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Investing in rural people

Report on IFAD's investment portfolio for the third quarter of 2016

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For: Information

Report on IFAD's investment portfolio for the third quarter of 2016

I. Executive summary

1. During the third quarter of 2016, the value of the investment portfolio in United States dollar terms decreased by US\$98.2 million, from US\$1,518.3 million as at 30 June 2016 to US\$1,420.1 million as at 30 September 2016. The main factors for this decrease were net outflows partially offset by investment income and positive foreign exchange movements (see section II).
2. IFAD's investment portfolio generated US\$13.1 million of net investment income during the third quarter of 2016 and a year-to-date net investment income of US\$56.5 million (see section III).
3. The year-to-date net rate of return for IFAD's investment portfolio was 4.06 per cent excluding the asset liability portfolio (ALP) which follows an asset liability management strategy and is not a part of the strategic asset allocation. During the same period the ALP generated a gross rate of return of 2.44 per cent and the combined total net rate of return was 3.87 per cent (see section IV).

II. Asset allocation

4. During the third quarter of 2016, the value of the investment portfolio in United States dollar terms decreased by US\$98.2 million. This was the result of net outflows of US\$113.3 million partially offset by net investment income of US\$13.1 million and positive foreign exchange movements of US\$1.6 million.
5. In line with IFAD's Investment Policy Statement¹ (IPS), the policy asset allocation presented in table 1 reports the ALP separately. The exposure allocated to global developed market equities has not been implemented as market conditions did not provide an efficient entry point. Equities exposure has therefore been reallocated to the global government and global inflation-indexed portfolios.
6. During the period under review, US\$30.0 million and US\$100.0 million was transferred from the externally managed global government and emerging market debt portfolios to the internally managed global liquidity portfolio (GLP). This change lowered overall portfolio risk, reduced investment manager fees and made more funds available to readily cover disbursements.

Table 1

Movements affecting the asset allocation within the IFAD portfolio during the third quarter of 2016

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Global strategic</i>	<i>Global liquidity</i>	<i>Global government</i>	<i>Global credit</i>	<i>Global inflation-indexed</i>	<i>Emerging market debt</i>	Subtotal excluding asset liability portfolio	<i>Asset liability portfolio</i>	Total including asset liability portfolio
Opening balance (30 June 2016)	71 487	199 181	13 937	313 478	258 565	217 695	238 742	1 313 086	205 245	1 518 330
Net investment income	145	897	190	463	3 175	2 138	4 767	11 773	1 292	13 066
Transfers due to expense allocation	1	7	19	105	118	77	126	453	21	474
Net flows ^b	(45 773)	-	87 423	(30 091)	-	(25 000)	(100 000)	(113 441)	106	(113 335)
Exchange movements	(556)	(1 352)	-	529	405	78	209	(686)	2 299	1 613
Closing balance (30 September 2016)	25 304	198 733	101 568	284 484	262 263	194 988	143 844	1 211 185	208 963	1 420 148
Actual asset allocation (percentage)	2.09	16.41	8.39	23.49	21.65	16.10	11.88	100.00		
IPS policy asset allocation (percentage)	4.00	18.00	15.55	15.55	20.00	12.90	14.00	100.00		
Difference in allocation	(1.91)	(1.59)	(7.16)	7.94	1.65	3.20	(2.12)	0.0		

^a Cash held with banks, readily available for disbursing loans, grants and administrative expenses.

^b Net flows consist of outflows for portfolio transfers, disbursements for loans, grants, investment and administrative expenses, inter-fund portfolio transfers and inflows from loan reflows and encashment of Member States' contributions.

Note: Numbers in this report have been rounded up or down. There may therefore be discrepancies between the actual totals of the individual amounts in the tables and the totals shown as well as between the numbers in the tables and the numbers given in the corresponding analyses in the text of the annual report. All roundings, totals, percentage changes and key figures were calculated using the complete (un-rounded) underlying data.

¹ Investment Policy Statement: EB 2015/116/R.23.

III. Investment income

7. Year-to-date net investment income amounted to US\$56.5 million, inclusive of investment-related fees and income generated by the ALP. During the third quarter of 2016 the investment portfolio income was US\$13.1 million including US\$1.3 million from the ALP.

