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Enabling poor rural people  
to overcome poverty

## **Report on IFAD's investment portfolio for the third quarter of 2011**

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**For: Information**

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

## I. Executive summary

1. During the third quarter of 2011, the value of the investment portfolio in United States dollar terms increased by US\$2,709,000 equivalent, from US\$2,471,117,000 equivalent at 30 June 2011 to US\$2,473,826,000 equivalent at 30 September 2011. The main factors for this increase were net disbursement inflows and positive investment income, which was offset by negative foreign exchange movements.
2. As at 30 September 2011, the year-to-date rate of return on the investment portfolio is 3.19 per cent, which translates into a year-to-date investment income amount of US\$78,621,000 equivalent.

## II. Introduction

3. This report on IFAD's investment portfolio<sup>1</sup> presents final data as at the end of the third 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 third quarter of 2011 despite remaining volatile, generating a positive performance for all IFAD's asset classes. The global government bonds asset class registered a positive performance, mostly due to investors' continuing demand for safe, high-quality government assets, where the majority of the Funds' assets are allocated. During the period investors also continued to remain wary regarding the status of public finances of some European Union peripheral issuers, causing a negative performance of debt issued by those countries. Towards the end of the quarter, the overall positive performance of the asset class was somewhat reduced by the United States Federal Reserve quantitative easing measures. The diversified fixed-interest asset class performance was very positive, on the back of investors' demand for higher-yielding, yet high quality assets. The inflation-indexed bonds asset class performance was also very positive, as it benefited from demand for safe high-quality government assets as well as from the inflation protection factor, although this last element became a detractor from performance towards the end of the quarter, as growth prospects dimmed, bringing down significantly inflation expectations.
5. Although central banks in the major developed markets are expected to maintain interest rates unchanged through 2012, IFAD's external investment managers have cautiously mitigated the risk of rising interest rates by maintaining a conservative low duration, 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 appreciated against the euro (7.30 per cent) and the British pound sterling (2.87 per cent) while depreciating against the Japanese yen (4.70 per cent).

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<sup>1</sup> 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.

## IV. Asset allocation

7. Table 1 shows the movements affecting the investment portfolio's major asset classes during the third quarter of 2011 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 net cash inflow of US\$31,850,000 equivalent in to the internally managed operational cash portfolio, representing cash receipts and encashment of Member States' contributions net of disbursements for loans, grants and administrative expenses.
9. The appreciation of the United States dollar against the euro and the British pound sterling, despite depreciating against the Japanese yen, resulted in a decrease in the portfolio balance in United States dollar terms of US\$66,202,000 equivalent during the third quarter of 2011.
10. The above movements, combined with an investment income of US\$37,061,000 equivalent, increased the overall investment portfolio value by US\$2,709,000 equivalent for the period.

Table 1

### Movements affecting asset allocation within the portfolio, third quarter 2011

(Thousands of United States dollars equivalent)

	<i>Operational cash<sup>a</sup></i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
<b>Opening balance (30 June 2011)</b>	<b>137 007</b>	<b>410 026</b>	<b>1 003 994</b>	<b>413 609</b>	<b>506 481</b>	<b>2 471 117</b>
Investment income <sup>b</sup>	287	3 311	10 095	15 117	8 251	37 061
Transfers due to allocation	46 735	(3 451)	(19 671)	(19 000)	(4 613)	-
Transfers due to expenses/income	(1 147)	43	514	258	332	-
Net disbursement <sup>c</sup>	31 850	-	-	-	-	31 850
Movements on exchange	(7 555)	(16 300)	(36 781)	(2)	(5 564)	(66 202)
<b>Closing balance (30 September 2011)</b>	<b>207 177</b>	<b>393 629</b>	<b>958 151</b>	<b>409 982</b>	<b>504 887</b>	<b>2 473 826</b>
Actual asset allocation (percentage)	8.4	15.9	38.7	16.6	20.4	100.0
Investment policy asset allocation <sup>d</sup> (percentage)	5.5	15.9	43.4	15.2	20.0	100.0
<b>Difference in asset allocation (percentage)</b>	<b>2.9</b>	<b>-</b>	<b>(4.7)</b>	<b>1.4</b>	<b>0.4</b>	<b>-</b>

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

<sup>b</sup> Investment income is further detailed in table 2.

<sup>c</sup> Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

<sup>d</sup> The investment policy allocation for the held-to-maturity portfolio is set to match the current 15.9 per cent asset allocation in the investment portfolio.

11. During the third quarter of 2011, transfers of US\$3,451,000 and US\$4,613,000 equivalent of coupon income generated from the held-to-maturity and inflation-indexed bonds portfolios respectively, were transferred to the operational cash portfolio.
12. In order to cover projected disbursement needs in the operational cash portfolio, US\$19,671,000 and US\$19,000,000 equivalent was transferred from the government and fixed-interest bonds portfolios respectively.

