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## Report on IFAD's Investment Portfolio for the Third Quarter of 2018

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For: Information

# Report on IFAD's Investment Portfolio for the Third Quarter of 2018

## I. Executive summary

1. The value of IFAD's investment portfolio in United States dollar terms decreased by US\$122.1 million from US\$1,260.2 million as of 30 June 2018 to US\$1,138.1 million as of 30 September 2018. The main factors underlying this decrease were net outflows of US\$122.3 million, positive net investment income of US\$3.3 million and negative foreign exchange movements of US\$3.4 million.
2. Risk levels in the investment portfolio were stable. The conditional value at risk (CVaR) of the overall portfolio marginally increased from 0.92 to 0.97 as portfolio duration levels increased from 1.16 to 1.23. It is worth noting that BBB-rated debt made up only 1.9 per cent of the portfolio relative to 12.5 per cent at the beginning of the quarter. It is envisaged that this number will decline to zero by the year end.
3. The currency composition of the investment portfolio shows a disalignment between assets and commitments in United States dollars due to the rapidly increasing demand for loans denominated in that currency. 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 bringing them in line with those observed at other international financial institutions.

### Key portfolio changes during the third quarter

	Q2 2018	Q3 2018
Portfolio size (thousands of US\$)	1 260 183	1 138 065
Net investment income (thousands of US\$)	449	3 272
Rate of return (%)	0.05	0.26
Duration	1.16	1.23
CVaR	0.92	0.97

## II. Market conditions

4. Investor risk appetite returned to the market during the third quarter due to strong United States growth and employment data. This prompted the Federal Reserve to increase the funds rate further.
5. As the Federal Reserve continued its tightening cycle, short-term rates continued to rise. Floating rate notes, such as those held in the global liquidity portfolio, benefitted from these higher rates, leading to strong returns for the portfolio.
6. In addition, an increased risk appetite led to tighter credit spreads. Consequently, the global credit bonds and asset-liability portfolio produced positive returns.

## III. Portfolio allocation

7. During the third quarter of 2018, the value of IFAD's investment portfolio in United States dollar terms decreased by US\$122.1 million.

Table 1

### Movements affecting IFAD's investment portfolio during the third quarter of 2018

(Thousands of United States dollars equivalent)

	<i>Opera- tional cash<sup>a</sup></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>Asset liability portfolio</i>	<i>Hedge portfolio</i>	<i>Grand total</i>
<b>Opening balance (30 Jun 2018)</b>	<b>152 096</b>	<b>170 588</b>	<b>115 468</b>	<b>629</b>	<b>100 782</b>	<b>150 597</b>	<b>7</b>	<b>104 344</b>	<b>461 364</b>	<b>4 308</b>	<b>1 260 183</b>
Net investment income	157	905	1 525	(1)	296	239	-	37	115	-	3 272
Transfers due to expense allocation	1	28	39	1	37	84	1	-	65	-	257
Net flows <sup>b</sup>	(117 500)	(6 536)	123 987	(1)	(7)	(7)	(7)	(104 381)	(13 401)	(4 428)	(122 282)
Foreign exchange movements	(48)	(262)	-	(23)	(578)	(217)	-	-	(2 361)	124	(3 364)
<b>Closing balance (30 Sept. 2018)</b>	<b>34 704</b>	<b>164 722</b>	<b>241 018</b>	<b>605</b>	<b>100 531</b>	<b>150 696</b>	<b>1</b>	<b>-</b>	<b>445 782</b>	<b>4</b>	<b>1 138 065</b>

<sup>a</sup> Cash held with banks that is readily available for disbursing loans, grants and administrative expenses.

<sup>b</sup> 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 2018 amounted to US\$3.6 million, with net investment income inclusive of all investment-related fees totalling US\$3.3 million. Year-to-date net investment income amounted to US\$1.2 million. Table 2 presents a summary of the third quarter 2018 investment income broken down by portfolio.

