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Investing in rural people

Report on IFAD's investment portfolio for 2016

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Report on IFAD's investment portfolio for 2016

I. Executive summary

1. In 2016, IFAD's investment portfolio generated a net rate of return of 2.91 per cent, translating into an investment income of US\$43.1 million.¹
2. The value of the investment portfolio in United States dollar terms decreased by US\$185.4 million from US\$1,513.7 million at 31 December 2015 to US\$1,328.3 million at 31 December 2016. The main factors underlying this decrease were net outflows and negative foreign exchange movements that were offset by investment income.

II. Market conditions

3. Market conditions were extremely challenging for fixed income in 2016. Accommodative monetary policies across developed markets kept government bond yields anchored at all-time lows. In addition, various changes to the political landscape in developed economies caused bouts of volatility. Consequently, the government bond asset class produced low, but positive, returns; however, these were constantly exposed to loss of value caused by momentary upward corrections in yields.
4. The low returns on government bonds drove investors to higher-yielding corporate and emerging market debt. Corporate debt was further bolstered by renewed optimism regarding the United States economy and continued central bank support, while emerging markets benefited from a recovery in commodity prices and improved market sentiment. Both asset classes generated strong returns for the year.
5. The recovery in commodity prices and better United States economic data also resulted in some reflation and consequently a strong performance for the global inflation-indexed asset class.

III. Asset allocation

6. During 2016, the value of the investment portfolio in United States dollar terms decreased by US\$185.4 million. This was the result of net outflows of US\$195.5 million and negative foreign exchange movements of US\$35.5 million, which were partially offset by net investment income of US\$43.1 million.
7. The emerging markets (EM) portfolio was significantly down ahead of the United States presidential elections and potential market turmoil. This tactical adjustment resulted in the realization of high returns and lower market risk in the overall portfolio.
8. A new global liquidity portfolio (GLP) was created in 2016 to manage liquidity more efficiently. The portfolio is invested in low-risk and highly liquid instruments and therefore generates a low and stable return. Following the inclusion of the Chinese renminbi in the special drawing right (SDR) currency composition,² a new dedicated Chinese renminbi portfolio (RMB) was created to facilitate SDR alignment and enhance returns.

¹ 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 (unrounded) underlying data.

² In November 2015, the International Monetary Fund decided that the Chinese renminbi would be included in the SDR basket, effective 1 October 2016 (www.imf.org/external/np/exr/facts/sdr.htm).

Table 1

Movements affecting IFAD's asset allocation within the portfolio in 2016

(Thousands of United States dollars equivalent)

	<i>Opera- tional cash^a</i>	<i>Global strategic portfolio</i>	<i>Global liquidity portfolio</i>	<i>Chinese renminbi portfolio</i>	<i>Global govern- ment bonds</i>	<i>Global credit bonds</i>	<i>Global inflation- indexed bonds</i>	<i>Emerging market bonds</i>	<i>Asset liability portfolio</i>	Total
Opening balance (31 December 2015)	55 999	212 575	-	-	364 399	246 873	263 221	218 758	151 839	1 513 665
Net investment income	243	3 359	308	95	1 531	7 403	8 849	17 556	3 711	43 056
Transfers due to expense allocation	3	114	46	3	611	580	464	628	116	2 564
Net flows ^b	(19 604)	(20 211)	52 923	21 000	(117 123)	-	(110 000)	(100 000)	97 540	(195 476)
Foreign exchange movements	(4 052)	(9 727)	-	(540)	(6 369)	(2 852)	(5 428)	(378)	(6 114)	(35 460)
Closing balance (31 December 2016)	32 587	186 110	53 278	20 558	243 048	252 004	157 105	136 564	247 092	1 328 346

^a Cash held with banks, readily available for disbursing loans, grants and administrative expenses.^b Net flows consist of outflows in respect of disbursements of loans, grants and administrative expenses and inflows from loan reflows and encashment of Member State contributions.**IV. Investment income**

9. Gross investment income in 2016 amounted to US\$45.7 million, while net investment income inclusive of all investment-related fees (US\$2.7 million) totalled US\$43.1 million. Table 2 presents a summary of 2016 investment income broken down by portfolio.

