the 2014 investment income broken down by asset class.

Table 2

Breakdown of IFAD's investment income by asset class in 2014

(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>	Total
Interest from fixed-income investments and bank accounts	187	5 715	10 370	8 560	3 510	10 909	39 251
Realized market losses	-	-	(15 889)	(677)	(2 845)	(2 645)	(22 056)
Unrealized market gains	-	-	9 586	6 958	7 834	11 236	35 614
Amortization*	-	(663)	-	-	-	-	(663)
Investment income before fees	187	5 052	4 067	14 841	8 499	19 500	52 146
Investment manager fees	-	-	(678)	(437)	(661)	(581)	(2 357)
Custody and bank charges	(92)	(41)	(135)	(45)	(89)	(42)	(444)
Financial advisory and other investment-related fees	-	(93)	(205)	(83)	(120)	(69)	(570)
Investment income after fees	95	4 918	3 049	14 276	7 629	18 808	48 775

* 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

16. The rate of return on 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 together with annual performances versus benchmarks in 2014

(Percentages in local currency terms)

	2014 quarterly and annual performances and benchmarks						
	First quarter	Second quarter	Third quarter	Fourth quarter	Annual 2014	Benchmark 2014	Difference
Operational cash	0.04	0.06	0.01	0.01	0.11	0.11	-
Global strategic portfolio	0.51	0.43	0.43	0.42	1.80	1.44	0.36
Global government bonds	0.14	0.25	0.24	0.14	0.77	0.42	0.35
Global diversified fixed-income bonds	1.97	1.89	0.63	1.52	6.13	5.37	0.76
Global inflation-indexed bonds	1.26	2.45	(0.84)	(0.51)	2.35	2.05	0.30
Emerging market debt bonds	4.16	4.17	0.05	0.82	9.44	9.10	0.34
Gross rate of return	1.03	1.32	0.03	0.33	2.74	2.24	0.50
Net rate of return	0.99	1.28	(0.00)	0.29	2.58	2.08	0.50

17. The investment portfolio returned 2.58 per cent in 2014, net of all investment-related expenses, outperforming the benchmark equivalent by 50 basis points.

Table 4

IFAD's historical portfolio and benchmark performances

(Percentages in local currency terms)

	One year	Three years	Five years
Portfolio performance	2.58	1.51	2.32
Benchmark performance	2.08	1.35	2.23
Excess return	0.50	0.16	0.09

18. Table 4 presents IFAD's historical long-term portfolio performances, which have consistently outperformed the prescribed benchmarks.

VII. Composition of the portfolio by instrument

19. Table 5 shows the composition of the investment portfolio by instrument at 31 December 2013 and 2014.

Table 5

Composition of investment portfolio by instrument at 31 December 2013 and 2014
(Thousands of United States dollars equivalent)

	31 December 2013	31 December 2014
Cash ^a	183 056	82 217
Time deposits ^b	95 394	142 097
Global government bonds/government agencies	1 428 519	1 199 733
Government mortgage-backed securities (MBSs) ^c	23 705	18 082
Corporate bonds	244 299	245 893
Unrealized market (losses) on forward contracts	(3 297)	(2 594)
Unrealized gains on futures	11 914	941
Subtotal: cash and investments	1 983 590	1 686 369
Receivables for investments sold	3 197	-
Payables for investments purchased	(9 033)	(1 085)
Total	1 977 754	1 685 284

^a Includes cash in non-convertible currencies amounting to US\$48,000 equivalent (US\$46,000 in 2013).

^b Includes time deposits in non-convertible currencies amounting to US\$384,000 equivalent (US\$367,000 in 2013).

^c MBSs in IFAD's investment portfolio require an AAA rating by at least two credit rating agencies.

VIII. Risk measurements

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

A. Market risk: Duration

21. Duration is a measure of the sensitivity of the market price of a fixed-income investment to a change in interest rates. Duration is expressed in number of years. The longer the duration the more sensitive the bond's price is to movements of market interest rates. Thus a longer duration is normally associated with higher risk. IFAD assesses the optimal duration for each asset class in line with risk budget levels and the duration limits versus benchmarks set in IFAD's investment guidelines.

Table 6

Effective durations of IFAD's investment portfolio and benchmarks at 31 December 2013 and 2014
(Duration in number of years)

	31 December 2013		31 December 2014	
	Portfolio	Benchmark	Portfolio	Benchmark
Global government bonds	0.92	0.99	0.74	0.97
Global diversified fixed-income bonds	4.42	4.35	4.04	4.57
Global inflation-indexed bonds	5.42	5.11	5.40	5.19
Emerging market debt bonds	6.54	6.31	7.17	6.98
Total portfolio (including global strategic portfolio and operational cash)	2.59	2.44	2.93	2.54

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

22. The overall portfolio duration was 2.93 years (2.59 years in 2013), which is an overall conservative positioning.

B. Market risk: Conditional value at risk

23. 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 6.0 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\$60,000 in one year.

