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Investing in rural people

Report on IFAD's investment portfolio for the third quarter of 2015

Note to Executive Board representatives

Focal points:

Technical questions:

Michel Mordasini
Vice-President and Interim Head, FOD
Tel.: +39 06 5459 2518
e-mail: m.mordasini@ifad.org

Domenico Nardelli
Director and Treasurer
Treasury Services Division
Tel.: +39 06 5459 2251
e-mail: d.nardelli@ifad.org

Sadia Nabi
Risk and Compliance Officer
Financial Planning and Analysis Unit
Tel.: +39 06 5459 2910
e-mail: s.nabi@ifad.org

Dispatch of documentation:

Alessandra Zusi Bergés
Officer-in-Charge
Governing Bodies Office
Tel.: +39 06 5459 2092
e-mail: gb_office@ifad.org

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For: Information

Report on IFAD's investment portfolio for the third quarter of 2015

I. Executive summary

1. During the third quarter of 2015, the value of the investment portfolio in United States dollar terms decreased by US\$107.8 million, from US\$1,657.7 million at 30 June 2015 to US\$1,549.9 million at 30 September 2015. The main factors for this decrease were negative net flows,¹ negative investment income and negative foreign exchange movements (see section IV).
2. During the period, IFAD's investment portfolio performed negatively with a net rate of return of negative 0.30 per cent, translating into an investment loss of US\$4.8 million, net of all investment-related fees. On a year-to-date basis, the investment portfolio performance was negative 0.15 percent, compared to a benchmark performance of positive 0.15 per cent (see section VI).

II. Market conditions

3. The global government bond portfolio registered a positive performance of 0.11 per cent over the period. Overall global economic data were generally worse than expected, which boosted demand for safe haven assets. However, due to its short duration, the impact on the portfolio was limited.
4. The global credit portfolio had a positive return of 0.34 per cent, well supported by an upturn in global risk aversion and a reduction of lower-rated positions over the period, which proved very timely. On the interest rate side however, the portfolio maintained a short duration which affected performance with yields continuing to decline during the quarter.
5. The global inflation-indexed portfolio registered a negative performance of 0.79 per cent over the quarter, due to real yields rising and breakeven rates falling in IFAD's preferred investments.
6. The emerging market government bond portfolio returned negative 2.15 per cent over the period. Emerging markets faced a challenging environment in the quarter. Uncertainty surrounding the timing of an interest rate rise by the Federal Reserve, falling commodity prices, and concerns about the growth of emerging markets (particularly in China and Brazil) were among the confluence of risks leading to heightened market volatility.
7. The asset liability portfolio returned positive 1.02 per cent, mainly driven by the positions in some core European government bonds, which benefited from demand for safe haven assets.

III. Investment Policy Statement review

8. The latest annual review of IFAD's Investment Policy Statement (IPS) will be submitted for approval at the 116th session of the Executive Board in December 2015.
9. IFAD has performed an investment strategy analysis to reassess the adequacy of the current asset allocation with continued focus on mitigating the prospects of negative performance while supporting IFAD's growing demand for liquidity in the light of a forecasted increase in disbursements over the coming years.

¹ Net flows consist of outflows for disbursements for loans, grants and administrative expenses and inflows from loan reflows and encashment of Member States' contributions.

IV. Asset allocation

10. During the third quarter of 2015, the value of the investment portfolio in United States dollar terms decreased by US\$107.8 million. This was the result of net outflows of US\$97.5 million, a net investment loss of US\$4.8 million and negative foreign exchange movements of US\$5.5 million.

