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Investing in rural people

Report on IFAD's investment portfolio for the third quarter of 2017

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For: Information

Report on IFAD's investment portfolio for the third quarter of 2017

I. Executive summary

1. During the third quarter of 2017, IFAD's investment portfolio generated a net rate of return of 0.59 per cent with net investment income of US\$8.8 million.¹ Year-to-date, IFAD's investment portfolio has generated a net rate of return of 1.82 per cent.
2. The value of the investment portfolio in United States dollar terms decreased by US\$116.7 million from US\$1,516.4 million at 30 June 2017 to US\$1,399.7 million at 30 September 2017. The main factors underlying this decrease were net inflows of negative US\$150.3 million, net investment income of US\$8.8 million and foreign exchange movements of US\$24.5 million.
3. IFAD joined the World Bank's Reserves Advisory Management Program (RAMP) in the second quarter and subsequently funded the RAMP portfolio in the third quarter. This enabled IFAD to pool its supplementary resources together with a portion of the regular portfolio and have these funds managed by the World Bank. The investment mandate with the World Bank has limited duration exposure and minimal credit risk.

II. Market conditions

4. Economic data continued to surprise to the upside, with stable expansion and benign inflation backed by positive earnings releases. Government bond markets were relatively stable. However, equities and credit markets advanced as investor risk appetite increased. Consequently, credit and country spreads tightened.
5. Portfolios with the greatest sensitivity to spread-tightening, such as the global credit and emerging market debt portfolios, benefited the most from these market conditions.
6. The internally managed asset liability portfolio (ALP) continued to produce returns in excess of the interest rate on the loan.

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. All roundings, totals, percentage changes and key figures were calculated using the complete (unrounded) underlying data.

III. Portfolio allocation

7. During the third quarter of 2017, the value of the investment portfolio in United States dollar terms decreased by US\$116.7 million.

Table 1

Movements affecting the asset allocation within the IFAD portfolio during the third quarter of 2017

(Thousands of United States dollars equivalent)

	Operational cash ^a	Global strategic	Global liquidity	Chinese renminbi (RMB) portfolio	Global government	Global credit	Global inflation-indexed	Emerging market debt	Ramp portfolio ^b	Asset liability portfolio	Total
Opening balance (30 June 2017)	68 307	199 277	251 999	82 058	152 569	188 785	100 210	104 278	-	368 953	1 516 436
Net investment income	49	947	875	719	54	1 490	714	2 396	19	1 542	8 805
Transfers due to expense allocation	1	4	5	(2)	44	89	55	85	8	1	290
Net flows ^c	(28 494)	(4 010)	(63 965)	(1)	(55 010)	(40 013)	(10)	(9)	45 000	(3 832)	(150 345)
Foreign exchange movements	43	1 893	1	1 642	3 318	2 222	1 595	439	-	13 372	24 524
Closing balance (30 September 2017)	39 904	198 110	188 914	84 417	100 975	152 572	102 563	107 189	45 027	380 037	1 399 709

^a Cash held with banks, readily available for disbursing loans, grants and administrative expenses.^b The World Bank Reserves Advisory and Management Program (RAMP) portfolio was funded on 31/08/2017.^c 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.

IV. Investment income

8. Gross investment income for the third quarter of 2017 amounted to US\$9.1 million, with net investment income inclusive of all investment-related fees totalling US\$8.8 million. Year-to-date, net investment income amounted to US\$26.2.² Table 2 presents a summary of the third quarter 2017 investment income broken down by portfolio.

