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Enabling poor rural people
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Report on IFAD's investment portfolio for the second quarter of 2011

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Report on IFAD's investment portfolio for the second quarter of 2011

I. Executive summary

1. During the second quarter of 2011, the value of the investment portfolio in United States dollar terms decreased by US\$22,803,000 equivalent, from US\$2,493,920,000 equivalent at 31 March 2011 to US\$2,471,117,000 equivalent at 30 June 2011. The main factors for this decrease were net disbursement outflows, which were partially offset by positive investment income and foreign exchange movements.
2. As at 30 June 2011, the year-to-date rate of return on the investment portfolio is 1.65 per cent, which translates into a year-to-date investment income amount of US\$41,560,000 equivalent.

II. Introduction

3. This report on IFAD's investment portfolio¹ presents final data as at the end of the second quarter of 2011. It consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio by currency; liquidity level in IFAD's investment portfolio; composition of the investment portfolio by credit rating; and risk measurement.

III. Market conditions

4. Fixed-income markets, where IFAD's portfolio is invested, continued to maintain a positive trend during the second quarter of 2011 despite remaining volatile, with all IFAD's asset classes contributing positively. The positive performance of the global government bonds asset class was mostly due to the demand for safe, high-quality government assets held in IFAD's portfolio. Investors again grew increasingly nervous about the status of public finances of some Eurozone peripheral issuers. The diversified fixed-interest asset class performed as a result of investors' demand for higher-yielding, yet high quality assets. The inflation-indexed bonds asset class performance was positive as it benefited from demand for safe high-quality government assets as well as for inflation protection, although this last element became less relevant as growth prospects dimmed.
5. Although central banks in the major developed markets are not expected to significantly raise interest rates before 2012, IFAD's external investment managers have cautiously mitigated the risk of rising interest rates by pro-actively shortening the portfolio's duration and thereby reducing the portfolio's interest rate sensitivity. If deemed necessary, IFAD may implement additional tactical measures to protect the portfolio.
6. In the currency market, the United States dollar depreciated against the euro (2.78 per cent) and the Japanese yen (2.76 per cent) while remaining stable against the British pound sterling (0.04 per cent).

IV. Asset allocation

7. Table 1 shows the movements affecting the investment portfolio's major asset classes during the second quarter of 2011 and compares the portfolio's asset allocation at the end of the quarter with the investment policy allocation.

¹ This quarterly report presents IFAD-only investment information, while financial information involving non-IFAD entities is presented to the Executive Board in the annual consolidated financial statements. The Annual Report for the Credit Union of IFAD Employees is published separately.

8. During the period, there was a net cash outflow of US\$78,207,000 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 and the Japanese yen, despite remaining stable against the British pound sterling, resulted in an increase in the portfolio balance in United States dollar terms of US\$23,507,000 equivalent during the second quarter of 2011.
10. The above movements, combined with an investment income of US\$31,897,000 equivalent, decreased the overall investment portfolio value by US\$22,803,000 equivalent for the period.

Table 1

Movements affecting asset allocation within the portfolio, second quarter 2011

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
Opening balance (31 March 2011)	208 988	406 302	983 671	405 159	489 800	2 493 920
Investment income ^b	329	3 888	8 538	8 217	10 925	31 897
Transfers due to allocation	4 244	(4 244)	-	-	-	-
Transfers due to expenses/income	(1 133)	42	516	257	318	-
Net disbursement ^c	(78 207)	-	-	-	-	(78 207)
Movements on exchange	2 786	4 038	11 269	(24)	5 438	23 507
Closing balance (30 June 2011)	137 007	410 026	1 003 994	413 609	506 481	2 471 117
Actual asset allocation (percentage)	5.5	16.6	40.6	16.7	20.6	100.0
Investment policy asset allocation ^d (percentage)	5.5	16.6	43.2	14.7	20.0	100.0
Difference in asset allocation (percentage)	-	-	(2.6)	2.0	0.6	-

^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 16.6 per cent asset allocation in the investment portfolio.

11. During the second quarter of 2011, transfers of US\$4,244,000 equivalent of coupon income generated from the held-to-maturity portfolio was progressively transferred to the operational cash portfolio.

V. Investment income

12. In the first half of 2011, net investment income amounted to US\$41,560,000 equivalent. All realized and unrealized gains and losses are included in investment income. Table 2 presents a summary of second quarter 2011 investment income broken down by asset class together with a year-to-date summary.