Table 7

CVaRs of IFAD's current asset classes at 31 December 2013 and 2014

(Confidence level at 95 per cent, percentages, based on historical simulations over five-year history)

	<i>Actual investment portfolio one-year CVaR</i>		<i>One-year CVaR IPS budget level</i>
	<i>31 December 2013</i>	<i>31 December 2014</i>	
Global government bonds	1.07	0.87	4.00
Global diversified fixed-income bonds	5.73	4.46	15.00
Global inflation-indexed bonds	6.87	5.74	9.00
Emerging market debt bonds	10.69	9.99	27.00
Total portfolio (including global strategic portfolio and operational cash)	2.76	2.56	6.00

24. The CVaRs of all single asset classes and that of the overall portfolio were below prescribed risk budget levels and lower than in the previous year.

C. Market risk: Ex ante tracking error

25. 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 benchmark (see table 3). For example, a one-year forward-looking ex ante tracking error of 0.2 per cent means that over the coming year the portfolio variance from the benchmark is expected to be in the range of +/- 0.2 per cent of the portfolio's mean value.

Table 8

IFAD's investment portfolio ex ante tracking error at 31 December 2013 and 2014

(Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>31 December 2013</i>	<i>31 December 2014</i>	
Global government bonds	0.37	0.40	1.50
Global diversified fixed-income bonds	0.94	0.52	3.00
Global inflation-indexed bonds	0.45	0.35	2.50
Emerging market debt bonds	1.19	0.73	4.00

26. Current levels of ex ante tracking error are below the prescribed budget levels, indicating a close resemblance between the portfolio strategy and the benchmark indices.

D. Credit risk: Credit rating analysis

27. IFAD's IPS establishes a credit rating floor for each 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 floor, procedures are in place to limit market losses through divestment.

Table 9

Investment portfolio compositions by credit ratings^a at 31 December 2014

(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	-	48 626	312 272	28 121	259 047	2 013	650 079	38.6
AA+/-	-	79 845	151 637	39 321	86 847	33 259	390 909	23.2
A+/-	-	10 049	33 661	184 951	9 424	35 718	273 803	16.2
BBB+/-	-	-	-	-	-	148 916	148 916	8.8
Cash ^b	55 847	517	17 716	3 061	2 225	4 176	83 542	5.0
P-1 (time deposits)	-	141 712	-	-	-	-	141 712	8.4
Pending sales and purchases ^c	-	-	(54)	(1 296)	(2 242)	(85)	(3 677)	(0.2)
Total 2014	55 847	280 749	515 232	254 158	355 301	223 997	1 685 284	100.0
Total 2013	162 883	303 027	678 225	251 714	373 724	208 181	1 977 754	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 these three agencies.

^b Consists of cash and cash equivalents with central banks and approved commercial 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

28. 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.
29. At 31 December 2014, 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\$1,837.3 million.

Table 10

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^b</i>	<i>Euro group^c</i>	<i>Yen</i>	<i>Pound sterling</i>	<i>Total</i>
Cash and investments ^a	852 019	537 133	105 636	190 064	1 684 852
Promissory notes	92 585	48 252	37 095	26 576	204 508
Contribution receivables from Member States	59 860	79 583	-	-	139 443
Less: commitments denominated in US dollars	(191 545)	-	-	-	(191 545)
Net asset amount	812 919	664 968	142 731	216 640	1 837 258
Net asset amount (percentage)	44.2	36.2	7.8	11.8	100.0
SDR weights (percentage)	45.7	35.4	7.0	11.9	100.0
Difference (percentage)	(1.5)	0.8	0.8	(0.1)	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\$432,000 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

30. IFAD's liquidity risk is addressed through the minimum liquidity requirement (MLR). IFAD's liquidity policy¹ together with the revised MLR for the Ninth Replenishment period (2013-2015) state 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.
31. IFAD's latest financial model assumptions, incorporating 2013 resources available for commitment under the sustainable cash flow approach, calculate an MLR of US\$608.0 million,² which is comfortably cleared by IFAD's investment portfolio balance of US\$1,685.3 million (see table 1).

¹ EB 2006/89/R.40.

² EB 2014/113/R.15./Rev.1.