Table 2

Breakdown of investment income by asset class during the third quarter and year-to-date 2016

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic</i>	<i>Global liquidity</i>	<i>Global government</i>	<i>Global credit</i>	<i>Global inflation-indexed</i>	<i>Emerging market debt</i>	<i>Asset liability portfolio</i>	Third quarter 2016	Year-to-date 2016
Interest from investments and bank accounts	35	1 027	143	948	1 802	505	1 923	254	6 636	21 175
Realized market gains/(losses)	133	-	16	727	1 795	905	3 678	294	7 548	1 938
Unrealized market gains	-	-	49	(1 106)	(305)	805	(708)	765	(499)	35 861
Amortization*	-	(123)	-	-	-	-	-	-	(123)	(391)
Investment income before fees	169	904	208	568	3 292	2 215	4 893	1 313	13 563	58 583
Investment manager fees	-	-	-	(90)	(108)	(80)	(117)	-	(394)	(1 337)
Custody fees and bank charges	(24)	(10)	(9)	(34)	(14)	(11)	(10)	(11)	(122)	(358)
Financial advisory and investment related fees	-	2	(9)	19	4	12	1	(9)	20	(346)
Investment income after fees	145	897	190	463	3 175	2 138	4 767	1 292	13 066	56 541

Note: A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value for portfolios reported at amortized cost.

IV. Rate of return

8. 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 V, E).
9. The rates of return are independently calculated by IFAD's Global Custodian using the geometric average methodology that reflects the time weighting of income as prescribed by the CFA Institute's Global Investment Performance Standards (GIPS).
10. Excluding the ALP, IFAD's investment portfolio generated a performance net of investment-related expenses of 4.06 per cent during the first nine months of 2016, versus a benchmark of 3.34 per cent. The ALP generated a gross performance of 2.44 per cent versus a target rate of return of 0.17 per cent for the same period. As a result the net rate of return of the entire investment portfolio including ALP was 3.87 per cent.

Table 3
Year-to-date 2016 performances versus benchmarks with one year (historical) quarterly performances
 (Percentages in local currency terms)

	One year historical quarterly performances				Year-to-date performances as at 30 September 2016		
	Fourth quarter 2015	First quarter 2016	Second quarter 2016	Third quarter 2016	Actual	Benchmark ^b	Difference
Operational cash	0.02	0.06	0.09	0.47	0.62	0.62	0.00
Global strategic	0.46	0.44	0.45	0.46	1.36	0.74	0.63
Global liquidity	-	-	0.02	0.38	0.41	0.00	0.41
Global government	0.12	0.18	0.20	0.18	0.55	0.81	(0.26)
Global credit	0.65	1.80	1.70	1.26	4.84	5.16	(0.32)
Global inflation-indexed	(0.90)	2.73	1.99	1.15	5.98	5.25	0.73
Emerging market debt	0.62	4.68	4.00	2.50	11.59	10.55	1.04
Gross rate of return excluding ALP	0.14	1.70	1.48	0.97	4.21	3.49	0.72
Net rate of return excluding ALP	0.09	1.64	1.43	0.94	4.06	3.34	0.72
Asset liability portfolio ^b	0.10	1.22	0.53	0.62	2.44	0.17	2.26
Gross rate of return including ALP	0.13	1.65	1.38	0.93	4.01	n.a.	n.a.
Net rate of return including ALP	0.09	1.59	1.33	0.89	3.87	n.a.	n.a.

Note: Performances are gross of fees unless otherwise indicated.

^a The GLP was funded progressively from 17 May 2016 with performances reported from this date. The GLP benchmark is zero.

^b The ALP benchmark is a target rate of return which represents the cost of funding which does not reflect the investment universe allowed by the guidelines.

11. For comparative purposes, table 4 presents the annual performance of the investment portfolio during the previous four years.

