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Investing in rural people

Report on IFAD's investment portfolio for 2017

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For: Information

Report on IFAD's investment portfolio for 2017

I. Executive summary

1. In 2017, IFAD's investment portfolio generated a net rate of return of 2.21 per cent, translating into an investment income of US\$31.2 million.¹
2. The value of the investment portfolio in United States dollar terms increased by US\$19.7 million from US\$1,328.3 million at 31 December 2016 to US\$1,348.0 million at 31 December 2017. This was the result of positive foreign exchange movements of US\$73.5 million and net investment income of US\$31.2 million, which were partially offset by net outflows of US\$87.0 million.

II. Market conditions

3. Government bond yields rose across developed markets in 2017. US treasury yields rose as the Federal Reserve continued to raise its policy rate as growth and inflation gathered momentum. In Europe, the yield rise was less significant, as the European Central Bank's policy stance remained accommodative, thereby leaving the majority of European government bonds in negative territory.
4. As investor's risk appetite returned to the market, not only equities but also credit and emerging market debt, were well supported. Therefore, while yields on developed market government bonds rose, yields on emerging market debt and corporate bonds fell, benefiting the global credit and emerging market debt portfolios.

III. Asset allocation

5. Significant divestments were made from the externally managed emerging market debt portfolio, global credit bond portfolio, global inflation portfolio in a continued effort to reduce the risk profile of the investment portfolio. Divestments were used to expand the internally managed global liquidity portfolio.
6. IFAD joined the World Bank's RAMP (Reserves Advisory Management Programme) in 2017. The programme entails both external fund manager services and training provided by World Bank. As a result, US\$45 million of IFAD's regular investment portfolio, as well as US\$ 105 million supplementary funds, was managed externally by the World Bank.

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.

Table 1
Movements affecting IFAD's asset allocation within the portfolio in 2017
(Thousands of United States dollars equivalent)

	Opera- tional cash ^a	Global strategic portfolio	Global liquidity portfolio	Chinese renminbi portfolio	Global govern- ment bonds	Global credit bonds	Global infla- tion- index- ed bonds	Emerging market bonds	RAMP portfolio	Asset liability portfolio	Hedge portfolio	Total
Opening balance (31 Dec 2016)	32 587	186 110	53 278	20 558	243 048	252 004	157 105	136 564	-	247 092	-	1 328 346
Net investment income	299	3 538	2 178	2 566	(51)	7 459	2 526	9 565	83	3 020	-	31 184
Transfers due to expense	5	114	89	31	231	519	326	418	49	160	-	1 943
Net flows ^b	33 247	(20 576)	51 200	28 550	(151 581)	(115 047)	(64 035)	(40 036)	45 001	146 320	-	(86 959)
Foreign exchange movements	(976)	4 705	844	4 566	10 233	9 037	7 781	1 688	-	38 358	(2 708)	73 529
Closing balance (31 Dec 2017)	65 162	173 891	107 589	56 271	101 879	153 974	103 704	108 200	45 132	434 951	(2 708)	1 348 044

^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

7. Gross investment income in 2017 amounted to US\$33.3 million, while net investment income inclusive of all investment-related fees (US\$2.1 million) totalled US\$31.2 million. Table 2 presents a summary of 2017 investment income broken down by portfolio.

Table 2
Breakdown of IFAD's investment income by asset class in 2017
(Thousands of United States dollars equivalent)

	Opera- tional cash	Global stra- tegic port- folio	Global liquid- ity port- folio	Chi- nese ren- minbi port- folio	Global govern- ment bonds	Global credit bonds	Global infla- tion- inde- xed bonds	Emer- ging market bonds	RAMP port- folio	Asset Lia- bility Port- folio	Hed- ging Port- folio	Total
Investment income												
Interest and coupon income	429	3 769	2 130	2 597	1 593	5 763	1 244	4 967	132	1 357	-	23 979
Realized market gains/(losses)	39	-	234	-	(1 941)	199	1 441	390	(2)	905	-	1 263
Unrealized market gains/(losses)	-	-	(97)	-	529	2 017	168	4 627	2	920	-	8 165
Amortization	-	(116)	-	-	-	-	-	-	-	-	-	(116)
Investment income before fees	467	3 652	2 267	2 597	180	7 979	2 852	9 984	132	3 181	-	33 292
Investment manager fees	-	-	-	-	(135)	(376)	(230)	(331)	(43)	-	-	(1 115)
Custody fees	(5)	(38)	(41)	(4)	(40)	(50)	(38)	(39)	(1)	(46)	-	(303)
Bank charges	(163)	-	-	-	-	-	-	-	-	(1)	-	(164)
Advisory and other investment-related fees	-	(75)	(48)	(27)	(55)	(93)	(59)	(49)	(5)	(114)	-	(526)
Investment income after fees	299	3 538	2 178	2 566	(51)	7 459	2 526	9 565	83	3 020	-	31 184

^a 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

8. 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

special drawing right (SDR) currency ratios (see section VII.E below).