Table 2

Breakdown of IFAD's investment income by asset class in 2016

(Thousands of United States dollars equivalent)

	<i>Opera- tional cash</i>	<i>Global strategic portfolio</i>	<i>Global liquidity portfolio</i>	<i>Chinese renminbi portfolio</i>	<i>Global govern- ment bonds</i>	<i>Global credit bonds</i>	<i>Global inflation- indexed bonds</i>	<i>Emer- ging market bonds</i>	<i>Asset liability portfolio</i>	Total
Interest and coupon income	154	3 966	323	98	4 183	7 097	1 945	8 550	871	27 188
Realized market gains/(losses)	182	-	26	-	(1 108)	1 684	227	3 071	667	4 749
Unrealized market gains/(losses)	-	-	6	-	(934)	(798)	7 140	6 564	2 290	14 267
Amortization [*]	-	(493)	-	-	-	-	-	-	-	(493)
Investment income before fees	337	3 473	354	98	2 142	7 983	9 313	18 184	3 828	45 711
Investment manager fees	-	-	-	-	(375)	(426)	(351)	(507)	-	(1 658)
Custody fees	(3)	(38)	(28)	-	(124)	(54)	(41)	(42)	(44)	(375)
Bank charges	(91)	-	-	-	-	-	-	-	-	(91)
Advisory and other investment-related fees	-	(75)	(18)	(3)	(112)	(100)	(71)	(80)	(72)	(532)
Investment income after fees	243	3 359	308	95	1 531	7 403	8 849	17 556	3 711	43 056

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

V. Rate of return

10. 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 liabilities with the SDR currency ratios (see section VIII, E).
11. The rates of return are independently calculated by IFAD's Global Custodian using the geometric mean methodology, which reflects the time-weighting of flows as prescribed by the Chartered Financial Analyst (CFA) Institute's Global Investment Performance Standards (GIPS).
12. Excluding the asset liability portfolio (ALP), IFAD's investment portfolio generated a net return of 2.94 per cent for 2016, outperforming the benchmark of 2.39 per cent. The ALP generated a gross yield of 2.31 per cent versus a target rate of return of 0.23 per cent for the same period. The net rate of return for the entire investment portfolio, including the ALP, was 2.91 per cent.

Table 3

Quarterly gross^a performances together with annual performances versus benchmarks in 2016
(Percentages in local currency terms)

	2016 quarterly and annual performances and benchmarks						
	First quarter	Second quarter	Third quarter	Fourth quarter	Annual 2016	Benchmark 2016	Difference
Operational cash	0.06	0.09	0.47	0.06	0.30	0.30	-
Global strategic portfolio	0.44	0.45	0.46	0.46	1.83	0.95	0.88
Global liquidity portfolio ^a	-	0.02	0.38	0.21	0.62	0.00	0.62
Chinese renminbi portfolio ^a	-	-	-	-	0.48	0.00	0.48
Global government bonds	0.18	0.20	0.18	0.09	0.64	1.03	(0.39)
Global credit bonds	1.80	1.70	1.26	(1.54)	3.23	3.52	(0.29)
Global inflation-indexed bonds	2.73	1.99	1.15	(1.48)	4.41	4.37	0.04
Emerging market debt bonds	4.68	4.00	2.50	(4.27)	6.83	6.40	0.43
Gross rate of return excluding ALP	1.70	1.48	0.97	(1.02)	3.14	2.59	0.55
Net rate of return excluding ALP	1.64	1.43	0.94	(1.07)	2.94	2.39	0.55
Asset liability portfolio (ALP) ^b	1.22	0.53	0.62	(0.12)	2.31	0.23	2.08
Gross rate of return including ALP	1.65	1.38	0.93	(0.89)	3.09	n.a.	n.a.
Net rate of return including ALP	1.59	1.33	0.89	(0.93)	2.91	n.a.	n.a.

^a The global liquidity and Chinese renminbi portfolios were progressively funded from May and October 2016 respectively. Benchmarks for both portfolios are zero.

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

Table 4

IFAD portfolio performance rolling average as at 31 December 2016
(Percentages in local currency terms)

	One year	Three years	Five years
Portfolio performance	2.91	1.80	1.47

13. For comparative purposes, table 5 presents annual performances during the previous four years.

Table 5
Historical annual performances versus benchmarks
(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
Asset liability portfolio	(0.78)	0.31	-	-	-	-	-	-
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 fees)	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

VI. Composition of the portfolio by instrument

14. Table 6 shows the composition of the investment portfolio by instrument as at 31 December 2016, compared to IFAD's Investment Policy Statement (IPS) asset allocation.