## V. Investment income

13. Table 2 presents a summary of the third quarter 2011 investment income broken down by asset class together with a year-to-date summary, showing a total year-to-date net investment income amount to US\$78,621,000 equivalent.

Table 2

### Breakdown of investment income by asset class, third 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 third quarter 2011</i>	<i>Total year-to-date 2011</i>
Fixed-interest investments and bank accounts	308	3 451	6 100	2 694	2 225	14 778	52 430
Realized capital gains/ (losses)	-	-	(522)	6 489	10 633	16 600	17 186
Unrealized capital gains	-	-	5 031	6 192	(4 275)	6 948	12 783
Amortization/accretion <sup>a</sup>	-	(97)	-	-	-	(97)	(283)
<b>Investment income before fees</b>	<b>308</b>	<b>3 354</b>	<b>10 609</b>	<b>15 375</b>	<b>8 583</b>	<b>38 229</b>	<b>82 116</b>
Investment manager fees	-	-	(388)	(209)	(272)	(869)	(2 597)
Custody fees/bank charges	(21)	(3)	(30)	(8)	(9)	(71)	(217)
Financial advisory and other investment management fees	-	(40)	(96)	(41)	(51)	(228)	(681)
<b>Investment income after fees</b>	<b>287</b>	<b>3 311</b>	<b>10 095</b>	<b>15 117</b>	<b>8 251</b>	<b>37 061</b>	<b>78 621</b>

<sup>a</sup> 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

14. 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.
15. The investment portfolio returned a positive 1.51 per cent in the third quarter of 2011 (compared to 1.28 per cent for second quarter and 0.36 per cent for first quarter of 2011), translating in to a year-to-date rate of return of 3.19 per cent.

Table 3

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

(Percentages in local currency terms)

	<i>Third quarter 2011</i>			<i>30 September 2011 year-to-date</i>		
	<i>Rate of return</i>	<i>Benchmark</i>	<i>Over/ (under) perform.</i>	<i>Rate of return</i>	<i>Benchmark</i>	<i>Over/ (under) perform.</i>
Operational cash	0.16	n.a.	n.a.	0.43	n.a.	n.a.
Held-to-maturity	0.84	0.87	(0.03)	2.83	2.70	0.13
Government bonds	1.11	1.00	0.11	1.93	1.80	0.13
Diversified fixed-interest bonds	3.87	4.17	(0.30)	6.27	6.77	(0.50)
Inflation-indexed bonds	1.75	1.21	0.54	5.52	5.87	(0.35)
<b>Gross rate of return</b>	<b>1.56</b>	<b>1.46</b>	<b>0.10</b>	<b>3.33</b>	<b>3.41</b>	<b>(0.08)</b>
Less expenses	(0.05)	(0.05)	n.a.	(0.14)	(0.14)	n.a.
<b>Net rate of return</b>	<b>1.51</b>	<b>1.41</b>	<b>0.10</b>	<b>3.19</b>	<b>3.27</b>	<b>(0.08)</b>

Note: n.a.: not applicable.

16. 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

17. 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.
18. 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.
19. 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 September 2011, are shown in table 4.

Table 4

### Units and weights applicable to SDR valuation basket

Currency	1 January 2011		30 September 2011	
	Units	Percentage weight	Units	Percentage weight
United States dollar	0.6600	41.9	0.6600	42.4
Euro	0.4230	37.4	0.4230	36.5
Yen	12.1000	9.4	12.1000	10.1
Pound sterling	0.1110	11.3	0.1110	11.0
<b>Total</b>		<b>100.0</b>		<b>100.0</b>

20. At 30 September 2011, assets in the form of cash, investments, promissory notes and contribution receivables from Member States, net of provisions, amounted to US\$2,836,752,000 equivalent, as summarized in table 5 (compared with US\$2,976,349,000 equivalent at 30 June 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 <sup>a</sup>	Promissory notes <sup>a</sup>	Contribution receivables from Member States	Total
United States dollar group <sup>b</sup>	1 094 773	130 276	47 850	1 272 899
Euro group <sup>c</sup>	831 984	35 457	87 807	955 248
Yen	227 853	62 033	-	289 886
Pound sterling	318 719	-	-	318 719
<b>Total</b>	<b>2 473 329</b>	<b>227 766</b>	<b>135 657</b>	<b>2 836 752</b>

<sup>a</sup> Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US\$497,000 equivalent for cash and investments, and US\$1,399,000 equivalent for promissory notes.

<sup>b</sup> Includes assets in Australian, Canadian and New Zealand dollars.