Table 2

Breakdown of investment income by asset class, second quarter and year-to-date 2011

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Subtotal second quarter 2011</i>	<i>Total year-to-date 2011</i>
Interest from fixed-interest investments and bank accounts	351	4 014	7 484	2 871	5 351	20 071	37 652
Realized capital gains/(losses)	-	-	(4 924)	1 841	3 812	729	586
Unrealized capital gains	-	-	6 494	3 762	2 080	12 336	5 835
Amortization/accretion ^a	-	(84)	-	-	-	(84)	(186)
Investment income before fees	351	3 930	9 054	8 474	11 243	33 052	43 887
Investment manager fees	-	-	(393)	(210)	(262)	(865)	(1 728)
Custody fees/bank charges	(22)	(3)	(28)	(8)	(8)	(69)	(146)
Financial advisory and other investment management fees	-	(39)	(95)	(39)	(48)	(221)	(453)
Investment income after fees	329	3 888	8 538	8 217	10 925	31 897	41 560

^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 International Financial Reporting Standards.

VI. Rate of return

13. 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.
14. The investment portfolio returned a positive 1.28 per cent in the second quarter of 2011, contributing to the first quarter performance of 0.36 per cent and achieving a year-to-date return of 1.65 per cent for the first six months of 2011.

Table 3

Quarterly rates of return on IFAD's investments for 2011 and year-to-date 2011 versus benchmark

(Percentages in local currency terms)

	<i>First quarter 2011</i>	<i>Second quarter 2011</i>			<i>30 June 2011 year-to-date</i>		
	<i>Rate of return</i>	<i>Rate of return</i>	<i>Bench mark</i>	<i>Over/(under) perform.</i>	<i>Rate of return</i>	<i>Bench mark</i>	<i>Over/(under) perform.</i>
Operational cash	0.11	0.16	n.a.	n.a.	0.27	n.a.	n.a.
Held-to-maturity	0.99	0.98	0.90	0.08	1.98	1.81	0.17
Government bonds	(0.11)	0.92	0.85	0.07	0.81	0.79	0.02
Diversified fixed-interest bonds	0.12	2.09	2.25	(0.16)	2.31	2.49	(0.18)
Inflation-indexed bonds	1.39	2.29	2.90	(0.61)	3.71	4.60	(0.89)
Gross rate of return	0.41	1.33	1.43	(0.10)	1.74	1.92	(0.18)
Less expenses	(0.05)	(0.05)	(0.05)	n.a.	(0.09)	(0.09)	n.a.
Net rate of return	0.36	1.28	1.38	(0.10)	1.65	1.83	(0.18)

Note: n.a.: not applicable.

15. Differences among the rates of return of the mandates are due to the diverse characteristics of asset classes and demonstrate the positive impact of portfolio diversification.

VII. Composition of the investment portfolio by currency

16. 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.
17. 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.
18. The current units for each of the four currencies making up the SDR valuation basket were determined on 30 December 2010 in such a way that the value of the SDR was precisely US\$1.54003, in terms of both the old units and the new units, which became effective on 1 January 2011. The applicable units, together with their weights as at 1 January 2011 and 30 June 2011, are shown in table 4.

Table 4
Units and weights applicable to SDR valuation basket

Currency	1 January 2011		30 June 2011	
	Units	Percentage weight	Units	Percentage weight
United States dollar	0.6600	41.9	0.6600	41.3
Euro	0.4230	37.4	0.4230	38.3
Yen	12.1000	9.4	12.1000	9.4
Pound sterling	0.1110	11.3	0.1110	11.0
Total		100.0		100.0

19. At 30 June 2011, assets in the form of cash, investments, promissory notes and contribution receivables from Member States, net of provisions, amounted to US\$2,976,349,000 equivalent, as summarized in table 5 (compared with US\$3,053,446,000 equivalent at 31 March 2011).

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	1 080 307	197 652	63 096	1 341 055
Euro group ^c	841 152	90 741	95 043	1 026 936
Yen	223 433	59 206	-	282 639
Pound sterling	325 719	-	-	325 719
Total	2 470 611	347 599	158 139	2 976 349

^a Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US\$506,000 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.

20. The alignment of assets by currency group against the SDR valuation basket as at 30 June 2011 is shown in table 6. The balance of commitments denominated in United States dollars at 30 June 2011 amounted to US\$172,516,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$77,516,000).