Table 6
Investment portfolio by instrument as at 31 December 2016
(Millions of United States dollars equivalent)

	31 December 2016		IFAD's (%) IPS asset allocation ^b	Difference (%)
	Actual portfolio allocation (US\$)	Actual portfolio allocation (%)		
Cash ^a	97.5	7.3	-	7.3
Time deposits	20.6	1.5	-	1.5
Global government bonds/agencies	504.7	38.0	50.0	(12.0)
Corporate credit bonds	431.9	32.5	25.0	7.5
Global inflation-indexed	146.4	11.0	10.0	1.0
Emerging market debt	133.5	10.0	15.0	(5.0)
Pending trades	(6.2)	(0.5)	-	(0.5)
Total	1 328.3	100.0	100.0	0.0

^a Includes operational cash (US\$83.9 million) and various cash held in other portfolios that are pending reinvestment.

^b IFAD's IPS EB 2016/119/R.36.

VII. Risk measurements

15. The IPS risk-budgeting measures used 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

16. Duration is a measure of the sensitivity of the market price of a fixed-income investment to a change in interest rates.

Table 7

Effective durations of IFAD's investment portfolio and benchmarks

(Duration in number of years)

	31 December 2016		31 December 2015	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	1.57	0.00	2.75	0.00
Global liquidity portfolio	0.11	0.00	-	-
Renminbi portfolio	0.07	0.00	-	-
Global government bonds	0.57	1.00	0.83	0.95
Global credit bonds	4.50	4.82	4.19	4.60
Global inflation-indexed bonds	5.87	5.33	6.25	5.31
Emerging market debt bonds	5.97	6.57	6.62	6.48
Total portfolio (including global strategic portfolio and operational cash)	2.83	2.97	3.49	2.85

Note: The total portfolio duration is lowered by the global strategic portfolio, reported at amortized cost, and the operational cash portfolio, as neither is subject to market fluctuations. The asset liability, global liquidity and Chinese renminbi portfolios are managed internally and have a duration benchmark of zero.

17. The overall portfolio duration was 2.83 years (3.49 years in 2015) which is an overall conservative positioning.

B. Market risk: Conditional value at risk

18. The one-year CVaR at 95 per cent is a measure of the potential average probable loss of a portfolio under extreme conditions and 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.
19. The IFAD portfolio risk budget level maximum is defined in the IPS as a CVaR of 6.0 per cent. The CVaR for the overall IFAD portfolio is 2.71 per cent, which is well below the approved risk budget and lower than in 2015. The reduction of risk is the result of a management strategy of divesting from high-risk portfolios (global inflation-indexed and emerging markets portfolios) to fund disbursements and creation of the new global liquidity portfolio. The current CVaR risk level of 2.71 per cent means that the average loss of the overall portfolio under extreme market conditions could be US\$36.0 million.

Table 8

CVaRs of IFAD's asset classes at 31 December 2016 and 2015

(95 per cent confidence level ; percentages based on historical simulations over five-year history)

	Actual investment portfolio one-year CVaR		One-year CVaR IPS budget level
	31 December 2016	31 December 2015	
Asset liability portfolio	1.48	6.68	8.00
Global liquidity portfolio	2.25	-	2.00
Chinese renminbi portfolio	1.68	-	2.00
Global government bonds	0.34	0.75	2.00
Global credit bonds	4.86	4.93	7.00
Global inflation-indexed bonds	6.27	7.15	9.00
Emerging market debt bonds	9.58	7.89	15.00
Total portfolio (including global strategic portfolio and cash)	2.71	3.34	6.00

20. The CVaR for the overall investment portfolio was well below the prescribed risk-budget level and lower overall than in 2015.

