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Investing in rural people

Report on IFAD's Investment Portfolio for the First Semester of 2018

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For: Information

Report on IFAD's Investment Portfolio for the First Semester of 2018

I. Executive summary

1. The value of the investment portfolio in United States dollar terms decreased by US\$87.9 million from US\$1,348.0 million at 31 December 2017 to US\$1,260.2 million at 30 June 2018. The main factors underlying this decrease were net outflows of US\$63.7 million, a negative net investment income of US\$2.1 million and negative foreign exchange movements of US\$22.8 million.¹
2. Higher bond yields and wider credit spreads led to losses on the emerging market debt (EMD) and global credit portfolios.
3. Risk levels in the investment portfolio continued to decline as the EMD and global inflation portfolios were closed. This caused the conditional value at risk (CVaR) of the overall portfolio to decline from 1.8 to 0.9 per cent and duration levels to decline from 2.2 to 1.2 years. BBB rated debt made up only 12.5 per cent of the portfolio relative to 17.3 per cent at the beginning of the semester. It is envisaged that this number will decline to zero by year-end.
4. The currency composition of the investment portfolio remains closely aligned to that of IFAD's commitments, while the size of the portfolio comfortably exceeds the minimum liquidity requirement. The methodologies for both the currency composition and the minimum liquidity requirement are currently under review with the aim of aligning them with those used at other international financial institutions.

Table 1

Key portfolio changes during the last two semesters

	S2 2017	S1 2018
Portfolio size (US\$ '000)	1 348 044	1 260 183
Net investment income (US\$ '000)	13 790	(2.053)
Rate of return (%)	0.96	(0.14)
Duration	2.2	1.2
CVaR	1.77	0.92

II. Market conditions

5. Global bond yields rose as the Federal Reserve continued to implement tighter monetary policies. In addition, risk aversion that stemmed from a slowing global economy, geopolitical tensions and political turmoil in Europe pushed investors towards safe haven assets leading to wider credit spreads. The higher yields, combined with wider spreads caused IFAD's EMD and global credit portfolios to suffer losses, while short-duration and high-credit portfolios such as the global liquidity portfolio boasted strong returns.
6. Against this backdrop, the EMD and global inflation portfolios were closed. Both portfolios had significant interest rate risk, while the EMD portfolio also carried substantial credit risk. The portfolios were approximately US\$100 million in value each and proceeds of the divestment were subsequently reinvested in the global liquidity portfolio in July.

¹ 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 report. All roundings, totals, percentage changes and key figures were calculated using the complete (unrounded) underlying data.

III. Portfolio allocation

7. During the first semester of 2018, the value of the investment portfolio in United States dollar terms decreased by US\$87.9 million.

Table 2

Movements affecting IFAD's investment portfolio in the first semester of 2018

(Thousands of United States dollars)

	<i>Opera- tional cash^a</i>	<i>Global strategic portfolio</i>	<i>Global liquidity portfolio</i>	<i>Chinese renminbi (RMB) portfolio</i>	<i>Global govern- ment bonds</i>	<i>Global credit bonds</i>	<i>Global inflation- indexed</i>	<i>Emerging market debt</i>	<i>RAMP^c portfolio</i>	<i>Asset liability portfolio</i>	<i>Hedge portfolio</i>	<i>Grand total</i>
Opening 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
Net investment income	180	1 815	1 095	764	340	(1 772)	(5)	(3 499)	35	(1 006)	(1)	(2 053)
Transfers due to expense allocation	1	50	37	45	89	169	119	146	7	77	1	742
Net flows ^b	88 079	(4 538)	6 748	(57 837)	(20)	(23)	(101 935)	(19)	(45 174)	42 451	8 552	(63 716)
Foreign exchange movements	(1 327)	(631)	(1)	1 387	(1 506)	(1 750)	(1 876)	(485)	-	(15 110)	(1 537)	(22 834)
Closing balance (30 Jun 2018)	152 096	170 588	115 468	629	100 782	150 597	7	104 344	-	461 364	4 308	1 260 183

^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.

^c The World Bank's Reserves Advisory and Management Program (RAMP).

IV. Investment income

8. Gross investment income for the first semester of 2018 amounted to – US\$1.2 million, with net investment income inclusive of all investment-related fees totalling –US\$2.1 million. Table 3 presents a summary of the first semester 2018 investment income broken down by portfolio.

