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Report on IFAD's investment portfolio for the second quarter of 2009

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Report on IFAD's investment portfolio for the second quarter of 2009

I. Executive summary

1. During the second quarter of 2009, IFAD's prudent investment policy and high-quality instruments contributed to protecting the investment portfolio from the turmoil in the global financial markets.

2. The value of the investment portfolio in United States dollar terms increased by US$71,193,000 equivalent, from US$2,437,389,000 equivalent at 31 March 2009 to US$2,508,582,000 equivalent at 30 June 2009. The main factors for this increase were net investment income and foreign exchange movements, which were partially offset by the net disbursement outflows.

3. The year-to-date investment portfolio's rate of return is 1.99 per cent, which translates into a year-to-date investment income amount of US$49,286,000 equivalent, inclusive of all fees and securities lending cash collateral activities.

II. Introduction

4. This report on IFAD's investment portfolio presents final data on the second quarter of 2009. It consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio by currency; securities lending cash collateral; liquidity level in IFAD's investment portfolio; and risk measurement.

III. Market conditions

5. During the second quarter of 2009, the financial markets showed some signs of stabilization as IFAD's fixed-income investments continued to perform positively under the favourable effects stemming from the quantitative easing measures and programmes put in place by the central banks and governments. In aiming to increase liquidity, these measures fostered long-term positive inflation expectations, which in turn supported the performance of inflation-indexed bonds. Similarly, IFAD's diversified fixed-interest bonds benefited from the signs of stabilization, and compensated for the somewhat flat performance in the government bonds asset class.

6. In the currency market, the United States dollar depreciated against the euro (-5.34 per cent), the Japanese yen (-2.31 per cent) and the British pound sterling (-12.96 per cent).

IV. Asset allocation

7. Table 1 shows the movements affecting the investment portfolio's major asset classes during the second quarter of 2009 and compares the portfolio's asset allocation at the end of the quarter with the investment policy allocation.

8. During the period, there was a cash outflow of US$25,880,000 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.

9. The depreciation of the United States dollar against the euro, Japanese yen and the pound sterling resulted in an increase in the portfolio balance in United States dollar terms by US$85,193,000 equivalent during the second quarter of 2009.

10. The above movements, combined with an investment income of US$11,880,000[1] equivalent, increased the overall investment portfolio value by US$71,193,000 equivalent for the period.

Table 1
Movements affecting the asset allocation within the portfolio, second quarter 2009
(Thousands of United States dollars equivalent)

	Operational cash[a]	*Held-to-maturity*	*Government bonds*	*Diversified fixed-interest bonds*	*Inflation-indexed bonds*	*Total*
Opening balance (1 April 2009)	**133 172**	**399 623**	**1 072 071**	**446 183**	**386 340**	**2 437 389**
Investment income[b]	278	4 523	(1 010)	3 432	4 657	11 880
Transfers due to allocation	3 108	(3 103)	(5)	-	-	-
Transfers due to expenses/income	(531)	(70)	260	163	178	-
Net disbursement[c]	(25 880)	-	-	-	-	(25 880)
Movements on exchange	3 386	12 042	52 898	14	16 853	85 193
Closing balance by portfolio (30 June 2009)	**113 533**	**413 015**	**1 124 214**	**449 792**	**408 028**	**2 508 582**
Actual asset allocation (percentage)	4.5	16.5	44.8	17.9	16.3	100.0
Investment policy asset allocation[d] (percentage)	5.5	16.5	43.2	14.8	20.0	100.0
Difference in asset allocation (percentage)	**(1.0)**	**-**	**1.6**	**3.1**	**(3.7)**	**-**

[a] Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.
[b] Investment income is further detailed in table 2.
[c] Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.
[d] The investment policy allocation for the held-to-maturity portfolio is set to match the current 16.5 per cent asset allocation in the investment portfolio.

V. Investment income

11. In the first half of 2009, the aggregate investment income amounted to US$49,286,000 equivalent. All realized and unrealized gains and losses are included in the investment income. Table 2 presents a summary of the second quarter 2009 investment income broken down by asset class.

[1] This figure does not include the impact of the unrealized gain/loss of the securities lending cash collateral reinvestment shown in table 2. The reason is that the security lending cash collateral is not directly related to any asset classes within the investment portfolio and therefore its market value change shall not affect the portfolio's asset allocation.