<sup>c</sup> Includes assets in Swiss francs, Swedish kronor, Danish and Norwegian kroner.

21. The alignment of assets by currency group against the SDR valuation basket as at 30 September 2011 is shown in table 6. The balance of commitments denominated in United States dollars at 30 September 2011 amounted to US\$178,468,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$83,468,000).

Table 6

**Alignment of assets per currency group with the SDR valuation composition as at 30 September 2011**

(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	1 272 899	(178 468)	1 094 431	41.2	42.4	(1.2)
Euro group	955 248	-	955 248	35.9	36.5	(0.6)
Yen	289 886	-	289 886	10.9	10.1	0.8
Pound sterling	318 719	-	318 719	12.0	11.0	1.0
<b>Total</b>	<b>2 836 752</b>	<b>(178 468)</b>	<b>2 658 284</b>	<b>100.0</b>	<b>100.0</b>	<b>0.0</b>

22. As at 30 September 2011, there was a shortfall in the United States dollar currency group (-1.2 per cent) and the euro currency group (-0.6 per cent), which was offset by an excess allocation in the pound sterling (+1.0 per cent) and the Japanese yen (+0.8 per cent).
23. IFAD takes active measures to bring the currency allocation in line with the SDR basket. Despite currency conversions to align the investment portfolio with the SDR basket weights, recent volatility in the foreign exchange market partially offset the proactive corrections.

## VIII. Liquidity level in IFAD's investment portfolio

24. Highly liquid assets in IFAD's investment portfolio as at 30 September 2011 amounted to US\$1,165,300,000 equivalent (table 7).

Table 7

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

(Thousands of United States dollars equivalent)

	<i>Actuals</i>	<i>Percentage</i>
<b>Highly liquid assets</b>	<b>1 165.3</b>	<b>47.1</b>
Short-term instruments	207.2	8.4
Government securities	958.1	38.7
<b>Fairly liquid assets</b>	<b>914.9</b>	<b>37.0</b>
Non-government securities	914.9	37.0
<b>Partially liquid assets</b>	<b>393.6</b>	<b>15.9</b>
Held-to-maturity	393.6	15.9
<b>Total portfolio</b>	<b>2 473.8</b>	<b>100.0</b>

## IX. Investment portfolio composition by credit rating

25. As at 30 September 2011, over 79 per cent of IFAD's fixed income investments had a rating of AAA (compared to 78 per cent as at 30 June 2011); over 20 per cent was rated between AA+ and AA- (compared to 12 per cent as at 30 June 2011) and there are currently no investments rated between A+ and A- (compared to 9 per cent as at 30 June 2011). 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<sup>a</sup> as at 30 September 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	-	284 920	724 900	368 993	431 327	1 810 140	79.4
AA+	-	30 371	20 890	20 875	5 658	77 794	3.4
AA	-	48 093	122 677	16 587	68 243	255 600	11.2
AA-	-	20 632	66 979	36 668	-	124 279	5.5
BBB+ and below	-	9 613	-	650	-	10 263	0.5
Cash and cash equivalents <sup>b</sup>	207 177	-	24 418	13 445	506	245 546	n.a.
Pending sales and purchases <sup>c</sup>	-	-	(1 713)	(47 236)	(847)	(49 796)	n.a.
<b>Total</b>	<b>207 177</b>	<b>393 629</b>	<b>958 151</b>	<b>409 982</b>	<b>504 887</b>	<b>2 473 826</b>	<b>100.0</b>

<sup>a</sup> As per IFAD's current Investment Guidelines, the credit ratings used in this report are based on the best credit ratings available from either Standard and Poor's (S&P) or Moody's credit rating agencies. The diversified fixed-interest bonds portfolio also uses Fitch Ratings together with S&P and Moody's.

<sup>b</sup> 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.

<sup>c</sup> 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 various portfolio investment guidelines, 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 September 2011, the standard deviation of IFAD's investment portfolio was 1.49 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 September 2011 and for previous periods.

Table 9

**Value-at-risk (VaR)**

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

Date	Investment portfolio		Investment policy	
	VaR (percentage)	Amount (thousands of US dollars)	VaR (percentage)	Amount (thousands of US dollars)
30 September 2011	1.25	30 884	1.21	29 979
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

29. At 30 September 2011, the investment portfolio's VaR was 1.25 per cent, a slight increase from the end of the previous quarter and marginally higher than the investment policy VaR of 1.21 per cent. This is due to the overall portfolio duration having marginally increased when compared to the end of previous quarter. When compared to the benchmark, the portfolio VaR at 30 September was somewhat higher. This was a consequence of the difference between the overall portfolio and benchmark allocation.
30. It should be noted that the investment policy VaR is based on the policy allocation (see table 1).