Table 3

Breakdown of IFAD's investment income by portfolio for the first semester of 2018

(Thousands of United States dollars equivalent)

<i>Investment income</i>	<i>Opera-tional cash</i>	<i>Global strategic portfolio</i>	<i>Global liquidity portfolio</i>	<i>Chinese RMB portfolio</i>	<i>Global govern-ment bonds</i>	<i>Global credit bonds</i>	<i>Global inflation-indexed</i>	<i>Emerging market bonds</i>	<i>RAMP portfolio</i>	<i>Asset liability portfolio</i>	<i>Hed-ging portfolio</i>	<i>Total</i>
Interest and coupon income	250	1 875	923	808	700	1 947	442	2 307	43	819	-	10 115
Realized market gains/(losses)	-	-	74	-	(236)	(999)	1 981	(4 059)	2	187	-	(3 050)
Unrealized market gains/(losses)	-	-	134	-	(35)	(2 551)	(2 309)	(1 601)	(2)	(1 935)	-	(8 298)
Amortization [*]	-	(9)	-	-	-	-	-	-	-	-	-	(9)
Investment income before fees	250	1 866	1 132	808	429	(1 603)	114	(3 353)	42	(928)	-	(1 242)
Investment manager fees	-	-	-	-	(51)	(118)	(75)	(109)	(3)	-	-	(355)
Custody fees	(1)	(19)	(21)	(3)	(20)	(23)	(19)	(19)	(1)	(26)	(1)	(153)
Bank charges	(68)	-	-	-	-	-	-	-	-	(1)	-	(69)
Advisory and other investment-related fees	-	(31)	(16)	(42)	(19)	(27)	(25)	(19)	(3)	(51)	-	(233)
Investment income after fees	180	1 815	1 095	764	340	(1 772)	(5)	(3 499)	35	(1 006)	(1)	(2 053)

^{*} 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

9. The rate of return on IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements, which are neutralized through the currency alignment of IFAD's assets and liabilities with special drawing right (SDR) currency ratios (see section VII.E).
10. Rates of return are independently calculated by IFAD's Global Custodian using the geometric mean methodology, which reflects time-weighting of flows.
11. Excluding the asset liability portfolio (ALP), IFAD's investment portfolio generated a positive net return of 0.16 per cent for the first semester of 2018, in line with the benchmark's return for the same period. The ALP generated a negative gross return of 0.01 per cent versus a target rate of return of -0.15 per cent for the same period. The net rate of return for the entire investment portfolio, including the ALP, was -0.14 per cent.

Table 4
Performances for 2017, first semester of 2018
 (Percentages in local currency terms)

	<i>Performances in 2017 by semester</i>		<i>Performance in 2018</i>		
	<i>First semester</i>	<i>Second semester</i>	<i>First semester</i>	<i>First semester benchmark return</i>	<i>Difference</i>
Operational cash	0.31	0.48	0.35	0.35	-
Global strategic portfolio	0.93	0.98	1.08	0.42	0.66
Global liquidity portfolio	0.66	0.72	0.91	-	0.91
Chinese RMB portfolio	2.03	1.64	1.46	-	1.46
Global government bonds	(0.08)	0.35	0.54	0.86	(0.32)
Global credit bonds	2.05	1.34	(1.05)	(0.53)	(0.52)
Global inflation-indexed bonds	0.44	1.41	0.16	0.39	(0.23)
RAMP portfolio	n/a	0.31	-	-	-
Emerging market debt bonds	5.08	3.14	(3.07)	(2.55)	(0.52)
Hedge portfolio	-	-	-	-	-
Gross rate of return excluding ALP	1.51	1.19	(0.01)	(0.15)	0.14
Net rate of return excluding ALP	1.41	1.12	(0.10)	(0.24)	0.14
ALP*	0.38	0.57	(0.19)	0.11	(0.29)
Gross rate of return including ALP	1.31	1.02	(0.08)	n.a.	n.a.
Net rate of return including ALP	1.22	0.96	(0.14)	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 5
IFAD portfolio performance rolling average as at 30 June 2018
 (Percentages in local currency terms)

	<i>One year</i>	<i>Three years</i>	<i>Five years</i>
Portfolio performance	0.83	1.58	1.57

12. For comparative purposes, table 6 presents annual performances during the previous four years.

Table 6
Historical annual performances versus benchmarks
 (Percentages in local currency terms)