Table 2
Breakdown of investment income by asset class and the impact of the reinvested securities lending cash collateral, second quarter and year-to-date 2009
(Thousands of United States dollars equivalent)

	Operational cash	*Held-to-maturity*	*Government bonds*	*Diversified fixed-interest bonds*	*Inflation-indexed bonds*	*Subtotal second quarter 2009*	*Subtotal year-to-date 2009*	*Year-to-date securities lending cash collateral impact*	*Total year-to-date 2009*
Interest from fixed-interest investments and bank accounts	294	4 668	10 712	4 077	2 631	22 382	42 762	-	42 762
Realized capital gains	25	-	3 872	1 518	1 164	6 579	22 616	-	22 616
Unrealized capital gains/(losses)	-	-	(15 334)	(2 010)	1 040	(16 304)	(26 433)	11 580	(14 853)
Amortization/accretion[a]	-	(215)	-	-	-	(215)	(393)	-	(393)
Income from securities lending	-	79	216	86	78	459	1 356	-	1 356
Investment income before fees & taxes	**319**	**4 532**	**(534)**	**3 671**	**4 913**	**12 901**	**39 908**	**11 580**	**51 488**
Investment manager fees	-	-	(446)	(207)	(221)	(874)	(1 728)	-	(1 728)
Custody fees/bank charges	(47)	(15)	(47)	(39)	(41)	(189)	(295)	-	(295)
Financial advisory and other investment management fees	-	6	17	7	6	36	(186)	-	(186)
Taxes recoverable	6	-	-	-	-	6	7	-	7
Investment income after fees & taxes	**278**	**4 523**	**(1 010)**	**3 432**	**4 657**	**11 880**	**37 706**	**11 580**	**49 286**

[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 as per the International Financial Reporting Standards.

VI. Rate of return

12. The rate of return of 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.

13. The investment portfolio returned a positive 1.99 per cent in the first half of 2009, inclusive of all fees and securities lending cash collateral activities.

Table 3
Year-to-date rate of return on IFAD's investments for second quarter 2009 and 2008
(Percentages in local currency terms)

	Rate of return	
	Year-to-date second quarter 2009	*Year-to-date second quarter 2008*
Gross rate of return	**2.09**	**1.64**
Less expenses	(0.10)	(0.09)
Rate of return	**1.99**	**1.55**

VII. Composition of the investment portfolio by currency

14. The majority of IFAD's commitments are expressed in special drawing rights. Consequently, the Fund's overall assets are maintained in such a way 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.

15. 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 reweighting of the basket.

16. The current units for each of the four currencies making up 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 30 June 2009, are shown in table 4.

Table 4
Units and weights applicable to SDR valuation basket

	1 January 2006		*30 June 2009*	
Currency	*Units*	*Percentage weight*	*Units*	*Percentage weight*
United States dollar	0.6320	43.7	0.6320	40.9
Euro	0.4100	34.3	0.4100	37.2
Yen	18.4000	10.9	18.4000	12.3
Pound sterling	0.0903	11.1	0.0903	9.6
Total		**100.0**		**100.0**

17. At 30 June 2009, assets in the form of cash, investments, promissory notes and contribution receivables from Member States under the Fifth, Sixth, Seventh and Eighth Replenishments, net of provisions, amounted to US$2,810,147,000 equivalent, as summarized in table 5 (compared with US$2,694,002,000 equivalent at 31 March 2009).

Table 5
Currency composition of assets in the form of cash, investments and other receivables
(Thousands of United States dollars equivalent)

Currency	*Cash and investments*[a]	*Promissory notes*[a]	*Contribution receivables from Member States*	*Total*
United States dollar group[b]	1 069 292	111 120	66 808	1 247 220
Euro group[c]	846 638	40 258	35 393	922 289
Yen	332 080	18 841	-	350 921
Pound sterling	260 038	15 981	13 698	289 717
Total	**2 508 048**	**186 200**	**115 899**	**2 810 147**

[a] Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US$534,000 equivalent for cash and investments, and US$1,399,000 equivalent for promissory notes.
[b] Includes assets in Australian, Canadian and New Zealand dollars.
[c] Includes assets in Swiss francs, Swedish kronor, Danish and Norwegian kroner.

18. The alignment of assets by currency group against the SDR valuation basket as at 30 June 2009 is shown in table 6. The balance of commitments denominated in United States dollars at 30 June 2009 amounted to US$172,015,000 equivalent, composed of the General Reserve (US$95,000,000) and commitments for grants denominated in United States dollars (US$77,015,000).

Table 6
Alignment of assets per currency group with the SDR valuation composition as at 30 June 2009
(Thousands of United States dollars equivalent)

Currency	*Asset amount*	*Less: commitments denominated in US dollars*	*Net asset amount*	*Net asset amount (percentage)*	*SDR weights (percentage)*	*Difference (percentage)*
US dollar group	1 247 220	(172 015)	1 075 205	40.7	40.9	(0.2)
Euro group	922 289	-	922 289	35.0	37.2	(2.2)
Yen	350 921	-	350 921	13.3	12.3	1.0
Pound sterling	289 717	-	289 717	11.0	9.6	1.4
Total	**2 810 147**	**(172 015)**	**2 638 132**	**100.0**	**100.0**	0.0

19. As at 30 June 2009, there was a shortfall in the euro currency group holdings (-2.2 per cent) and in the United States dollar currency group (-0.2 per cent), which was offset by an excess allocation in the pound sterling (+1.4 per cent) and in the Japanese yen (+1.0 per cent).