Table 2

### Breakdown of investment income by portfolio during the third quarter 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>Asset liability portfolio</i>	<i>Hed- ging portfolio</i>	<i>Total</i>
Interest and coupon income	185	936	949	-	364	947	1	37	417	-	3 836
Realized market gains/(losses)	-	-	248	-	39	(284)	-	-	(50)	-	(47)
Unrealized market gains/(losses)	-	-	366	-	(69)	(340)	-	-	(186)	-	(229)
Amortization <sup>*</sup>	-	(4)	-	-	-	-	-	-	-	-	(4)
<b>Investment income before fees</b>	<b>185</b>	<b>933</b>	<b>1 563</b>	<b>-</b>	<b>333</b>	<b>324</b>	<b>1</b>	<b>37</b>	<b>180</b>	<b>-</b>	<b>3 556</b>
Investment manager fees	-	-	-	-	(28)	(68)	5	6	-	-	(85)
Custody fees	(1)	(6)	(8)	(1)	(7)	(7)	(6)	(7)	(9)	-	(52)
Bank charges	(28)	-	-	-	-	-	-	-	-	-	(28)
advisory and other investment-related fees	-	(21)	(31)	-	(2)	(9)	-	-	(56)	-	(120)
<b>Investment income after fees</b>	<b>157</b>	<b>905</b>	<b>1 525</b>	<b>(1)</b>	<b>296</b>	<b>239</b>	<b>-</b>	<b>37</b>	<b>115</b>	<b>-</b>	<b>3 272</b>

<sup>\*</sup>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.

## 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.
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 0.39 per cent during the third quarter of 2018, 22 basis points above the benchmark return for the same period. The ALP generated a positive gross return of 0.04 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 0.26 per cent.

Table 3  
**Quarterly performance for 2017, year to date 2018 and third-quarter benchmarks**  
(Percentages in local currency terms)

	Quarterly performances in 2017				Quarterly performance in 2018				
	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Third quarter benchmark return	Difference
Operational cash	0.14	0.17	0.22	0.26	0.19	0.16	0.29	0.29	-
Global strategic portfolio	0.46	0.47	0.47	0.51	0.53	0.55	0.56	0.21	0.35
Global liquidity portfolio	0.31	0.35	0.41	0.31	0.41	0.50	0.60	-	0.60
Chinese RMB portfolio	0.93	1.10	0.85	0.79	0.84	0.61	-	-	-
Global government bonds	(0.04)	(0.04)	0.10	0.25	0.18	0.36	0.33	0.43	(0.10)
Global credit bonds	0.95	1.10	0.81	0.53	(1.03)	(0.02)	0.22	0.44	(0.22)
Global inflation-indexed bonds	0.65	(0.21)	0.74	0.67	(0.47)	0.64	-	-	-
World Bank Reserves Advisory and Management Program (RAMP) portfolio	n/a	n/a	0.08	0.23	0.12	-	-	-	-
Emerging market debt bonds	3.24	1.84	2.36	0.78	(1.93)	(1.16)	-	-	-
Hedge portfolio	-	-	-	-	-	-	-	-	-
<b>Gross rate of return excluding ALP</b>	<b>0.83</b>	<b>0.68</b>	<b>0.69</b>	<b>0.50</b>	<b>(0.21)</b>	<b>0.21</b>	<b>0.43</b>	<b>0.20</b>	<b>0.23</b>
<b>Net rate of return excluding ALP</b>	<b>0.78</b>	<b>0.63</b>	<b>0.66</b>	<b>0.46</b>	<b>(0.26)</b>	<b>0.16</b>	<b>0.39</b>	<b>0.17</b>	<b>0.22</b>
<b>ALP*</b>	<b>0.19</b>	<b>0.19</b>	<b>0.39</b>	<b>0.18</b>	<b>(0.03)</b>	<b>(0.16)</b>	<b>0.04</b>	<b>0.05</b>	<b>(0.01)</b>
<b>Gross rate of return including ALP</b>	<b>0.72</b>	<b>0.59</b>	<b>0.61</b>	<b>0.41</b>	<b>(0.15)</b>	<b>0.08</b>	<b>0.28</b>	<b>n.a.</b>	<b>n.a.</b>
<b>Net rate of return including ALP</b>	<b>0.67</b>	<b>0.55</b>	<b>0.59</b>	<b>0.37</b>	<b>(0.19)</b>	<b>0.05</b>	<b>0.26</b>	<b>n.a.</b>	<b>n.a.</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's portfolio performance rolling average as of September 2018**  
(Percentages in local currency terms)

	One year	Three years	Five years
Net portfolio performance (including ALP)	0.49	1.77	1.54

Table 5  
**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
ALP	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
<b>Gross rate of return</b> (excluding fees)	<b>2.35</b>	<b>n.a.</b>	<b>3.09</b>	<b>n.a.</b>	<b>0.13</b>	<b>0.35</b>	<b>2.74</b>	<b>2.24</b>
<b>Net rate of return</b> (including all fees)	<b>2.21</b>	<b>n.a.</b>	<b>2.91</b>	<b>n.a.</b>	<b>(0.06)</b>	<b>0.16</b>	<b>2.58</b>	<b>2.08</b>

## VI. Composition of the portfolio by instrument

12. Table 6 shows the composition of the investment portfolio by instrument as of 30 September 2018, compared with IFAD's Investment Policy Statement (IPS) asset allocation.

