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Enabling poor rural people
to overcome poverty

Report on IFAD's investment portfolio for the second quarter of 2008

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Note to Executive Board Directors

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Report on IFAD's investment portfolio for the second quarter of 2008

I. Executive summary

1. IFAD's investment portfolio performed positively during the first semester of 2008, with a net investment rate of return for the period of 1.55 per cent. Since the end of the first quarter, a slowdown in fixed-income markets negatively impacted the strong first-quarter performance. The year-to-date net investment income for the period amounts to US\$39,510,000 equivalent. At the end of June 2008, IFAD's investment portfolio was valued at US\$2,589,991,000 equivalent.

II. Introduction

2. This report on IFAD's investment portfolio presents final data on the second quarter of 2008. It consists of five sections: asset allocation; investment income; rate of return and performance comparison; liquidity level in IFAD's investment portfolio; and risk measurement. Additional information on the period's currency composition will become available after dispatch of this document and will be therefore included as an annex to the report on the third quarter of 2008. The present report also contains an annex setting out the final data for the entire first quarter of 2008.

III. Asset allocation

3. Table 1 shows the movements affecting the investment portfolio's major asset classes during the second quarter of 2008 and compares the portfolio's asset allocation with the investment policy allocation.
4. During the period, there was a net outflow of US\$74,040,000 equivalent from the operational cash portfolio, representing disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member States' contributions.
5. During the second quarter, to cover disbursement needs, US\$40,072,000 equivalent was transferred from the short-term tactical instruments to the operational cash portfolio. In addition, US\$5,335,000 equivalent, representing coupon payments, was transferred from the held-to-maturity portfolio to the operational cash portfolio.
6. The net movements on foreign exchange totalled negative US\$26,636,000 equivalent. The United States dollar slightly appreciated against the euro while slightly depreciating against the British pound sterling. It appreciated against the Japanese yen, reducing the value of the inflation-indexed bonds portfolio, which is 80 per cent hedged back to the yen.
7. The investment portfolio value decreased from US\$2,710,361,000 equivalent at the end of March 2008 to US\$2,589,991,000 equivalent at the end of June 2008. This is due to the combined effect of the negative investment income of US\$19,694,000 equivalent and the negative foreign exchange movements of US\$26,636,000 and net outflows of US\$74,040,000 equivalent.

Table 1

Movements in cash and investments by portfolio, second quarter 2008

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Short-term tactical instruments^b</i>	<i>Held-to-maturity</i>	<i>Global government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
Opening balance (1 April 2008)	212 084	62 543	443 138	1 143 053	433 374	416 169	2 710 361
Net investment income/(loss)	1 403	607	4 531	(19 936)	(5 877)	(422)	(19 694)
Transfers due to allocation	45 460	(40 072)	(5 335)	-	(53)	-	-
Transfers due to expenses/income	(291)	2	(115)	170	108	126	-
Net disbursements	(74 040)	-	-	-	-	-	(74 040)
Movements on exchange	142	(1 101)	(947)	(5 561)	(23)	(19 146)	(26 636)
Closing balance (30 June 2008)	184 758	21 979	441 272	1 117 726	427 529	396 727	2 589 991
Actual asset allocation	7.1%	0.9%	17.0%	43.2%	16.5%	15.3%	100.0%
Investment policy asset allocation	5.5%	-	16.7%	43.1%	14.7%	20.0%	100.0%
Difference in asset allocation	1.6%	0.9%	0.3%	0.1%	1.8%	(4.7)%	-

^a Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.^b Short-term instruments including time deposits and commercial papers.**IV. Investment income**

8. Since the end of the first quarter, a slowdown in fixed-income markets negatively impacted the strong first-quarter performance. Fixed-income product prices tumbled amid fears about inflation, triggered by surging food and energy prices. Inflation concerns had a positive impact on the inflation-indexed bonds market, which outperformed nominal government bonds during this period. To ensure financial stability, the Federal Reserve Bank of the United States cut the interest rate to 2.00 per cent. The Bank of England also cut the interest rate, to 5.00 per cent. The Bank of Japan and the European Central Bank kept interest rates unchanged as inflation remained their primary concern. In the currency market, the United States dollar remained almost stable against the Euro (0.57 per cent) and against the British pound sterling (-0.13 per cent) while showing strong appreciation against the Japanese yen (6.81 per cent).
9. Table 2 provides details on net investment income for the second quarter of 2008 by portfolio. Overall year-to-date net investment income amounted to US\$39,510,000 equivalent, with a negative second quarter result of US\$19,694,000 equivalent.