Table 4
Annual performance versus benchmark from 2012 to 2015
 (Percentages in local currency terms)

	2015		2014		2013		2012	
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark
Operational cash	0.13	0.13	0.11	0.11	0.07	0.07	0.12	0.12
Global strategic portfolio	1.75	1.12	1.80	1.44	2.13	1.94	3.41	2.94
Global government bonds	0.05	0.43	0.77	0.42	0.34	0.16	1.63	1.51
Global credit portfolio	1.17	1.25	6.13	5.37	(0.04)	(0.32)	4.31	3.46
Global inflation-indexed bonds	(0.85)	(0.51)	2.35	2.05	(4.23)	(3.99)	4.73	6.13
Emerging market debt bonds	(1.17)	(0.86)	9.44	9.10	(7.49)	(6.54)	6.01	4.83
Gross rate of return excluding ALP	0.12	0.30						
Asset liability portfolio ^a	(0.78)	0.31						
Gross rate of return including ALP	0.13	0.35	2.74	2.24	(0.95)	(0.83)	3.28	3.16
Net rate of return including all fees	(0.06)	0.16	2.58	2.08	(1.11)	(0.99)	3.11	2.99

^a The ALP was funded on 19 February 2015 and performances are reported from this date. The ALP benchmark represents the cost of funding and does not reflect the investment universe allowed by the guidelines.

12. Table 5 presents IFAD's historical long-term net portfolio performances including the ALP.

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

	<i>One year</i>	<i>Three years</i>	<i>Five years</i>
Net portfolio performance (including ALP)	3.96	2.12	1.78

V. Risk measurements

13. 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. Other risk indicators are reported in subsections A, D, E and F.

A. Market risk: Duration

14. Duration is a measure of the sensitivity of the market price of a fixed-income investment to a change in interest rates. IFAD assesses the optimal duration for each asset class in line with risk budget levels and the benchmark duration limits set in IFAD's investment guidelines.

Table 6
Investment portfolio effective duration and benchmark as at 31 December 2015 and 30 September 2016
 (In number of years)

	<i>31 December 2015</i>		<i>30 September 2016</i>	
	<i>Portfolio</i>	<i>Benchmark</i>	<i>Portfolio</i>	<i>Benchmark</i>
Asset liability	2.75	n.a.	1.56	n.a.
Global liquidity	-	-	0.10	n.a.
Global government	0.83	0.95	0.70	1.00
Global credit	4.19	4.60	4.57	4.83
Global inflation-indexed	6.25	5.31	6.02	5.42
Emerging market debt	6.62	6.48	7.04	6.90
Total portfolio (including held-to-maturity bonds and cash portfolios)	3.49	2.85	3.05	3.05

Note: The total portfolio duration is lowered by the global strategic portfolio which is reported at amortized cost and not subject to fluctuations in market prices and by operational cash. The ALP and GLP are managed internally and have a zero duration benchmark.

15. The overall portfolio duration was 3.05 years as at 30 September 2016 (3.49 years as at 31 December 2015) which is an overall conservative positioning.

B. Market risk: Conditional value-at-risk

16. The one-year CVaR at 95 per cent is a measure of the potential average expected loss of a portfolio under extreme conditions. It gives an indication of how much value a portfolio could lose 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 concurrent adverse market condition scenarios.
17. The IFAD portfolio risk budget level maximum is defined in the IPS as a CVaR of 6.0 per cent. The CVaR for the current IFAD portfolio is 2.58 per cent which means that the average loss of the overall portfolio under extreme market conditions could be \$36.6 million.

Table 7

CVaR of current asset classes as at 31 December 2015 and 30 September 2016

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

<i>IFAD portfolios</i>	<i>Actual investment portfolio one-year CVaR</i>		<i>One-year CVaR IPS budget level</i>
	<i>31 December 2015</i>	<i>30 September 2016</i>	
Asset liability (excluding cash)	6.68	1.47	8.00
Global liquidity	-	1.96	n.a.
Global government	0.75	0.51	2.00
Global credit	4.93	4.92	15.00
Global inflation-indexed	7.15	6.19	9.00
Emerging market debt	7.89	8.00	27.00
Total portfolio (including held-to-maturity bonds and cash portfolios)	3.34	2.58	6.00

Note: The GLP portfolio was established in 2016 and the portfolio CVaR allocation is defined in the updated version of the IPS that will be submitted to the December 2016 session of the Executive Board.