Table 2

Breakdown of investment income by asset class during the third quarter of 2017

(Thousands of United States dollars equivalent)

Investment income	Operational cash	Global strategic	Global liquidity	RMB portfolio	Global government	Global credit	Global inflation-indexed	Emerging market debt	Ramp portfolio	Asset liability portfolio	Total
Interest and coupon income	82	973	737	717	399	1 178	235	1 113	39	375	5 849
Realized market gains/(losses)	-	-	195	-	(1 012)	(129)	87	143	(1)	-	(716)
Unrealized market gains/(losses)	-	-	(53)	-	711	530	446	1 225	(11)	1 169	4 016
Amortization [*]	-	(22)	-	-	-	-	-	-	-	-	(22)
Investment income before fees	82	951	880	717	98	1 579	769	2 481	27	1 544	9 127
Investment manager fees	-	-	-	-	(37)	(80)	(49)	(79)	(10)	-	(254)
Custody fees	(1)	(10)	(11)	(1)	(10)	(13)	(10)	(9)	-	(12)	(77)
Bank charges	(32)	-	-	-	-	-	-	-	-	-	(32)
Advisory and other investment-related fees	5	6	6	3	3	5	3	3	1	11	46
Investment income after fees	53	947	875	719	54	1 490	714	2 396	19	1 542	8 809

* 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.

² The net income contains an estimate of external managers' fees.

V. Rate of return

9. 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 assets and liabilities with the special drawing right (SDR) currency ratios (see section VI.E below).
10. 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.
11. Excluding the ALP, IFAD's investment portfolio generated a net return of 0.66 per cent for the third quarter of 2017, outperforming the benchmark of 0.04 per cent. The ALP generated a gross return of 0.39 per cent versus a target rate of return of 0.05 per cent for the same period. The net rate of return for the entire investment portfolio, including the ALP, was 0.59 per cent.

Table 3

Quarterly performance for 2016, year-to-date 2017 and third quarter benchmarks

(Percentages in local currency terms)

	Quarterly performances in 2016				Quarterly performances in 2017				
	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Third quarter benchmark return	Difference
Operational cash	0.06	0.09	0.47	0.06	0.14	0.17	0.22	0.22	-
Global strategic portfolio	0.44	0.45	0.46	0.46	0.46	0.47	0.47	0.20	0.28
Global liquidity portfolio	-	0.02	0.38	0.21	0.31	0.35	0.41	-	0.41
Chinese renminbi portfolio	-	-	-	-	0.93	1.10	0.85	-	1.10
Global government bonds	0.18	0.20	0.18	0.09	(0.04)	(0.04)	0.10	0.36	(0.26)
Global credit bonds	1.80	1.70	1.26	(1.54)	0.95	1.10	0.81	0.89	(0.08)
Global inflation-indexed bonds	2.73	1.99	1.15	(1.48)	0.65	(0.21)	0.74	0.61	0.12
RAMP portfolio	n/a	n/a	n/a	n/a	n/a	n/a	0.08	0.07	0.01
Emerging market debt bonds	4.68	4.00	2.50	(4.27)	3.24	1.84	2.36	2.06	0.30
Gross rate of return excluding ALP	1.70	1.48	0.97	(1.02)	0.83	0.68	0.69	0.65	0.04
Net rate of return excluding ALP	1.64	1.43	0.94	(1.07)	0.78	0.63	0.66	0.62	0.04
Asset liability portfolio (ALP)	1.22	0.53	0.62	(0.12)	0.19	0.19	0.39	0.05	0.33
Gross rate of return including ALP	1.65	1.38	0.93	(0.89)	0.72	0.59	0.61	n.a.	n.a.
Net rate of return including ALP	1.59	1.33	0.89	(0.93)	0.67	0.55	0.59	n.a.	n.a.

Note: Performances are gross of fees unless otherwise indicated.