9. 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 Institute's Global Investment Performance Standards.
10. Excluding the asset liability portfolio (ALP), IFAD's investment portfolio generated a net return of 2.56 per cent for 2017, outperforming the benchmark of 2.08 per cent. The ALP generated a gross yield of 0.96 per cent versus a target rate of return of 0.22 per cent for the same period. The net rate of return for the entire investment portfolio, including the ALP, was 2.21 per cent.

Table 3

Quarterly gross performances together with annual performances versus benchmarks in 2017
(Percentages in local currency terms)

	2017 quarterly and annual performances and benchmarks						
	First quarter	Second quarter	Third quarter	Fourth quarter	Annual 2017	Benchmark 2017	Difference
Operational cash	0.14	0.17	0.22	0.26	0.79	0.79	-
Global strategic portfolio	0.46	0.47	0.47	0.51	1.92	0.80	1.12
Global liquidity portfolio	0.31	0.35	0.41	0.31	1.39	0.00	1.39
Chinese renminbi portfolio	0.93	1.10	0.85	0.79	3.72	0.00	3.72
Global government bonds	(0.04)	(0.04)	0.10	0.25	0.27	0.99	(0.72)
Global credit bonds	0.95	1.10	0.81	0.53	3.43	3.31	(0.12)
Global inflation-indexed bonds	0.65	(0.21)	0.74	0.67	1.86	1.53	0.33
RAMP portfolio	n/a	n/a	0.08	0.23	0.31	0.30	0.01
Emerging market debt bonds	3.24	1.84	2.36	0.78	8.45	7.64	0.81
Hedge portfolio				-	-	-	-
Gross rate of return excluding ALP	0.83	0.68	0.69	0.50	2.73	2.25	0.48
Net rate of return excluding ALP	0.78	0.63	0.66	0.46	2.56	2.08	0.48
Asset liability portfolio [*]	0.19	0.19	0.39	0.18	0.96	0.22	0.74
Gross rate of return including ALP	0.72	0.59	0.61	0.41	2.35	n.a.	n.a.
Net rate of return including ALP	0.67	0.55	0.59	0.37	2.21	n.a.	n.a.

^{*} 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 2017

(Percentages in local currency terms)

	One year	Three years	Five years
Portfolio performance	2.21	1.67	1.29

11. 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)

	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 31 December 2017, compared to IFAD's Investment Policy Statement (IPS) asset allocation.

Table 6
Investment portfolio by instrument as at 31 December 2017
(Millions of United States dollars equivalent)

	31 December 2017		IFAD's (%) IPS maximum allocation ^b
	Actual portfolio allocation (US\$)	Actual portfolio allocation (%)	
Cash ^a	123.3	9.1	-
Time deposit	58.2	4.3	-
Global government bonds/agencies	471.0	34.9	100.0
Global credit bonds	490.0	36.3	25.0
Global inflation-linked bonds	97.5	7.2	10.0
Emerging market debt bonds	108.0	8.0	15.0
Global developed market equities	-	-	10.0
Total	1 348.0	100.0	-

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

^b See IFAD's Investment Policy statement (EB 2017/122/R.31, annex III).

VII. Risk measurements

13. 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

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

Table 7

Effective durations of IFAD's investment portfolio and benchmarks

(Duration in number of years)

	31 December 2017		31 December 2016	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	1.27	0.00	1.57	0.00
Global liquidity portfolio	0.22	0.00	0.11	-
Chinese renminbi portfolio	0.06	0.00	0.07	-
Global government bonds	0.30	1.08	0.57	0.95
Global credit bonds	4.28	4.83	4.50	4.60
Global inflation-indexed bonds	5.62	5.32	5.87	5.31
RAMP portfolio	0.51	0.51	n.a.	n.a.
Emerging market debt bonds	7.07	6.92	5.97	6.48
Hedge portfolio	n.a.	n.a.	n.a.	n.a.
Total portfolio (including global strategic portfolio and operational cash)	2.23	2.30	2.83	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.