Table 6  
**Investment portfolio by instrument as of 30 September 2018**  
(Thousands of United States dollars equivalent)

	30 September 2018		IFAD's (%) IPS asset allocation <sup>b</sup>
	Actual portfolio allocation (US\$)	Actual portfolio allocation (%)	
Cash <sup>a</sup>	72 753	6.4	-
Time deposits	-	-	-
Global government bonds/agencies	596 437	52.4	50.0
Global credit bonds	473 559	41.6	25.0
Global inflation-indexed bonds	-	-	10.0
Emerging market debt bonds	-	-	15.0
Pending trades	(4 684)	(0.4)	-
<b>Total</b>	<b>1 138 065</b>	<b>100.0</b>	<b>100.0</b>

<sup>a</sup> Includes operational cash (US\$34.6 million) and other cash held in investment portfolios pending reinvestment.

<sup>b</sup> See IFAD's Investment Policy Statement (EB 2017/122/R.31), annex III.

## VII. Risk measurement

13. The IPS risk-budgeting measures used are the CVaR and the ex-ante tracking error, which are reported in sub-sections B and C below. Other risk indicators are reported in sub-sections 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 2018		30 June 2018	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	0.89	-	0.95	-
Global liquidity portfolio	0.19	-	0.39	-
Chinese RMB portfolio	-	-	-	-
Global government bonds	0.29	0.89	0.41	0.91
Global credit bonds	4.33	4.68	4.18	4.68
<b>Total portfolio</b> (including global strategic portfolio and operational cash)	<b>1.23</b>	<b>1.29</b>	<b>1.16</b>	<b>1.22</b>

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

15. The overall portfolio duration was 1.23 years as of 30 September 2018 (1.16 years as of 30 June 2018), 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. It provides an indication of how much value a portfolio could lose over a forward-looking one-year horizon with a confidence level of 95 per cent.
17. The IFAD portfolio risk budget level maximum is defined in the IPS as a CVaR of 6 per cent. The CVaR for the overall IFAD portfolio was 0.97 per cent, which is well below the approved risk budget. The current CVaR risk level of 0.97 per cent means that the average loss of the overall portfolio under extreme market conditions could be US\$11 million.

Table 8

#### CVaRs of IFAD's asset classes

(95 per cent confidence level: percentages based on historical simulations five-years)

	Actual investment portfolio one-year CVaR		One-year CVaR IPS budget level
	30 September 2018	30 June 2018	
ALP	1.37	1.41	8.00
Global liquidity portfolio	0.48	1.05	2.00
Chinese RMB portfolio	-	-	2.00
Global government bonds	0.87	0.60	2.00
Global credit bonds	3.84	3.87	7.00
RAMP portfolio	-	-	2.00
<b>Total portfolio</b> (including global strategic portfolio and cash)	<b>0.97</b>	<b>0.92</b>	<b>6.00</b>

18. The CVaR of single asset classes and 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>30 September 2018</i>	<i>30 June 2018</i>	<i>IPS budget level</i>
Global government bonds	0.43	0.32	1.50
Global credit bonds	0.27	0.33	3.00

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 RMB 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 for 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 described 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 Management Unit are undertaking systematic credit analysis as a means of safeguarding IFAD's investments.

Table 10

#### Investment portfolio composition by credit rating<sup>a</sup> as of 30 September 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>Asset liability portfolio</i>	<i>Hedge portfolio</i>	<i>Total</i>	<i>%</i>
AAA	-	58 451	179 551	-	58 731	17 388	-	-	-	314 121	27.60
AA+/-	-	54 538	40 190	-	40 815	36 909	-	103 907	-	276 358	24.28
A+/-	-	51 159	-	-	-	97 127	-	309 724	-	458 010	40.24
BBB+/-	-	-	-	-	-	-	-	21 508	-	21 508	1.89
Cash <sup>b</sup>	34 704	575	21 278	605	986	3 957	1	10 643	4	72 753	6.39
Time deposit	-	-	-	-	-	-	-	-	-	-	-
Pending trades <sup>c</sup>	-	-	-	-	-	(4 684)	-	-	-	(4 684)	(0.41)
<b>Total</b>	<b>34 704</b>	<b>164 722</b>	<b>241 018</b>	<b>605</b>	<b>100 531</b>	<b>150 696</b>	<b>1</b>	<b>445 782</b>	<b>4</b>	<b>1 138 065</b>	<b>100.00</b>

<sup>a</sup> 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 and Fitch.

