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IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Executive Board — Sixty-Sixth Session

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REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR 1998

I. INTRODUCTION

1. At its Thirty-Sixth Session in April 1989, the Executive Board approved a proposal to present the Report on IFAD's Investment Portfolio twice a year, covering the previous calendar year and the first six months of the current year at its April and September sessions, respectively. In addition, at its Sixty-Fourth Session in September 1998, the Executive Board approved a proposal to present quarterly reports on the investment portfolio with respect to the first and third quarters at its April and December sessions, respectively. Accordingly, the following report covers the year ending 31 December 1998, and includes comparative figures for the year ending 31 December 1997. In addition, Annex XVII includes a report on the performance of the investment portfolio during the fourth quarter of 1998.

II. INVESTMENT CONDITIONS AND STRATEGY

2. This section reviews the economic and investment environment prevailing in 1998 and the investment strategy applied.

A. Economic Background

Gross Domestic Product

3. Annex I, Chart 1, shows the percentage change in real gross domestic product (GDP) for 14 developed countries. The growth estimates generally show a somewhat slower growth for 1999, after strong growth in 1997 and 1998. The major exception is Japan, which is now experiencing a recession.

4. In 1997, the United States economy grew by 3.9%, and growth remained strong in 1998 at an estimated rate of 3.8%, led by growth in domestic consumption spending. The United States economy is expected to continue to grow above its trend rate in the short term, but slower growth thereafter seems likely (forecast 1999, 3.2%). Projections assume that the cyclical slowdown will be moderated by interest rate reductions during the period September to November 1998, the depreciation of the United States dollar (USD), and the modest fiscal stimulus.

5. In Japan, the economy grew by 1.4% in 1997, but fell by an estimated 2.7% in 1998 (forecast 1999, 0.8%). The downward revised numbers reflect continued stagnation of private domestic demand, which is linked to difficulties in the financial sector, as well as implications for exports due to the appreciation of the yen since September 1998. These factors are expected to be only partially offset by additional countercyclical policy measures, such as supplementary funds made available by the Japanese Ministry of Finance.

6. In the United Kingdom, the economy grew by 3.5% in 1997, but slowed markedly during 1998 (estimated growth 2.5%). Growth is expected to weaken further in the period ahead (forecast 1999, 0.9%.). The slowdown stems from the sharp tightening of monetary conditions between late 1997 and early 1998, and the deceleration of global growth. In aggregate, the Euro-zone countries experienced growth of approximately 2.8% in 1998. Growth is expected to weaken in 1999 to about 2.4%.

7. Annex I, Chart 2, shows GDP growth in ten Asian countries in which IFAD has invested. Many of the crisis-affected economies have suffered deep recessions in 1998. Prospects for 1999 are better, with small declines in output or modest recoveries.

8. Annex I, Chart 3, shows GDP growth in six Latin American countries in which IFAD has invested. Among the regional groups of developing countries, near-term growth prospects have weakened most in Latin America, particularly in Brazil, the largest economy in the region, and in Venezuela, where the slowdown has been due in part to the drop in world oil prices.

Inflation

9. Global inflationary pressures are likely to remain extremely benign over the next two years. The world economy will continue to have plentiful spare capacity that will keep underlying inflationary pressures in check. Most countries are currently experiencing falling prices for goods and rising prices for services, and with the manufacturing sectors facing the most severe price competition and the greatest impact from the weak global price environment, this situation is likely to persist.

10. Annex II, Chart 1, shows the inflation figures for developed countries. There appears to be no significant upside risk for inflation. Consumer prices are essentially stable, and other measures of inflation higher up the supply chain are declining. Continued weak commodity prices, subdued labour costs, a lack of corporate pricing power and falling rates of physical capacity utilization imply that this situation will persist through the next two years. European Monetary Union will add further downward pressure to Euro-area inflation, for instance via rising price transparency, accelerated corporate restructuring and merger activity. In the United Kingdom, inflation is expected to decline throughout 1999 and 2000. The Japanese economy is currently experiencing deflation, and this situation is unlikely to reverse in the short term.

11. In many emerging economies, the downward trend in inflation paused last year as various devaluations led to sharply higher prices for imported goods. But the increase in inflation in Asia, as illustrated in Annex II Chart 2, has not been as great as previously feared, and consensus inflation expectations for this region have been revised down during the last few months.

12. Annex II, Chart 3 presents inflation rates for six Latin American countries. The whole region shows a downward trend.

Labour-Market Development

13. Annex III shows unemployment rates as a percentage of the labour force in the developed countries. On the whole, the estimated numbers for 1998 as well as 1999 show a gradual downward trend compared to previous years.

Monetary Policies

14. Annex IV shows the evolution of central bank and government-controlled interest rates for the five currencies included in the Special Drawing Rights (SDR) valuation basket. During the first half of 1998, central banks kept their interest rates unchanged, with the exception of the Bank of England, which raised its base interest rate.

15. From September through November 1998, the Federal Reserve Bank cut interest rates three times in response to deteriorating global economic conditions, global financial strains and fears of a credit crunch.

16. In the United Kingdom, the Bank of England cut rates sharply three times during the fourth quarter in reaction to the slowing economy and with inflation back within the Bank's long-term target.

17. The 11 central banks of the European Monetary Union surprised the markets with a coordinated rate cut in December 1998, in response to indications that growth would be below expectations and with near-zero inflation.

Exchange Rates

18. Annex V illustrates the end-of-the-month exchange rates for the United States dollar against the other four currencies included in the SDR valuation basket during 1998. At year-end 1998, the United States dollar had depreciated against the other four currencies in the SDR basket. Generally, the depreciation against the dollar took place during the second half of 1998.