	2017		2016		2015		2014	
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark
Operational cash	0.79	0.79	0.30	0.30	0.13	0.13	0.11	0.11
Global strategic portfolio	1.92	0.80	1.83	0.95	1.75	1.12	1.80	1.44
Asset liability portfolio	1.39	-	0.62	-	(0.78)	0.31	-	-
Chinese RMB portfolio	3.72	-	0.48	-	-	-	-	-
Global government bonds	0.27	0.99	0.64	1.03	0.05	0.43	0.77	0.42
Global credit bonds	3.43	3.31	3.23	3.52	1.17	1.25	6.13	5.37
Global inflation-indexed bonds	1.86	1.53	4.41	4.37	(0.85)	(0.51)	2.35	2.05
RAMP portfolio	0.31	0.30	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Emerging market debt bonds	8.45	7.64	6.83	6.40	(1.17)	(0.86)	9.44	9.10
Gross rate of return (excluding fees)	2.35	n.a.	3.09	n.a.	0.13	0.35	2.74	2.24
Net rate of return (including all fees)	2.21	n.a.	2.91	n.a.	(0.06)	0.16	2.58	2.08

VI. Composition of the portfolio by instrument

13. Table 7 shows the composition of the investment portfolio by instrument as at 30 June 2018, compared with IFAD's Investment Policy Statement (IPS) asset allocation.

Table 7
Investment portfolio by instrument as at 30 June 2018
 (Thousands of United States dollars equivalent)

	30 June 2018		IFAD's (%) IPS asset allocation ^b
	Actual portfolio allocation (US\$)	Actual portfolio allocation (%)	
Cash ^a	267 919	21.3	-
Time deposits	-	-	-
Global government bonds/agencies	540 460	42.9	50.0
Corporate credit bonds	544 002	43.2	25.0
Global inflation-indexed bonds	-	-	10.0
Emerging market debt bonds	-	-	15.0
Pending trades	(92 198)	(7.3)	-
Total	1 260 183	100.0	100.0

^aIncludes operational cash (US\$86.3 million) and other cash held in investment portfolios pending reinvestment.

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

VII. Risk measurements

14. The IPS risk-budgeting measures used are conditional value at risk and the ex ante tracking error. These are reported in subsections B and C. Other risk indicators are reported in subsections A, D, E and F.

A. Market risk: duration

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

Table 8

Effective durations of IFAD's investment portfolio and benchmarks

(Duration in number of years)

	30 June 2018		31 December 2017	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	0.90	-	1.27	-
Global liquidity portfolio	0.40	-	0.22	-
Chinese RMB portfolio	-	-	0.06	-
Global government bonds	0.40	0.90	0.30	1.08
Global credit bonds	4.20	4.70	4.28	4.83
Global inflation-indexed bonds	-	-	5.62	5.32
RAMP portfolio	n.a.	n.a.	0.51	0.51
Emerging market debt bonds	-	-	7.07	6.92
Total portfolio (including global strategic portfolio and operational cash)	1.20	0.63	2.23	2.30

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 RMB portfolios are managed internally and have a duration benchmark of zero. The global inflation-indexed and EMD portfolios were liquidated during the month of June 2018.

16. The overall portfolio duration was 1.20 years (2.23 years in December 2017).

B. Market risk: conditional value at risk

17. 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.
18. The IFAD portfolio risk budget level maximum is defined in the IPS as a CVaR of 6.0 per cent. CVaR for the overall IFAD portfolio was 0.92 per cent, which is well below the approved risk budget. The current CVaR risk level of 0.92 per cent means that the average loss of the overall portfolio under extreme market conditions could be US\$11.6 million.

Table 9

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		One-year CVaR IPS budget level
	30 June 2018	31 December 2017	
Asset liability portfolio	1.41	1.38	8.00
Global liquidity portfolio	1.05	1.46	2.00
Chinese RMB portfolio	-	1.43	2.00
Global government bonds	0.60	0.60	2.00
Global credit bonds	3.87	4.13	7.00
Global inflation-indexed bonds	-	5.14	9.00
RAMP portfolio	-	0.39	2.00
Emerging market debt bonds	-	8.04	15.00
Total portfolio (including global strategic portfolio and cash)	0.92	1.77	6.00

Note: Total portfolio CVaR is lowered by the global strategic portfolio, reported at amortized cost, and the operational cash portfolio, as neither is subject to market fluctuations.

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 10
IFAD's investment portfolio ex ante tracking error
 (Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>30 June 2018</i>	<i>31 December 2017</i>	
Global government bonds	0.32	0.40	1.50
Global credit bonds	0.33	0.63	3.00
Global inflation-indexed bonds	n.a	0.36	2.50
Emerging market debt bonds	n.a	0.52	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 therefore not reported, because the comparative benchmark is not representative of the actual portfolio universe allowed by the investment guidelines. Global inflation-indexed and EMD portfolios were liquidated during the month of June 2018.