Table 2
Net investment income by portfolio, second quarter 2008
 (Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Short-term tactical instruments</i>	<i>Held-to-maturity</i>	<i>Global government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total second quarter</i>	<i>Year-to-date 2008</i>
Interest from fixed-interest investments and bank accounts	1 438	74	4 551	11 631	4 884	2 795	25 373	51 802
Realized capital gains/(losses)	-	467	-	(1 933)	(629)	1 495	(600)	15 526
Unrealized capital gains/(losses)	-	68	-	(29 464)	(10 024)	(4 586)	(44 006)	(27 506)
Amortization/accretion ^a	-	-	(135)	-	-	-	(135)	(287)
Income from securities lending	-	-	165	418	160	148	891	2 369
Subtotal: gross investment income/(loss)	1 438	609	4 581	(19 348)	(5 609)	(148)	(18 477)	41 904
Investment manager fees	-	-	-	(457)	(201)	(214)	(872)	(1 749)
Custody fees/bank charges	(35)	-	(10)	(30)	(28)	(24)	(127)	(215)
Financial advisory and other investment management fees	-	(2)	(40)	(101)	(39)	(36)	(218)	(433)
Taxes recoverable	-	-	-	-	-	-	-	3
Net investment income/(loss)	1 403	607	4 531	(19 936)	(5 877)	(422)	(19 694)	39 510

^a A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments in accordance with International Financial Reporting Standards.

V. Rate of return and performance comparison

- Performance is measured against pre-assigned 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.
- Table 3 compares the actual net return on the overall portfolio to the benchmark return. On a year-to-date basis, the portfolio returned 1.55 per cent, underperforming the benchmark by 16 basis points. The portfolio returned -0.70 per cent during the second quarter of 2008, net of investment expenses and excluding the impact of foreign exchange movements. This represented an underperformance of 10 basis points against the aggregate benchmark.

Table 3

IFAD investment portfolio performance compared with benchmarks, second quarter and year-to-date 2008

(Percentage in local currency terms)

Portfolio	Second quarter 2008 ^a			Year-to-date 2008		
	Rate of return		Out/(Under) performance	Rate of return		Out/(Under) performance
	Portfolio	Benchmark		Portfolio	Benchmark	
Overall gross rate of return^a	(0.66)	(0.56)	(0.10)	1.64	1.80	(0.16)
Less expenses	(0.04)	(0.04)	-	(0.09)	(0.09)	-
Overall net rate of return^a	(0.70)	(0.60)	(0.10)	1.55	1.71	(0.16)

^a The overall benchmark was based on actual portfolio weights at the end of each month during the period.**VI. Liquidity level in IFAD's investment portfolio**

12. IFAD's Liquidity Policy, approved by the Executive Board in December 2006, states that IFAD's liquidity ("highly liquid assets")¹ should remain above the level of US\$437 million over the Seventh Replenishment period.
13. Highly liquid assets in IFAD's investment portfolio as at 30 June 2008 amounted to US\$1,325,000,000 equivalent, which comfortably clears the minimum liquidity requirement (table 4).

Table 4

Liquidity level in IFAD's investment portfolio, as at 30 June 2008

(Millions of United States dollars equivalent)

	Actuals	Percentage
Highly liquid assets	1 325	51.2
Short-term instruments	207	8.0
Government securities	1 118	43.2
Fairly liquid assets	824	31.8
Non-government securities	824	31.8
Partially liquid assets	441	17.0
Held-to-maturity	441	17.0
Total portfolio	2 590	100

VII. Risk measurement

14. With the exception of operational cash and held-to-maturity investments, investment portfolio performance 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 30 June 2008, the standard deviation of IFAD's investment portfolio was 1.7 per cent, compared with 1.9 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 policy as at 30 June 2008 and for previous periods.

¹ Defined as being convertible to cash quickly without significant loss of value.