Table 1

Movements affecting the portfolio during the third quarter of 2015

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Global strategic portfolio</i>	<i>Asset liability portfolio</i>	<i>Global government bonds</i>	<i>Global credit portfolio</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt bonds</i>	<i>Total</i>
Opening balance								
(30 June 2015)	45 933	282 249	108 976	426 785	248 297	322 649	222 835	1 657 724
Net investment income ^b	(5)	1 009	987	298	734	(2 707)	(5 095)	(4 779)
Transfers due to allocation	100 225	(50 122)	(104)	-	-	(50 000)	-	(1)
Transfers due to expense allocation	(711)	27	4	190	140	171	179	-
Net flows ^c	(97 528)	0	1	-	-	(1)	1	(97 527)
Movements on exchange	(61)	(2 212)	308	(1 644)	(1 372)	(543)	20	(5 504)
Closing balance								
(30 September 2015)	47 853	230 951	110 172	425 629	247 799	269 569	217 940	1 549 913
Actual asset allocation (percentage)	3.1	14.9	7.1	27.4	16	17.4	14.1	100.0
Investment asset allocation (percentage)	6.5	15.8	7.1	33.4	9.3	18.6	9.3	100.0
Difference in allocation (percentage)	(3.4)	-0.9	-	(6.0)	6.7	(1.2)	4.8	-

^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 flows consist of outflows for disbursements for loans, grants and administrative expenses and inflows from loan reflows and encashment of Member States' contributions.

11. During the period, an amount of US\$50.1 million was transferred from the global strategic portfolio and US\$50.0 million from global inflation-indexed bonds into the operational cash portfolio to cover disbursement requirements.

V. Investment income

12. During the third quarter of 2015, the investment portfolio registered a loss of US\$4.8 million. Table 2 presents a summary of investment income broken down by portfolio.

Table 2

Breakdown of investment income by portfolio during the third quarter of 2015

(Thousands of United States dollars equivalent)

	Operational cash portfolio	Global strategic portfolio	Asset liability portfolio	Global government bonds	Global credit portfolio	Global inflation-indexed bonds	Emerging market debt bonds	Total investment portfolio
Interest from fixed-income investments and bank accounts	18	1 181	143	1 353	2 023	569	2 558	7 845
Realized market gains/(losses)	-	-	(72)	(2 663)	(1 546)	(695)	(2 089)	(7 065)
Unrealized market gains/(losses)	-	-	920	1 798	397	(2 410)	(5 385)	(4 680)
Amortization*	-	(145)	-	-	-	-	-	(145)
Investment income before fees	18	1 036	991	488	874	(2 536)	(4 916)	(4 045)
Investment manager fees	-	-	-	(127)	(113)	(140)	(155)	(535)
Custody fees/bank charges	(23)	(10)	(3)	(37)	(13)	(13)	(11)	(110)
Financial advisory a other investment-related fees	-	(17)	(1)	(26)	(14)	(18)	(13)	(89)
Investment income after fees	(5)	1 009	987	298	734	(2 707)	(5 095)	(4 779)

* 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

13. 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 with the special drawing rights (SDR) currency ratios (see section VII, E).
14. The investment portfolio generated a performance, net of all investment-related expenses, of negative 0.30 per cent during the third quarter of 2015, versus a benchmark of negative 0.20 per cent for the same period. The third quarter trend continues to illustrate the uncertainties and volatility in financial markets.

Table 3

First, second, and third quarter 2015: Portfolio performance versus benchmark together with year-to-date performances versus benchmarks

(Percentages in local currency terms)

	First quarter 2015		Second quarter 2015		Third quarter 2015		Year-to-Date 2015		
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Difference
Operational cash	0.04	0.04	0.04	0.04	0.03	0.03	0.11	0.11	0.00
Global strategic portfolio	0.41	0.33	0.42	0.24	0.44	0.27	1.28	0.85	0.43
Asset liability portfolio*	0.01	0.00	-1.91	0.11	1.02	0.08	1.02	0.08	0.94
Global government bonds	0.21	0.18	-0.39	0.06	0.11	0.12	-0.07	0.36	-0.43
Global credit portfolio	1.44	1.56	-1.25	-1.42	0.34	0.82	0.51	0.93	-0.42
Global inflation-indexed bonds	1.38	1.13	-0.53	-0.24	-0.79	-0.78	0.05	0.10	-0.05
Emerging market debt bonds	2.35	2.16	-1.93	-1.74	-2.15	-1.86	-1.78	-1.48	-0.31
Gross rate of return (excluding fees)	0.96	0.72	-0.72	-0.27	-0.25	-0.15	-0.01	0.29	-0.30
Net rate of return (including all fees)	0.91	0.67	-0.76	-0.32	-0.30	-0.20	-0.15	0.15	-0.30

