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Enabling poor rural people
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Report on IFAD's investment portfolio for the first two months of 2008

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Report on IFAD's investment portfolio for the first two months of 2008

I. Executive summary

1. IFAD's investment portfolio performed positively during the first two months of 2008 with a net investment rate of return for the period of 2.20 per cent compared with a target rate of return for the period of 0.58 per cent (equivalent to 3.50 per cent on a yearly basis). The net investment income for the period amounts to US$55,087,000 equivalent. IFAD's prudent investment policy and high-quality instruments in the portfolio secured it against the continued high volatility in the overall financial markets.

2. During the period, the value of the investment portfolio increased in United States dollar terms by US$105,906,000 equivalent, from US$2,501,060,000 equivalent to US$2,606,966,000 equivalent. The main contributors to this growth were net investment income and foreign exchange movements.

II. Introduction

3. This report on IFAD's investment portfolio covers the first two months of 2008 and consists of five sections: asset allocation, investment income, rate of return and performance comparison, liquidity level and risk management. Since the final data relating to March 2008 will only become available after finalization of this report, information on the entire first quarter of 2008 covering performance attribution, currency composition and risk measurement will be presented as an annex to the report on the second quarter of 2008.

III. Asset allocation

4. Table 1 shows the movements affecting the investment portfolio's major asset classes during the first two months of 2008 and compares the portfolio's asset allocation with the investment policy allocation.

5. At the end of January 2008, an amount of approximately US$18,000,000 equivalent was invested in commercial papers. The proceeds were partially funded by transfers from the operational cash portfolio and by coupons matured in the held-to-maturity portfolio.

6. During the period, there was a net disbursement of about US$842,000 equivalent from the internally managed operational cash portfolio, representing disbursements for loans, grants and administrative expenses, net of cash receipts and encashment of Member States' contributions.

7. The investment portfolio increased to US$2,606,966,000 equivalent. This is due to the combined effect of the net investment income of US$55,087,000 equivalent and the positive foreign exchange movements of US$51,661,000 equivalent, which offset the net disbursement outflows.

Table 1
Movements in cash and investments by portfolio, first two months of 2008
(Thousands of United States dollars equivalent)

	Operational cash[a]	*Short-term tactical instruments*[b]	*Held-to-maturity*	*Government bonds*	*Diversified fixed-interest bonds*	*Inflation-indexed bonds*	*Total*
Opening balance (1 January 2008)	**169 519**	**40 351**	**427 968**	**1 067 800**	**425 185**	**370 237**	**2 501 060**
Net investment income	1 112	235	3 075	29 318	8 889	12 458	55 087
Transfers due to allocation	(15 018)	18 304	(3 286)	-	-	-	-
Transfers due to expenses	81	(7)	(119)	(13)	21	37	-
Net disbursements[c]	(842)	-	-	-	-	-	(842)
Movements on exchange	2 757	1 572	6 921	21 946	13	18 452	51 661
Closing balance (29 February 2008)	**157 609**	**60 455**	**434 559**	**1 119 051**	**434 108**	**401 184**	**2 606 966**
Actual asset allocation	6.0%	2.3%	16.7%	42.9%	16.7%	15.4%	100.0%
Investment policy asset allocation[d]	5.5%	-	16.7%	43.1%	14.7%	20.0%	100.0%
Difference in asset allocation	**0.5%**	**2.3%**	**-**	**(0.2)%**	**2.0%**	**(4.6)%**	**-**

[a] Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.
[b] Short-term instruments (time deposits and commercial papers).
[c] Disbursements for loans, grants and administrative expenses, net of cash receipts and encashment of Member States' contributions.
[d] The investment policy allocation includes the 16.7 per cent allocation to the held-to-maturity portfolio, which is fixed at the original amount of US$400,000,000.

IV. Investment income

8. IFAD's fixed-income investments made a good start in 2008 despite the continued volatility observed in the overall financial markets. To ensure financial stability, the Federal Reserve Bank of the United States cut the interest rate twice, bringing down the interest rate from 4.25 per cent to 3.0 per cent. The Bank of England also cut the interest rate, once, from 5.50 per cent to 5.25 per cent. The Bank of Japan and the European Central Bank kept interest rates unchanged while inflation remained their primary concern. During the first two months of 2008, the Government and corporate bond markets performed favourably, reflecting strong investor demands for high-quality and safe investments. Inflation concerns have also had a positive impact on the inflation-indexed bond market, which performed strongly during this period. In the currency market, the United States dollar continued to depreciate against the euro (-3.69 per cent) and the Japanese yen (-6.81 per cent) but remained almost stable against the British pound sterling (0.07 per cent).

9. Table 2 provides details on net investment income for the first two months of 2008 by portfolio. The overall net investment income during the period amounted to US$55,087,000 equivalent, to which all portfolios contributed positively.