Table 5

Value-at-risk (VaR)

(Forecast horizon of three months, confidence level of 95 per cent)

<i>Date</i>	<i>Investment portfolio</i>		<i>Investment policy</i>	
	<i>VaR (Percentage)^a</i>	<i>Amount (Thousands of U.S. dollars)</i>	<i>VaR (Percentage)^a</i>	<i>Amount (Thousands of U.S. dollars)</i>
30 June 2008	1.4	36 300	1.6	41 400
31 March 2008	1.3	35 300	1.5	39 400
31 December 2007	1.3	32 500	1.4	35 000
30 September 2007	1.4	33 900	1.4	33 900
30 June 2007	0.9	21 400	1.4	33 200
31 March 2007	0.7	16 600	1.3	30 800
31 December 2006	0.8	18 000	1.4	32 300
30 September 2006	0.8	19 100	1.4	33 400

^aBased on rounded figures

16. At 30 June 2008, the investment portfolio's VaR was 1.4 per cent, lower than the investment policy's VaR of 1.6 per cent.

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

I. Executive summary

1. IFAD's investment portfolio performed positively during the first quarter of 2008 with a net investment rate of return for the period of 2.27 per cent. The net investment income for the period amounted to US\$59,204,000 equivalent. IFAD's prudent investment policy and high-quality instruments secured it against the high volatility in the overall financial markets. At the end of the first quarter, IFAD's investment portfolio was valued at US\$ 2,710,361,000 equivalent.

II. Introduction

2. This report on IFAD's investment portfolio presents final data on the first quarter of 2008. It consists of six sections: asset allocation; investment income; rate of return and performance comparison; liquidity level in IFAD's investment portfolio; composition of the investment portfolio by currency and risk measurement.

III. Asset allocation

3. Table 1 shows the movements affecting the investment portfolio's major asset classes during the first quarter of 2008 and compares the portfolio's asset allocation with the investment policy allocation.
4. During the period, there was a net cash inflow of US\$47,745,000 equivalent from the internally managed operational cash portfolio, representing cash receipts and encashment of Member States' contributions, net of disbursements for loans, grants and administrative expenses.
5. IFAD's multi-currency portfolio had a positive unrealized movement of US\$102,352,000 equivalent during the first quarter of 2008. This was due to the depreciation of the United States dollar against the other SDR currencies.
6. These movements, combined with a net investment income of US\$59,204,000 equivalent, increased the overall investment portfolio value by US\$209,301,000 equivalent for the period.

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

	<i>Operational cash^a</i>	<i>Short-term tactical instruments^b</i>	<i>Held-to-maturity</i>	<i>Global government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
Opening balance (1 January 2008)	169 519	40 351	427 968	1 067 800	425 185	370 237	2 501 060
Net investment income	1 637	445	4 808	30 857	8 159	13 298	59 204
Transfers due to allocation	(13 336)	18 184	(4 848)	-	-	-	-
Transfers due to expenses/income	319	5	(222)	(114)	(5)	17	-
Net disbursements ^c	47 745	-	-	-	-	-	47 745
Movements on exchange	6 200	3 558	15 432	44 510	35	32 617	102 352
Closing balance (31 March 2008)	212 084	62 543	443 138	1 143 053	433 374	416 169	2 710 361
Actual asset allocation	7.8%	2.3%	16.3%	42.2%	16.0%	15.4%	100.0%
Investment policy asset allocation	5.5%	-	16.3%	43.3%	14.9%	20.0%	100.0%
Difference in asset allocation	2.3%	2.3%	-	(1.1%)	1.1%	(4.6%)	-

^a Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.

^b Short-term instruments including time deposits and commercial papers.

^c Disbursements for loans, grants and administrative expenditures.

IV. Investment income

- Despite the volatility observed in the overall financial markets, IFAD's fixed-income investments performed positively in the first quarter of 2008. Global government bond markets continued to perform extremely well as signs of slower economic growth in the United States and higher default rates in the sub-prime mortgage sector led to flight-to-quality. Inflation-indexed bonds continued to benefit from inflationary concerns and corporate bonds performed well with favourable trends in investment, production and retail surveys. In the currency market, the United States dollar depreciated against the euro (-7.73 per cent) and the Japanese yen (-10.9 per cent), while remaining somewhat stable against the British pound sterling (0.16 per cent).
- Table 2 provides details on net investment income for the first quarter of 2008 by portfolio. Overall net investment income during the period amounted to US\$59,204,000 equivalent, to which all portfolios contributed positively.