* The asset liability portfolio was funded on 19 February 2015 and performance is shown from that date.

15. On a year-to-date basis, the investment portfolio performance was negative 0.15 per cent, compared to a benchmark performance of positive 0.15 per cent.
16. For comparative purposes, table 4 presents the annual performance results generated by the investment portfolio during the previous four years.

Table 4
Annual performance versus benchmark from 2011 to 2014 for comparative purposes
 (Percentages in local currency terms)

	2014		2013		2012		2011	
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark
Operational cash	0.11	0.11	0.07	0.07	0.12	0.12	0.56	0.56
Global strategic portfolio	1.80	1.44	2.13	1.94	3.41	2.94	2.91	3.56
Global government bonds	0.77	0.42	0.34	0.16	1.63	1.51	2.42	2.36
Global credit portfolio	6.13	5.37	(0.04)	(0.32)	4.31	3.46	7.28	7.67
Global inflation-indexed bonds	2.35	2.05	(4.23)	(3.99)	4.73	6.13	6.97	6.84
Emerging market debt bonds	9.44	9.10	(7.49)	(6.54)	6.01	4.83	n.a.	n.a.
Gross rate of return (excluding fees)	2.74	2.24	(0.95)	(0.83)	3.28	3.16	4.01	4.13
Net rate of return (including all fees)	2.58	2.08	(1.11)	(0.99)	3.11	2.99	3.82	3.94

Table 5
IFAD's historical portfolio and benchmark performances on a one-year rolling average
 (Percentages in local currency terms)

	One year	Three years	Five years
Net portfolio performance	0.14	0.62	1.58
Prescribed benchmark performance	0.33	0.55	1.58
Excess return	-0.19	0.07	0.00

17. Table 5 above presents IFAD's historical long-term net portfolio performances in comparison to the prescribed benchmarks.

VII. Risk measurements

18. 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 respectively below. In addition, other risk indicators are reported in subsections A, D, E and F.

A. Market risk: Duration

19. Duration is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. 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.

Table 6

IFAD's investment portfolio and benchmark effective duration as at 30 June 2015 and 30 September 2015

(Duration in number of years)

	30 June 2015		30 September 2015	
	Portfolio	Benchmark	Portfolio	Benchmark
Global government bonds	1.1	1.0	0.8	1.0
Global credit portfolio	4.1	4.6	4.2	4.6
Global inflation-indexed bonds	6.8	5.4	6.8	5.4
Emerging market debt bonds	6.9	6.7	6.6	6.5
Total portfolio (including global strategic, asset liability and operational cash portfolios)	3.7	2.9	3.6	3.0

Note: The total portfolio duration is lowered by the global strategic portfolio, which is held to maturity and therefore not subject to fluctuations in market prices, and by the the operational cash and the asset liability portfolios which was held in cash as at 31 March 2015.

20. The overall portfolio duration was 3.6 years, which is a conservative position and has moved only slightly from the previous quarter.

B. Market risk: Conditional value-at-risk

21. 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 5.0 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\$50,000 in one year.