Table 4

IFAD's portfolio performances rolling average September 2017

(Percentages in local currency terms)

	One year	Three years	Five years
Net portfolio performance (including ALP)	0.88	1.64	1.33

Table 5
Historical annual performances versus benchmarks
 (Percentages in local currency terms)

	2016		2015		2014		2013	
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark
Operational cash	0.30	0.30	0.13	0.13	0.11	0.11	0.07	0.07
Global strategic portfolio	1.83	0.95	1.75	1.12	1.80	1.44	2.13	1.94
Asset liability portfolio	0.62	0.00	(0.78)	0.31	-	-	-	-
Chinese renminbi portfolio	0.48	0.00	-	-	-	-	-	-
Global government bonds	0.64	1.03	0.05	0.43	0.77	0.42	0.34	0.16
Global credit bonds	3.23	3.52	1.17	1.25	6.13	5.37	(0.04)	(0.32)
Global inflation-indexed bonds	4.41	4.37	(0.85)	(0.51)	2.35	2.05	(4.23)	(3.99)
Emerging market debt bonds	6.83	6.40	(1.17)	(0.86)	9.44	9.10	(7.49)	(6.54)
Gross rate of return (excluding fees)	3.09	n.a.	0.13	0.35	2.74	2.24	(0.95)	(0.83)
Net rate of return (including all fees)	2.91	n.a.	(0.06)	0.16	2.58	2.08	(1.11)	(0.99)

VI. Composition of the portfolio by instrument

12. Table 6 shows the composition of the investment portfolio by instrument as at 30 September 2017, compared with IFAD's Investment Policy Statement (IPS) asset allocation.

Table 6
Investment portfolio by instrument as at 30 September 2017
 (Thousands of United States dollars equivalent)

	30 September 2017		IFAD's (%) IPS asset allocation ^b	Difference (%)
	Actual portfolio allocation (%)	Actual portfolio allocation (US\$)		
Cash ^a	6.2	87 181	-	6.2
Time deposits	6.3	87 649	-	6.3
Global government bonds/agencies	38.9	544 441	50	(11.1)
Corporate credit bonds	34.6	483 769	25	9.6
Global inflation-indexed bonds	7.1	99 620	10	(2.9)
Emerging market debt bonds	7.5	105 672	15	(7.5)
Pending trades	(0.6)	(8 623)	-	(0.6)
Total	100	1 399 709	100	-

^a Includes operational cash (US\$68.3 million) and other cash held in investment portfolios pending reinvestment.

^b See EB 2016/119/R.36, IFAD's Investment Policy Statement, annex III.

VI I. 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.

Table 7

Effective durations of IFAD's investment portfolio and benchmarks

(Duration in number of years)

	30 September 2017		31 December 2016	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	1.82	0.00	1.57	0.00
Global liquidity portfolio	0.23	0.00	0.11	0.00
Chinese renminbi portfolio	0.13	0.00	0.07	0.00
Global government bonds	0.13	1.13	0.57	1.00
Global credit bonds	4.70	4.88	4.50	4.82
Global inflation-indexed bonds	5.89	5.38	5.87	5.33
Emerging market debt bonds	7.06	6.87	5.97	6.57
Ramp portfolio	0.53	0.00	n/a	n/a
Total portfolio (including global strategic portfolio and operational cash)	2.30	2.28	2.83	2.97

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 2.30 years as at 30 September 2017 (2.83 years as at 31 December 2016), 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 1.95 per cent which means that the average loss of the overall portfolio under extreme market conditions could be \$27.3 million.

Table 8

CVaRs of IFAD's asset classes

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

	Actual investment portfolio one-year CVaR		
	30 September 2017	31 December 2016	One-year CVaR IPS budget level
Asset liability portfolio	1.77	1.48	8.00
Global liquidity portfolio	1.47	2.25	2.00
Chinese renminbi portfolio	2.48	1.68	2.00
Global government bonds	0.99	0.34	2.00
Global credit bonds	4.77	4.86	7.00
Global inflation-indexed bonds	5.82	6.27	9.00
Emerging market debt bonds	8.67	9.58	15.00
Ramp portfolio	0.32	n/a	n/a
Total portfolio (including global strategic portfolio and cash)	1.95	2.71	6.00

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 is a measure of how closely a portfolio is expected to track its benchmark. A higher tracking error indicates larger expected deviations.