Table 2
Net investment income by portfolio, first quarter 2008

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Short-term tactical instruments</i>	<i>Held-to-maturity</i>	<i>Global government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
Interest from fixed-interest investments and bank accounts	1 628	27	4 738	12 149	5 091	2 796	26 429
Realized capital gains	49	734	-	6 606	5 878	2 859	16 126
Unrealized capital gains/(losses)	(22)	(311)	-	11 988	(2 815)	7 660	16 500
Amortization/accretion ^a	-	-	(152)	-	-	-	(152)
Income from securities lending	-	-	269	693	263	253	1 478
Subtotal: gross investment income	1 654	450	4 855	31 437	8 417	13 568	60 381
Investment manager fees	-	-	-	(457)	(202)	(218)	(877)
Custody fees/bank charges	(20)	-	(9)	(24)	(19)	(16)	(88)
Financial advisory and other investment management fees	-	(5)	(38)	(99)	(37)	(36)	(215)
Taxes recoverable	3	-	-	-	-	-	3
Net investment income	1 637	445	4 808	30 857	8 159	13 298	59 204

^a A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments in accordance with International Financial Reporting Standards.

V. Rate of return and performance comparison

- Performance is measured against pre-assigned 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.
- Table 3 compares the actual net return on the overall portfolio to the overall benchmark return for each portfolio. The total investment portfolio returned a positive 2.27 per cent during the first quarter of 2008, net of investment expenses and excluding the impact of foreign exchange movements. Despite the positive level of performance, the overall portfolio slightly underperformed (negative 5 basis points) against the aggregate benchmark. This was mainly due to a modest performance by the diversified fixed-interest mandate compared to their benchmark.

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

Portfolio	First quarter 2008			First quarter 2007		
	Rate of return		Out/(Under) performance	Rate of return		Out/(Under) performance
	Portfolio	Benchmark ^a		Portfolio	Benchmark ^a	
Overall gross rate of return	2.32	2.37	(0.05)	1.07	1.06	0.01
Less expenses	(0.05)	(0.05)	-	(0.03)	(0.03)	-
Overall net rate of return	2.27	2.32	(0.05)	1.04	1.03	0.01

^a The overall benchmark was based on actual portfolio weights at the end of each month during the period.

VI. Liquidity level in IFAD's investment portfolio

- IFAD's Liquidity Policy, approved by the Executive Board in December 2006, states that IFAD's liquidity ("highly liquid assets") should remain above the level of US\$437 million for the Seventh Replenishment period.
- Highly liquid assets in IFAD's investment portfolio as at 31 March 2008 amounted to US\$1,417,000,000 equivalent, which comfortably clears the minimum liquidity requirement (table 4).

Table 4
Liquidity level in IFAD's investment portfolio, as at 31 March 2008
 (Millions of United States dollars equivalent)

	Actuals	Percentage
Highly liquid assets	1 417	52.3
Short-term instruments	274	10.1
Government securities	1 143	42.2
Fairly liquid assets	850	31.3
Non-government securities	850	31.3
Partially liquid assets	443	16.4
Held-to-maturity	443	16.4
Total portfolio	2 710	100

VII. Composition of the investment portfolio by currency

- The majority of IFAD's commitments are expressed in special drawing rights (SDRs). Consequently, the Fund's overall assets are maintained so as to ensure that commitments for undisbursed loans and grants denominated in SDRs are matched, to the extent possible, by assets denominated in the currencies and ratios of the SDR valuation basket. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in the same currency.
- The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be part of the basket and what their percentage weight should be at the date of re-weighting of the basket.
- The new units for each of the four currencies composing the SDR valuation basket were determined on 30 December 2005 in such a way that the value of the SDR was precisely US\$1.42927, in terms of both the old units and the new units, which

became effective on 1 January 2006. The applicable units, together with their weights as at 1 January 2006 and 31 March 2008, are shown in table 5.