Table 6

Alignment of assets per currency group with the SDR valuation composition as at 30 June 2010

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Asset amount</i>	<i>Less: commitments denominated in US dollars</i>	<i>Net asset amount</i>	<i>Net asset amount (percentage)</i>	<i>SDR weights (percentage)</i>	<i>Difference (percentage)</i>
US dollar group	1 341 055	(172 516)	1 168 539	41.7	41.3	0.4
Euro group	1 026 936	-	1 026 936	36.6	38.3	(1.7)
Yen	282 639	-	282 639	10.1	9.4	0.7
Pound sterling	325 719	-	325 719	11.6	11.0	0.6
Total	2 976 349	(172 516)	2 803 833	100.0	100.0	0.0

21. As at 30 June 2011, there was a shortfall in the euro currency group (-1.7 per cent), which was offset by an excess allocation in the pound sterling (+0.6 per cent), the Japanese yen (+0.7 per cent) and in the United States dollar currency group (+0.4 per cent).
22. IFAD takes 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. Liquidity level in IFAD's investment portfolio

23. Highly liquid assets in IFAD's investment portfolio as at 30 June 2011 amounted to US\$1,141,000,000 equivalent (table 7).

Table 7

Liquidity level in IFAD's investment portfolio as at 30 June 2011

(Thousands of United States dollars equivalent)

	<i>Actuals</i>	<i>Percentage</i>
Highly liquid assets	1 141.0	46.1
Short-term instruments	137.0	5.5
Government securities	1 004.0	40.6
Fairly liquid assets	920.1	37.3
Non-government securities	920.1	37.3
Partially liquid assets	410.0	16.6
Held-to-maturity	410.0	16.6
Total portfolio	2 471.1	100.0

IX. Investment portfolio composition by credit rating

24. The credit ratings used in this report are primarily issued by Standard and Poor's (S&P), however some investments where the S&P rating was not available, have been rated by either Moody's or Fitch Ratings credit rating agencies.

25. As at 30 June 2011, the majority of IFAD's fixed income investments had a rating of AAA (over 78 per cent); over 12 per cent was rated between AA+ and AA- and over 9 per cent between A+ and A-. Cash and cash equivalents together with pending trade sales and purchases are not directly rated by credit rating agencies and are therefore excluded from the analysis (see table 8).

Table 8

Composition of the investment portfolio by credit ratings as at 30 June 2011

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>	<i>Percentage (%)</i>
AAA	-	286 465	758 032	369 182	466 867	1 880 546	78.3
AA+ to AA-	-	92 053	100 673	53 074	43 879	289 679	12.1
A+ to A-	-	21 196	102 610	24 020	69 499	217 325	9.1
BBB+ to BBB-	-	10 312	2 084	167	-	12 563	0.5
Cash and cash equivalents ^a	137 007	-	33 145	17 233	37 383	224 768	n.a.
Pending sales and purchases ^b	-	-	7 450	(50 067)	(111 147)	(153 764)	n.a.
Total	137 007	410 026	1 003 994	413 609	506 481	2 471 117	100.0

^a Cash and cash equivalents consists of cash with central banks, corporate banks and cash held by external portfolio managers. These amounts are not directly rated by credit rating agencies.

^b Pending sales and purchases are pending foreign exchange purchases and sales used for foreign exchange hedging purposes and pending investment trades that are in the process of being finalized by the external portfolio managers for investment purposes. These amounts do not have an applicable credit rating attached to them.

Note: n.a.: not applicable

26. Should investments fall below the credit rating floor of the current investment policy, they are monitored carefully so as to be redeemed at the earliest opportunity without realizing any significant losses.

X. Risk measurement

27. 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 2011, the standard deviation of IFAD's investment portfolio was 1.42 per cent, compared with 1.45 per cent for the investment policy.
28. 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. Table 9 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 30 June 2011 and for previous periods.

Table 9
Value-at-risk (VaR)
 (Forecast horizon of three months, confidence level at 95 per cent)

<i>Date</i>	<i>Investment portfolio</i>		<i>Investment policy</i>	
	<i>VaR (percentage)</i>	<i>Amount (thousands of US dollars)</i>	<i>VaR (percentage)</i>	<i>Amount (thousands of US dollars)</i>
30 June 2011	1.19	29 411	1.22	30 027
31 March 2011	0.98	24 338	1.17	29 190
31 December 2010	1.11	27 986	1.19	29 946
30 September 2010	1.15	29 716	1.15	29 628
30 June 2010	1.17	29 090	1.26	31 256

29. At 30 June 2011, the investment portfolio's VaR was 1.19 per cent, an increase from the end of the previous quarter. This is due to more conservative assumptions applied in the risk measurement model used to obtain risk analyses on the portfolio. The VaR remains very low in absolute terms and lower than the Investment Policy VaR.
30. It should be noted that the investment policy VaR is based on the policy allocation (see table 1).