Table 9

IFAD's investment portfolio ex ante tracking error (Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>30 September 2017</i>	<i>31 December 2016</i>	
Global government bonds	0.58	0.29	1.50
Global credit bonds	0.58	0.50	3.00
Global inflation-indexed bonds	0.48	0.61	2.50
Emerging market debt bonds	0.49	0.64	4.00
Ramp portfolio	0.17	n/a	n/a

Note: Although IFAD's IPS prescribes a tracking error risk-tolerance level, the ALP 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 therefore not reported, because the comparative benchmark is not representative of the actual portfolio universe allowed by the investment guidelines.

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 (TRE) and the Risk and Compliance Function are undertaking systematic credit analysis as a means of safeguarding IFAD's investments.

Table 10

Investment portfolio composition by credit ratings^a as at 30 September 2017

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic</i>	<i>Global liquidity</i>	<i>RMB portfolio</i>	<i>Global government</i>	<i>Global credit</i>	<i>Global inflation-indexed</i>	<i>Emerging market debt</i>	<i>Ramp portfolio</i>	<i>Asset liability portfolio</i>	Total amount	%
AAA	-	67 775	122 931	-	75 344	13 461	80 959	-	-	38 792	399 263	28.5
AA+/-	-	68 297	65 219	-	23 394	19 109	18 661	13 750	23 983	3 515	235 928	16.9
A+/-	-	60 063	-	-	-	107 609	-	34 312	210 221	-	412 205	29.4
BBB+/-	-	503	-	-	-	14 860	-	57 611	113 133	-	186 107	13.3
Cash ^b	39 904	1 472	765	1 589	2 235	3 033	2 943	2 532	32 700	8	87 181	6.2
Bank deposits	-	-	-	82 828	-	-	-	-	-	4 821	87 649	6.3
Pending sales and purchases ^c	-	-	-	-	2	(5 500)	-	(1 016)	-	(2 109)	(8 623)	(0.6)
Total	39 904	198 110	188 914	84 417	100 975	152 572	102 563	107 189	380 037	45 027	1 399 709	100

^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, assets are maintained, to the extent possible, in the same currencies and ratios as commitments, i.e. in SDR.
23. At 30 September 2017, the net assets subject to SDR alignment amounted to US\$574.9 million as shown in table 11 below.

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>Chinese renminbi</i>	<i>Euro group</i>	<i>Pound sterling</i>	<i>Japanese yen</i>	<i>United States dollar group</i>	<i>Total</i>
Cash and investments*	84 417	144 272	90 471	26 312	674 274	1 019 745
Contribution receivables from Member States	-	84 313	49 032	-	117 236	250 581
Less: Non-SDR denominated loans	-	(37 943)	-	-	(592 829)	(630 772)
Promissory notes	-	18 907	24 515	40 227	65 792	149 441
Less: commitments not denominated in SDR	-	(5 211)	-	-	(208 896)	(214 108)
Net asset amount	84 417	204 338	164 017	66 538	55 576	574 887
Net asset amount (percentage)	14.68	35.54	28.53	11.57	9.67	100.0
SDR weights (percentage)	10.83	32.30	8.14	7.47	41.25	100.0
Percentage difference	3.86	3.24	20.39	4.10	(31.59)	0.0

* The difference in the cash and investments balance compared with other tables derives mostly from the exclusion of the ALP (US\$369.0 million equivalent). The latter is not subject to the SDR currency alignment as it is maintained in euros in line with commitments.

24. The notable underweight in United States dollars was primarily due to the approval of a single currency loan in September. This difference has since been corrected by TRE.

F. Liquidity risk: Minimum liquidity requirement

25. IFAD's liquidity risk is addressed through the minimum liquidity requirement (MLR). IFAD's liquidity policy³ 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 2017 resources available for commitment under the sustainable cash flow approach, calculate an MLR of US\$541.2 million (60 per cent of gross annual outflows),⁴ which is comfortably cleared by IFAD's investment portfolio balance of US\$1,399.7 million (see table 1).

³ Liquidity policy: EB 2006/89/R.40.

⁴ Resources available for commitment: EB 2016/119/R.19.