Table 7

CVaR of current asset classes as at 30 June 2015 and 30 September 2015

(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
	30 June 2015	30 September 2015	
Global government bonds	0.9	0.9	4.0
Global credit portfolio	4.5	5.0	15.0
Global inflation-indexed bonds	7.5	7.4	9.0
Emerging market debt bonds	8.2	7.9	27.0
Total portfolio (including held-to-maturity bonds and asset liability and operational cash portfolios)	3.4	3.3	6.0

22. The CVaR of individual portfolios and of the overall portfolio were all below risk budget levels.

C. Market risk: Ex ante tracking error

23. 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 underperform 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 8
IFAD's investment portfolio ex ante tracking error as at 30 June 2015 and 30 September 2015
 (Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>30 June 2015</i>	<i>30 September 2015</i>	
Global government bonds	0.5	0.5	1.5
Global credit portfolio	0.9	0.7	3.0
Global inflation-indexed bonds	0.9	0.8	2.5
Emerging market debt bonds	0.6	0.8	4.0

24. 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

25. 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 9
Investment portfolio composition by credit ratings^a as at 30 September 2015
 (Thousands of United States dollars equivalent)

	<i>Operational cash portfolio</i>	<i>Global strategic portfolio</i>	<i>Asset liability portfolio</i>	<i>Global government bonds</i>	<i>Global credit portfolio</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt</i>	<i>Total</i>	<i>%</i>
AAA	-	105 090	15 642	269 983	15 243	199 509	2 200	607 667	39.2
AA+/-	-	71 713	38 882	107 218	30 413	54 683	48 906	351 815	22.7
A+/-	-	42 621	36 567	38 007	175 691	11 249	46 422	350 557	22.6
BBB+/-	-	459	6 887	-	24 608	-	114 827	146 781	9.5
Cash ^b	47 853	-	12 194	11 084	2 912	4 417	5 935	84 395	5.5
Time deposits	-	11 068	-	-	-	-	-	11 068	0.7
Pending sales and purchases ^c	-	-	-	(664)	(1 068)	(289)	(350)	(2 370)	(0.2)
Total	47 853	230 951	110 172	425 628	247 799	269 569	217 940	1 549 913	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 rating agencies Standard and Poor's (S&P), Moody's or Fitch. The global strategic portfolio is more conservative and reports the lowest credit rating of the three above-mentioned agencies.

^b Consists of cash equivalents, cash with central banks and corporate banks and cash held by external portfolio managers. These amounts are not rated by credit rating agencies.

^c Pending 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

26. The majority of IFAD's commitments pertain to undisbursed loans and grants and are expressed in SDR. 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.
27. At 30 September 2015, 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\$1,840.4 million.

Table 10

Currency composition of net assets in the form of cash, investments and other receivables

(Thousands of United States dollars equivalent)

	Currency				Total
	United States dollar group ^b	Euro group ^c	Yen	Pound sterling	
Cash and investments ^a	781 288	406 840	81 147	170 036	1 439 311
Promissory notes	62 985	-	24 757	25 818	113 560
Contribution receivables from Member States	234 956	178 395	49 284	-	462 635
Less: commitments denominated in US dollars	(176 064)	-	-	-	(176 064)
Net asset amount	904 165	585 235	155 188	19 854	1 840 442
Net asset amount (percentage)	49.2	31.8	8.4	10.6	100.0
SDR weights (percentage)	47.2	33.7	7.2	11.9	100.0
Difference (percentage)	2.0	(1.9)	1.2	(1.3)	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 (US\$471,420 equivalent) and the asset liability portfolio (US\$110.2 million equivalent). The latter is not subject to the SDR currency alignment as it is maintained in euros in line with its commitments for loans.

^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

28. IFAD's liquidity risk is addressed through the minimum liquidity requirement (MLR). IFAD's liquidity policy² 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.
29. IFAD's latest financial model assumptions, incorporating 2015 resources available for commitment under the sustainable cash flow approach, calculate an MLR of US\$680.0 million,³ which is comfortably cleared by IFAD's investment portfolio balance of US\$1,549.9 million (see table 1).

² EB 2006/89/R.40.

³ EB 2015/116/R.13