Table 2
Net investment income by portfolio, first two months of 2008
(Thousands of United States dollars equivalent)

	Operational cash	*Short-term tactical instruments*	*Held-to-maturity*	*Government bonds*	*Diversified fixed-interest bonds*	*Inflation-indexed bonds*	*Total*
Interest from fixed-interest investments and bank accounts	1 122	21	3 056	7 781	3 445	1 795	17 220
Realized capital gains/(losses)	23	441	-	2 857	4 582	2 807	10 710
Unrealized capital gains/(losses)	(22)	(220)	-	18 661	880	7 891	27 190
Amortization/accretion[a]	-	-	(103)	-	-	-	(103)
Income from securities lending	-	-	161	415	161	149	886
Subtotal: gross investment income	**1 123**	**242**	**3 114**	**29 714**	**9 068**	**12 642**	**55 903**
Investment manager fees	-	-	-	(298)	(132)	(141)	(571)
Custody fees/bank charges	(15)	(2)	(6)	(13)	(14)	(12)	(62)
Financial advisory and other investment management fees	-	(5)	(33)	(85)	(33)	(31)	(187)
Tax recoverable	4	-	-	-	-	-	4
Net investment income	**1 112**	**235**	**3 075**	**29 318**	**8 889**	**12 458**	**55 087**

[a] A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of held-to-maturity investments as per the International Financial Reporting Standards.

V. Rate of return and performance comparison

10. Performance is measured against preassigned independent benchmarks indicating the return that would be expected through passive management of defined sectors of the market. The indexes used are the J.P. Morgan customized global government bonds index for government bonds, the Lehman Brothers United States aggregate index for diversified fixed-interest bonds and the Barclays customized inflation-linked index for inflation-indexed bonds.

11. Table 3 compares the actual net return on the overall portfolio with the overall benchmark return. The portfolio returned 2.20 per cent during the first two months of 2008, net of investment expenses and excluding the impact of foreign exchange movements. This represented a very positive performance against the same two-month period of 2007, when the overall portfolio returned 0.80 per cent.

Table 3
IFAD investment portfolio performance compared with benchmarks, first two months of 2008
(Percentage in local currency terms)

	Rate of return		
Portfolio	*Portfolio*	*Benchmark*	*Out/(Under) performance*
Overall portfolio gross rate of return	2.21	2.14	0.07
Less expenses	(0.01)	(0.01)	-
Overall portfolio net rate of return	2.20	2.13	0.07

VI. Liquidity level

12. IFAD's Liquidity Policy, approved by the Executive Board in December 2006, requires that for the Seventh Replenishment period, IFAD's liquidity ("highly liquid assets") remain above the level of US$437 million.

13. Highly liquid assets in IFAD's investment portfolio as at 29 February 2008 amounted to US$1,337 million, which comfortably clears the minimum liquidity requirement (see table 4).

Table 4
Liquidity level in IFAD's investment portfolio, as at 29 February 2008
(Millions of United States dollars)

	Actuals	*Percentage*
Highly liquid assets	**1 337**	**51.3**
Short-term instruments	218	8.4
Government securities	1 119	42.9
Fairly liquid assets	**835**	**32.0**
Non-government securities	835	32.0
Partially liquid assets	**435**	**16.7**
Held-to-maturities	435	16.7
Total portfolio	**2 607**	**100**

VII. Risk Management

14. The performance of the investment portfolio – with the exception of operational cash, tactical short-term and held-to-maturity investments – is subject to market movements. Historically, different asset classes have shown different levels of volatility, often referred to as "risk". Volatility is measured in terms of standard deviation of returns from their mean. At 29 February 2008, the standard deviation of IFAD's investment portfolio was 1.68 per cent, compared with 1.78 per cent for the investment policy.

15. Value-at-risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount that the portfolio could lose in value over a three-month time horizon, with a 95 per cent confidence level. Table 5 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 29 February 2008 and for previous periods.

Table 5
Value-at-risk (VaR)
(Forecast horizon of three months, confidence level at 95 per cent)

	Investment portfolio		*Investment policy*	
Date	*VaR (Percentage)*	*Amount (Thousands of U.S. dollars)*	*VaR (Percentage)*	*Amount (Thousands of U.S. dollars)*
29 February 2008	1.4	36 600	1.5	38 700
31 December 2007	1.3	32 500	1.4	35 000
31 December 2006	0.8	18 000	1.4	32 300

16. At 29 February 2008, the investment portfolio's VaR was 1.4 per cent, slightly higher from year-end but consistently below the investment policy VaR of 1.5 per cent. It should be noted that the investment policy VaR is based on the policy allocation (see table 1).