18. The CVaR of single asset classes and of the overall portfolio were all below risk budget levels.

C. Market risk: Ex ante tracking error

19. The ex ante tracking error gives an indication of how different an active strategy is from its benchmark.

Table 8

IFAD's investment portfolio ex ante tracking error as at 31 December 2015 and 30 September 2016

(Percentages)

<i>IFAD portfolios</i>	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>31 December 2015</i>	<i>30 September 2016</i>	
Global government	0.38	0.31	1.50
Global credit	0.73	0.53	3.00
Global inflation-indexed	0.66	0.64	2.50
Emerging market debt	0.70	0.62	4.00

Note: The ALP does not have a benchmark as performance is tracked against the cost of funding. The portfolio tracking error is therefore not defined for this portfolio as it would not be representative of the actual portfolio universe allowed by the guidelines. Similarly the GLP has a benchmark of zero with no investment universe and consequently the portfolio tracking error is not reported.

20. The current levels of ex ante tracking errors of individual portfolios are below the prescribed budget levels indicating a close resemblance between the portfolio strategy and the benchmark indices.

D. Credit risk: Credit rating analysis

21. IFAD's IPS establishes a policy credit-rating floor. Credit risk is managed through the monitoring of securities in accordance with investment guidelines, which may foresee stricter credit quality requirements than those contained in the IPS. In addition to using rating agencies for credit guidance on individual securities and sector issues, the Treasury Services Division and the Risk and Compliance Function are undertaking systematic credit analysis as a means of safeguarding IFAD's investments.

Table 9

Investment portfolio composition by credit ratings^a as at 30 September 2016

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic</i>	<i>Global liquidity</i>	<i>Global government</i>	<i>Global credit</i>	<i>Global inflation-indexed</i>	<i>Emerging market debt</i>	<i>Asset liability portfolio</i>	Total amount	<i>Percentage</i>
AAA	-	69 321	89 689	185 696	32 246	155 048	-	-	531 999	37.5
AA+/-	-	80 022	5 008	88 116	62 945	35 077	32 523	58 442	362 133	25.5
A+/-	-	46 979	-	-	149 192	-	30 459	92 637	319 267	22.5
BBB+/-	-	503	-	-	25 112	-	79 321	55 383	160 318	11.3
Cash ^b	25 304	1 909	853	10 673	3 755	4 863	3 310	2 501	53 169	3.7
Pending sales and purchases ^c	-	-	6 018	-	(10 987)	-	(1 769)	-	(6 738)	(0.5)
Total	25 304	198 733	101 568	284 484	262 263	194 988	143 844	208 963	1 420 148	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.

^b Consists of cash equivalents, cash 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

22. 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.
23. At 30 September 2016, the net assets subject to SDR alignment amounted to US\$1,491.7 million as shown in table 10 below.
24. In anticipation of the rebalancing of the currency weights in the SDR basket expected with the introduction of the Chinese renminbi in October 2016, Management decided not to take action to correct the 9.13 per cent underweight in the euro currency. Preparatory steps are being made to execute investments in Chinese renminbi and the currency alignment situation will be re-evaluated following the introduction of the new SDR basket on 1 October, 2016.

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	727 194	294 630	58 441	130 493	1 210 758
Promissory notes	110 636	35 331	72 933	-	218 900
Contribution receivables from Member States	185 272	135 407	-	74 143	394 822
Less: commitments denominated in US dollars	(195 660)	(4 528)	-	-	(200 187)
Non SDR loans (committed)	(40 164)	(92 455)	-	-	(132 619)
Net asset amount	787 279	368 385	131 375	204 636	1 491 674
Net asset amount (percentage)	52.78	24.70	8.81	13.72	100.0
SDR weights (percentage)	47.29	33.82	8.58	10.31	100.0
Difference (percentage)	5.48	(9.13)	0.23	3.41	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 and the asset liability portfolio (US\$209.0 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

25. 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.
26. IFAD's latest financial model assumptions, incorporating 2015 resources available for commitment under the sustainable cash flow approach, calculate an MLR of US\$584.7 million (60 per cent of gross annual outflows),³ which is comfortably cleared by IFAD's investment portfolio balance of US\$1,420.1 million (see table 1).

² Liquidity policy: EB 2006/89/R.40.

³ Resources available for commitment: EB 2015/116/R.13.