C. Market risk: Ex ante tracking error

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

Table 9

IFAD's investment portfolio ex ante tracking error at 31 December 2016 and 2015 (Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>31 December 2016</i>	<i>31 December 2015</i>	
Global government bonds	0.29	0.38	1.50
Global credit bonds	0.50	0.73	3.00
Global inflation-indexed bonds	0.61	0.66	2.50
Emerging market debt bonds	0.64	0.70	4.00

Note: Although IFAD's IPS prescribes a tracking error risk-tolerance level, the asset liability portfolio does not have a benchmark universe based on investment guidelines; instead, performance is tracked against the cost of funding. Similarly the global liquidity and Chinese renminbi portfolios have a zero per cent benchmark. The portfolio tracking error is not reported, because the comparative benchmark is not representative of the actual portfolio universe allowed by the investment guidelines.

22. Current levels of ex ante tracking errors in individual portfolios are below the prescribed budget levels, thereby indicating a close resemblance between the portfolio strategy and the benchmark indices.

D. Credit risk: Credit rating analysis

23. IFAD's IPS establishes a policy credit rating floor, with credit risk managed by monitoring securities in accordance with investment guidelines, which may foresee stricter credit quality requirements than those contained in the IPS.

Table 10

Investment portfolio compositions by credit ratings^a at 31 December 2016 (Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic portfolio</i>	<i>Global liquidity portfolio</i>	<i>Chinese renminbi portfolio</i>	<i>Global government bonds</i>	<i>Global credit bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt</i>	<i>Asset liability portfolio</i>	<i>Total</i>	<i>Percent -age</i>
AAA	-	58 354	48 136	-	166 541	24 997	126 138	-	-	424 165	31.9
AA+/-	-	79 924	5 012	-	72 296	53 896	28 830	33 114	68 261	341 332	25.7
A+/-	-	46 883	-	-	-	151 868	-	26 886	82 830	308 467	23.2
BBB+/-	-	501	-	-	-	23 853	-	73 487	44 661	142 502	10.7
Cash ^b	32 587	448	130	-	4 211	3 551	2 138	3 077	51 340	97 482	7.3
Time deposit	-	-	-	20 558	-	-	-	-	-	20 558	1.5
Pending trades ^c	-	-	-	-	-	(6 160)	-	-	-	(6 160)	(0.5)
Total 2016	32 587	186 110	53 278	20 558	243 048	252 004	157 105	136 564	247 092	1 328 346	100.0
Total 2015	56 000	212 575	-	-	364 399	246 873	263 221	218 758	151 839	1 513 665	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.

^b Consists of cash and 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

24. 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 as its commitments, i.e. in SDR.
25. During 2016, IFAD's net asset position subject to the SDR currency composition was adjusted to reflect the inclusion of the Chinese renminbi and newly approved non-SDR loans (see table 11).
26. At 31 December 2016, the net asset value amounted to US\$1,123.2 million.

Table 11

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</i>	<i>Euro group</i>	<i>Chinese renminbi</i>	<i>Yen</i>	<i>Pound sterling</i>	<i>Total</i>
Cash and investments*	644 475	252 015	20 558	48 464	115 321	1 080 833
Promissory notes	133 181	52 605	-	63 322	23 508	272 617
Contribution receivables from Member States	220 807	121 667	-	-	47 019	389 493
Less: Non-SDR denominated loans	(268 934)	(121 054)	-	-	-	(389 988)
Less: commitments not denominated in SDR	(225 069)	(4 735)	-	-	-	(229 804)
Net asset amount	504 460	300 499	20 558	111 787	185 849	1 123 152
Net asset amount (percentage)	44.91	26.75	1.83	9.95	16.55	100.0
SDR weights (percentage)	43.34	30.32	10.89	7.58	7.86	100.0
Percentage difference	1.57	(3.57)	(9.06)	2.37	8.68	0.0

* The difference in the cash and investments balance compared with other tables derives from the exclusion of assets in non-convertible currencies (US\$416,000 equivalent) and the ALP (US\$247.1 million equivalent). The latter is not subject to the SDR currency alignment as it is maintained in euros in line with its commitments.

F. Liquidity risk: Minimum liquidity requirement

27. IFAD's latest financial model assumptions – incorporating 2016 resources available for commitment under the sustainable cash flow approach – calculate a minimum liquidity requirement of US\$582.5 million (60 per cent of gross annual outflows),³ which is comfortably cleared by IFAD's investment portfolio balance of US\$1,328.3 million (see table 1).

³ EB 2016/119/R.19.