20. Current levels of ex ante tracking errors in individual portfolios are all 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 by monitoring securities in accordance with investment guidelines, which may foresee stricter credit quality requirements than those contained in the IPS.

Table 11
Investment portfolio composition by credit ratings^a at 30 June 2018
 (Thousands of United States dollars equivalent)

	<i>Opera- tional cash</i>	<i>Global strategic portfolio</i>	<i>Global liquidity portfolio</i>	<i>Chinese RMB portfolio</i>	<i>Global govern- ment bonds</i>	<i>Global credit bonds</i>	<i>Global inflation- indexed bonds</i>	<i>Emerging market debt</i>	<i>Asset liability portfolio</i>	<i>Hedge portfolio</i>	<i>Total</i>	<i>%</i>
AAA	-	38 442	164 986	-	65 900	19 857	-	-	-	-	289 185	22.9
AA+/-	-	68 350	40 172	-	33 541	33 640	-	-	53 155	-	228 859	18.2
A+/-	-	63 384	-	-	-	97 087	-	-	248 984	-	409 455	32.5
BBB+/-	-	-	-	-	-	-	-	-	156 964	-	156 964	12.5
Cash ^b	152 096	411	(25)	629	1 344	2 661	7	104 369	2 261	4	263 759	20.9
Time deposit	-	-	-	-	-	-	-	-	-	-	-	-
Pending trades ^c	-	-	(89 666)	-	(3)	(2 648)	-	(26)	-	4 304	(88 038)	(7.0)
Total	152 096	170 588	115 468	629	100 782	150 597	7	104 344	461 364	4 308	1 260 183	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 credit-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 currency as its majority of commitments, that is, in SDR.
23. Starting with this report, a new template showing the currency composition of IFAD's assets and commitments is presented. The previous template only showed the assets subject to SDR realignment and excluded commitments in currencies other than SDR.

Table 12

Currency composition of assets and commitments as at 30 June 2018

(Thousands of United States dollars equivalent)

Category	Currency group					Grand total
	Chinese renminbi	Euro	Pound sterling	Japanese yen	United States dollar	
Assets						
Cash	-	13 612	5 082	53	132 903	151 651
Contribution receivables	-	103 912	25 120	-	134 478	263 510
Investments	629	88 651	37 595	10 969	504 651	642 495
Non-SDR loans outstanding amount	-	1 515	-	-	42 158	43 673
Promissory notes	-	-	25 118	26 647	40 912	92 676
SDR loans outstanding amount	770 520	2 261 906	566 591	540 561	2 917 541	7 057 119
Total assets	771 149	2 469 597	659 506	578 230	3 772 642	8 251 124
Commitments						
Non-SDR Debt Sustainability Framework (DSF) undisbursed amount	-	(26 153)	-	-	(161 431)	(187 585)
Non-SDR grants undisbursed amount	-	(5 334)	-	-	(126 345)	(131 679)
Non-SDR loans undisbursed amount	-	(83 740)	-	-	(1 250 728)	(1 334 468)
SDR DSF undisbursed amount	(76 834)	(225 551)	(56 499)	(53 903)	(290 929)	(703 715)
SDR grants undisbursed amount	(2 755)	(8 087)	(2 026)	(1 933)	(10 431)	(25 231)
SDR loans undisbursed amount	(222 633)	(653 552)	(163 710)	(156 189)	(842 991)	(2 039 075)
Total commitments	(302 222)	(1 002 417)	(222 235)	(212 025)	(2 682 854)	(4 421 752)
Hedging						
Currency forwards	-	(75 696)	-	-	80 000	4 304
Total hedging	-	(75 696)	-	-	80 000	4 304
Net	468 927	1 391 484	437 272	366 205	1 169 788	3 833 676
Net (percentage)	12.23	36.30	11.41	9.55	30.51	100.00
SDR weights (percentage)	10.92	32.05	8.03	7.66	41.34	100.00
Difference (percentage)	1.31	4.24	3.38	1.89	(10.83)	-
Difference amount	50 354	162 736	129 480	72 554	(415 123)	-

¹ The main difference in the cash and investments balance compared with other tables derives from the exclusion of assets in non-convertible currencies (US\$377,000 equivalent) and the ALP (US\$499.4 million equivalent). The latter is not subject to the SDR currency alignment as it is maintained in euro in line with its commitments. The residual marginal difference is due to the composition report being based on the unaudited figures available at the moment the report is run.

F. Liquidity risk: minimum liquidity requirement

24. 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\$1,260.2 million (see table 1).

² See EB 2016/119/R.19.