Table 5
Units and weights applicable to the SDR valuation basket

<i>Currency</i>	<i>1 January 2006</i>		<i>31 March 2008</i>	
	<i>Units</i>	<i>Percentage weight</i>	<i>Units</i>	<i>Percentage weight</i>
United States dollar	0.6320	43.7	0.6320	38.4
Euro	0.4100	34.3	0.4100	39.5
Yen	18.4000	10.9	18.4000	11.2
Pound sterling	0.0903	11.1	0.0903	10.9
Total		100.0		100.0

16. At 31 March 2008, assets in the form of cash, investments, promissory notes and contributions receivable from Member States, net of provisions, amounted to US\$3,178,537,000 equivalent, as summarized in table 6 (compared with US\$3,062,214,000 equivalent as at 31 December 2007).

Table 6
Currency composition of assets in the form of cash, investments and other receivables, as at 31 March 2008

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Cash and investments^a</i>	<i>Promissory notes^a</i>	<i>Contributions receivable from Member States</i>	<i>Total</i>
United States dollar group ^b	1 153 599	93 362	82 480	1 329 441
Euro group ^c	939 799	120 404	71 237	1 131 440
Yen	330 568	27 395	-	357 963
Pound sterling	285 702	-	73 991	359 693
Total	2 709 668	241 161	227 708	3 178 537

^a Includes only assets in freely convertible currencies. Excluded assets in non-convertible currencies amounted to US\$693,000 equivalent for cash and investments and US\$1,399,000 equivalent for promissory notes.

^b Includes assets in Australian, Canadian and New Zealand dollars (AUD, CAD and NZD).

^c Includes assets in Swiss francs (CHF), Swedish kronor (SEK) and Danish and Norwegian kroner (DKK and NOK).

17. The alignment of assets by currency group against the SDR valuation basket as at 31 March 2008 is shown in table 7. The balance of the commitments denominated in United States dollars at 31 March 2008 amounted to US\$166,226,000 equivalent, composed of the General Reserve US\$95,000,000 equivalent and commitments for grants denominated in United States dollars US\$71,226,000 equivalent.

Table 7

Alignment of assets per currency group with SDR valuation composition, as at 31 March 2008

(Thousands of United States dollars equivalent)

Currency	Asset amount	Less: commitments denominated in U.S. dollars	Net asset amount	Net asset amount (Percentage)	SDR weights (Percentage)	Difference (Percentage)
United States dollar group ^a	1 329 065	(166 226)	1 163 215	38.6	38.4	0.2
Euro group ^b	1 131 440	-	1 131 440	37.6	39.5	(1.9)
Yen	357 963	-	357 963	11.9	11.2	0.7
Pound sterling	359 693	-	359 693	11.9	10.9	1.0
Total	3 178 161	(166 226)	3 012 311	100.0	100.0	-

^a Includes assets in AUD, CAD and NZD.^b Includes assets in CHF, SEK, DKK and NOK.

18. As at 31 March 2008, there was an excess allocation in United States dollar currency group holdings (+0.2 per cent), Japanese yen (+0.7 per cent) and British pounds sterling (+1.0 per cent) which was offset by a shortfall in the Euro currency group (-1.9 per cent).
19. IFAD's Treasury Division has already taken active measures to bring the currency allocation more in line with the SDR basket. During the second quarter of 2008, a number of foreign exchange conversions, specifically from British pound sterling into euro and United States dollars, were executed. This helped to correct the Euro currency group shortfall and the pound sterling excess.

VIII. Risk measurement

20. With the exception of operational cash, tactical short-term and held-to-maturity investments, investment portfolio performance 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 31 March 2008, the standard deviation of IFAD's investment portfolio was 1.3 per cent, compared with 1.5 per cent for the investment policy.
21. 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 8 shows the VaR of IFAD's investment portfolio and policy as at 31 March 2008 and for previous periods.

Table 8

Value-at-risk (VaR)

(Forecast horizon of three-months, confidence level of 95 per cent)

Date	Investment portfolio		Investment policy	
	VaR (Percentage)	Amount (Thousands of U.S. dollars)	VaR (Percentage)	Amount (Thousands of U.S. dollars)
31 March 2008	1.3	35 300	1.5	39 400
31 December 2007	1.3	32 500	1.4	35 000
30 September 2007	1.4	33 900	1.4	33 900
30 June 2007	0.9	21 400	1.4	33 200
31 March 2007	0.7	16 600	1.3	30 800

22. At 31 March 2008, the investment portfolio's VaR was 1.3 per cent, in line with the previous quarter's end, and well below the investment policy VaR of 1.5 per cent. The investment policy VaR reflects the policy allocation (table 1).