20. IFAD’s Treasury Division has taken active measures to bring the currency allocation more in line with the SDR basket. Despite currency conversions to align the investment portfolio with the SDR basket weights, volatility in the foreign exchange market partially offset the proactive corrections.

VIII. Securities lending cash collateral

21. The market value of cash collateral reinvested against securities lent as at 30 June 2009 was US$408,436,000 equivalent, with a corresponding liability to the borrowers for US$415,132,000 equivalent. The asset class as well as credit quality compositions of the cash collateral reinvested against securities lent are shown in table 7. The difference in the collateral reinvested and the corresponding liability as at 30 June 2009 shrank to US$6,696,000 equivalent from US$18,276,000 equivalent as at 31 December 2008 thus bringing an unrealized gain of US$11,580,000 for the first half of 2009, as shown in table 2.

Table 7
Composition and credit ratings of the cash collateral reinvested against securities lent as at 30 June 2009
(Thousands of United States dollars equivalent)

	AAA	*AA*	*A*	*BBB*	*Total*	*Percentage*
Cash	244 985	-	-	-	244 985	59.0
Corporate bonds	-	19 192	11 257	481	30 930	7.5
Government agencies	11 295	-	-	-	11 295	2.7
Banking industry	-	25 338	3 368	-	28 706	6.9
Mortgage backed securities	8 704	511	994	4 358	14 567	3.5
Asset backed securities	80 435	1 470	417	2 327	84 649	20.4
Total	**345 419**	**46 511**	**16 036**	**7 166**	**415 132**	**100.0**
Composition weight	**83.2**	**11.2**	**3.9**	**1.7**	**100.0**	**-**

22. The maturity structure of the cash collateral reinvested against securities lent is shown in table 8.

Table 8
Maturity structure of the cash collateral reinvested against securities lent, as at 30 June 2009[a]
(Thousands of United States dollars equivalent)

	30 June 2009		*31 December 2008*	
Period due	*Amount*	*Percentage*	*Amount*	*Percentage*
Due in one year or less	333 700	80.4	340 125	74.6
Due after one year through two years	57 424	13.8	76 296	16.7
Due after two years through three years	21 271	5.1	28 683	6.3
Due after three years through four years	2 737	0.7	10 849	2.4
Total	**415 132**	**100.0**	**455 953**	**100.0**

[a] The maturity structure represents the financial maturities of the reinvested cash collateral, not the legal maturities.

23. As evident from tables 7 and 8, the reinvested cash collateral maintains a high level of quality with over 83 per cent in triple A, while being fairly liquid – reflecting 59 per cent in cash and over 74 per cent to be redeemed through maturity within one year. This implies that the cash collateral reinvestment will not make any meaningful impact on IFAD's liquidity level, which is already very high relative to the minimum requirement as reported in the following section IX.

IX. Liquidity level in IFAD's investment portfolio

24. IFAD's Liquidity Policy, approved by the Executive Board in December 2006, states that IFAD's liquidity ("highly liquid assets")[2] should remain above the level of US$437 million over the Seventh Replenishment period.

25. Highly liquid assets in IFAD's investment portfolio as at 30 June 2009 amounted to US$1,237,700,000 equivalent, which comfortably clears the minimum liquidity requirement (table 9).

Table 9
Liquidity level in IFAD's investment portfolio, as at 30 June 2009
(Thousands of United States dollars equivalent)

	Actuals	*Percentage*
Highly liquid assets	**1 237.7**	**49.3**
Short-term instruments	113.5	4.5
Government securities	1 124.2	44.8
Fairly liquid assets	**857.9**	**34.2**
Non-government securities	857.9	34.2
Partially liquid assets	**413.0**	**16.5**
Held-to-maturity	413.0	16.5
Total portfolio	**2 508.6**	**100.0**

[2] Defined as being convertible to cash quickly and without significant loss of value.

X. Risk measurement

26. With the exception of operational cash and held-to-maturity investments, the 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 2009, the standard deviation of IFAD's investment portfolio was 1.73 per cent, compared with 1.89 per cent for the investment policy.[3]

27. 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 forward time horizon, with a 95 per cent confidence level.[4] Table 10 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 30 June 2009 and for previous periods.

Table 10
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)*
30 June 2009	1.4	36 232	1.6	39 564
31 March 2009	1.6	40 180	1.6	38 350
31 December 2008	1.5	36 182	1.6	39 533
30 September 2008	1.4	34 544	1.5	37 012
30 June 2008	1.4	36 300	1.6	41 400

28. At 30 June 2009, the investment portfolio's VaR was 1.4 per cent, a decrease from the end of the previous quarter, and below the investment policy VaR of 1.6 per cent. It should be noted that the investment policy VaR is based on the policy allocation (see table 1).

[3] The security lending cash collateral programme is not factored into this volatility measurement.
[4] The security lending cash collateral programme is not factored into this VaR measurement.