15. The overall portfolio duration was 2.23 years (2.83 years in 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 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.
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 overall IFAD portfolio is 1.77 per cent, which is well below the approved risk budget and lower than in 2016. 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 the creation of the new global liquidity portfolio. The current CVaR risk level of 1.77 per cent means that the average loss of the overall portfolio under extreme market conditions could be US\$23.9 million.

Table 8

CVaRs of IFAD's asset classes at 31 December 2017 and 2016

(95 per cent confidence level; 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 2017</i>	<i>31 December 2016</i>	
Asset liability portfolio	1.38	1.48	8.00
Global liquidity portfolio	1.46	2.25	2.00
Chinese renminbi portfolio	1.43	1.68	2.00
Global government bonds	0.60	0.34	2.00
Global credit bonds	4.13	4.86	7.00
Global inflation-indexed bonds	5.14	6.27	9.00
RAMP portfolio	0.39	n.a.	2.00
Emerging market debt bonds	8.04	9.58	15.00
Hedge portfolio	n.a.	n.a.	
Total portfolio (including global strategic portfolio and cash)	1.77	2.71	6.00

18. The CVaR for the overall investment portfolio was well below the prescribed risk-budget level and lower overall than in 2016.

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 at 31 December 2017 and 2016

(Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>31 December 2017</i>	<i>31 December 2016</i>	
Global government bonds	0.40	0.29	1.50
Global credit bonds	0.63	0.50	3.00
Global inflation-indexed bonds	0.36	0.61	2.50
Emerging market debt bonds	0.52	0.64	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.

20. 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

21. 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 2017

(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>RAMP portfolio</i>	<i>Asset liability portfolio</i>	<i>Hedge portfolio</i>	<i>Total</i>	<i>Percent -age</i>
AAA	-	33 789	61 687	-	77 225	12 444	79 783	-	40 313	-	-	305 241	22.6
AA+/-	-	68 477	45 142	-	23 098	21 058	20 959	15 071	4 792	24 357	-	222 955	16.5
A+/-	-	70 150	-	-	-	105 132	-	31 539	-	192 474	-	399 294	29.6
BBB+/-	-	501	-	-	-	13 403	-	60 030	-	158 829	-	232 762	17.3
Cash ^b	65 162	974	760	1	1 740	4 374	2 862	1 518	7	59 291	-	136 688	10.1
Time deposit	-	-	-	56 270	-	-	-	-	1 965	-	-	58 235	4.3
Pending trades ^c	-	-	-	-	(185)	(2 438)	100	43	(1 945)	-	(2 708)	(7 132)	(0.5)
Total 2017	65 162	173 891	107 589	56 271	101 879	153 974	103 704	108 200	45 132	434 951	(2 708)	1 348 044	100.0
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

^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, 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

22. 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.
23. During 2017, 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).
24. At 31 December 2017, the net asset value amounted to US\$455.3 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>Japanese yen</i>	<i>Pound sterling</i>	<i>Total</i>
Cash and investments*	786 199	115 473	56 271	(1 208)	(44 045)	912 689
Promissory notes	71 562	40 221	-	39 563	333	151 679
Contribution receivables from Member States	100 610	61 447	-	-	51 509	213 566
Less: Non-SDR denominated loans	(581 762)	(37 557)	-	-	-	(619 319)
Less: commitments not denominated in SDR	(198 543)	(4 771)	-	-	-	(203 314)
Net asset amount	178 065	174 812	56 271	38 355	7 797	455 300
Net asset amount (percentage)	39.11	38.39	12.36	8.42	1.71	100.0
SDR weights (percentage)	40.91	32.57	10.97	7.40	8.15	100.0
Percentage difference	(1.80)	5.83	1.39	1.02	(6.44)	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\$350,000 equivalent) and the ALP (US\$435.0 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

25. IFAD's latest financial model assumptions – incorporating 2017 resources available for commitment under the sustainable cash flow approach – calculate a minimum liquidity requirement of US\$533.6 million (60 per cent of gross annual outflows),² which is comfortably cleared by IFAD's investment portfolio balance of US\$1,348.0 million (see table 1).

² Resources available for commitment, EB 2016/119/R.19.