<sup>b</sup> 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.

<sup>c</sup> 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 protect IFAD's balance sheet against currency fluctuations, the Fund's assets are maintained in the same currencies as the majority of its commitments whenever possible – that is, in special drawing rights and United States dollars. However, this methodology is currently under review.

Table 11

### Currency composition of net assets in the form of cash, investments and other receivables

(Thousands of United States dollars equivalent)

Category	Currency group					Grand total
	Chinese renminbi	Euro	Pound sterling	Japanese yen	United States dollar	
<b>Assets</b>						
Cash	-	8 169	991	52	25 062	34 273
Contribution receivables	79 421	319 212	85 828	56 151	198 136	738 748
Investments <sup>*</sup>	605	90 567	38 130	10 192	518 160	657 654
Non-SDR loans outstanding amount	-	1 507	-	-	49 610	51 117
Promissory notes	-	-	24 810	25 985	48 412	99 207
SDR loans outstanding amount	748 721	2 266 984	567 598	531 096	2 951 323	7 065 723
<b>Total assets</b>	<b>828 748</b>	<b>2 686 438</b>	<b>717 357</b>	<b>623 477</b>	<b>3 790 702</b>	<b>8 646 722</b>
<b>Commitments</b>						
Non-SDR Debt Sustainability Framework (DSF) undisbursed amount	-	(25 785)	-	-	(160 266)	(186 051)
Non-SDR grants undisbursed amount	-	(4 839)	-	-	(111 845)	(116 683)
Non-SDR loans undisbursed amount	-	(77 995)	-	-	(1 252 069)	(1 330 064)
SDR DSF undisbursed amount	(70 202)	(212 559)	(53 220)	(49 797)	(276 724)	(662 501)
SDR grants undisbursed amount	(2 555)	(7 735)	(1 937)	(1 812)	(10 070)	(24 108)
SDR loans undisbursed amount	(200 562)	(607 262)	(152 044)	(142 266)	(790 577)	(1 892 711)
<b>Total commitments</b>	<b>(273 318)</b>	<b>(936 174)</b>	<b>(207 200)</b>	<b>(193 875)</b>	<b>(2 601 551)</b>	<b>(4 212 118)</b>
<b>Hedging</b>						
Currency forwards	-	-	-	-	-	-
<b>Total hedging</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net</b>	<b>555 430</b>	<b>1 750 264</b>	<b>510 157</b>	<b>429 602</b>	<b>1 189 151</b>	<b>4 434 604</b>
Net (percentage)	12.52	39.47	11.50	9.69	26.82	100.00
SDR weights (percentage)	10.60	32.08	8.03	7.52	41.77	100.00
<b>Difference (percentage)</b>	<b>1.93</b>	<b>7.38</b>	<b>3.47</b>	<b>2.17</b>	<b>(14.95)</b>	<b>-</b>
<b>Difference amount</b>	<b>85 516</b>	<b>327 455</b>	<b>153 920</b>	<b>96 274</b>	<b>(663 165)</b>	<b>-</b>

\* The difference in the cash and investments balance compared with other tables is derived mostly from the exclusion of the ALP (US\$446 million equivalent). The latter is not subject to the SDR currency alignment since it is maintained in euros in line with commitments.

23. The notable underweight in United States dollars was primarily due to the approval of single-currency loans during the past 12 months. Since most of these newly approved loans are not yet disbursable (US\$870 million), the current stock of United States dollar assets is sufficient to satisfy the requests of the disbursements in that currency in the short to medium term.

## F. Liquidity risk: Minimum liquidity requirement

24. IFAD's latest financial model assumptions – incorporating 2018 resources available for commitment using the sustainable cash flow approach – calculate a minimum liquidity requirement of US\$534 million (60 per cent of gross annual outflows),<sup>1</sup> which is comfortably cleared by IFAD's investment portfolio balance of US\$1,138.1 million (see table 1).

<sup>1</sup> See EB 2017/122/R.5.