19. During the first half of 1998, the United States dollar appreciated by some 8% against the Japanese yen, reflecting the contrasting economic positions of Japan and the United States. However, during the second half of the year, the dollar depreciated some 18% against the yen, mainly due to short-term trading conditions, interest rate cuts in the United States, and Japan's increasing trade surplus with the United States. As a result, the United States dollar depreciated 10% against the Japanese yen in 1998.

20. During the first half of the year, steady growth in Europe led to mimimal changes in the exchange rate of the United States dollar against the German mark and the French franc. However, during the second half of the year, the dollar depreciated some 6% and 8%, respectively, against the mark and the franc, due to sharper interest rate cuts in the United States than in the two European countries. The appreciation of the British pound sterling against the United States dollar was smaller as interest rate cuts were matched.

Fiscal Policy

21. Annex VI shows budget deficits as a percentage of nominal GDP as projected by the International Monetary Fund (IMF). Deficits were lower in 1998 than in 1997 for most developed countries, and in most cases this trend is expected to continue in 1999. The main exception is Japan, where the estimated budget deficit for 1998 is 5.7% and the forecast for 1999 is 7%.

B. Financial Markets

22. Annex VII shows the evolution of short and long-term interest rates for the five currencies included in the SDR valuation basket. In the United States, short and long-term interest rates continued to converge as long-term interest rates fell. In France and Germany, long-term interest rates fell sharply, especially during the second half of the year. In the United Kingdom, tightening of short-term interest rates during the first half of the year continued to drive short-term rates above long-term rates. In Japan, long-term rates fell for most of the year and then rose sharply towards the end of the year due to supply concerns.

23. Annex VIII shows bond market returns in 1998, measured in local currency terms for countries making up the J. P. Morgan Global Government Bond Traded Index, IFAD's benchmark index for the global fixed-income portfolio. Returns include both bond coupon income and capital gains, according to market practice. The strong bond market returns in 1998 reflected projections of lower economic growth and prospects of interest rate cuts. However, the returns for the Japanese bond market in 1998 were weak due to significantly rising bond yields in the fourth quarter. This was a result of the expected large increase in the Japanese bond supply in 1999.

24. Annex IX shows the development in 1998 on the four regional equity markets in which IFAD has invested, namely Japan, Asia and Australasia (excluding Japan), Emerging Markets and North America.

25. During 1998, equity markets demonstrated great movements as well as significant differences among regions. In the first half of 1998, equity markets rose to new highs in industrialized countries. Performance built up mainly in the first quarter and then slowed down in the second. During this period equity markets in United States rose on the basis of sustained economic growth and low inflation. At the same time, Japanese markets rose modestly, reflecting the economic downturn in the country. In the Emerging Markets, a strong first quarter, reflecting promises of economic restructuring programmes, was followed by fresh uncertainties.

26. Largely due to increasing concerns about a fall in corporate profits, following the downturn in world trade in the wake of the Asian recession, the United States equity markets fell sharply in August and September, followed by the global equity markets. At the same time, Emerging Markets were affected by fears of default and the introduction of exchange controls, following the Russian financial crisis. However repeated interest rate cuts by central banks world-wide in the fourth quarter helped restore confidence and produced a dramatic reversal, and Emerging Markets recovered broadly. In sharp contrast, Japan lagged behind global markets, returning relatively modestly during the quarter.

C. Investment Strategy

27. In 1998, IFAD's investment portfolio showed a strong overall performance despite volatile conditions in global markets. In aggregate, the external investment managers outperformed their benchmarks, and progress was made in diversifying the portfolio into equities and diversified fixed income.

Global Bonds

28. During 1998, IFAD's fixed income managers maintained a strategy of long duration, taking advantage of rallies in global bond markets resulting from interest rate cuts in Europe, Japan and the United States. With respect to market selection, overweighting Europe and the United States and

underweighting Japan had a positive impact on performance, which was largely offset by exchange losses when the Japanese yen appreciated sharply in the second half of the year.

Diversified Fixed Income

29. Since its inception in August 1998, the strategy of the two diversified fixed income managers has been concentrated on sector allocation. The corporate-sector exposure added to performance through tightening interest rate spreads. The overweight exposure to mortgages was also a positive factor in performance. Investments in United States dollar-denominated Emerging Markets issues contributed significantly to returns, as the softening of interest rates by the Federal Reserve helped relieve systemic risks and led to narrowed interest rate spreads.

Equities

30. IFAD's equities mandates cover four distinct geographical markets: Asia and Australasia, (excluding Japan), Emerging Markets, Japan and North America.

Japan

31. IFAD's Japan equities manager continued to pursue a sector strategy throughout the year. With the strengthening of the yen in the last quarter, emphasis was placed on sectors with a greater domestic focus such as food, the retail sector, pulp and paper and real estate. Underweighting the banking sector also proved to be a successful strategy.

Asia and Australasia (excluding Japan)

32. IFAD's Asia and Australasia manager outperformed the benchmark during the first three quarters of 1998, but underperformed during the last quarter. The portfolio's large cash holdings and the manager's conservative position, focusing on quality and balance-sheet criteria, caused missed opportunities, such as participation in certain market rallies (e.g., Republic of Korea). However, the portfolio benefited from strong stock selection in Australia, Hong Kong and India.

Emerging Markets

33. The value of IFAD's Emerging Markets portfolio manager declined by 22% during 1998, as the crisis experienced early in the year depressed markets. The rally in the second half of the year was insufficient to fully regain earlier losses. The portfolio is weighted towards industries that should retain their value during times of crisis. Banks constituted the largest share of the portfolio at year's end, followed by telecommunications, multi-industry and energy sources.

34. The portfolio was heavily exposed to Asia (52%) and Latin America (31%) on the expectation that recovery would occur in these regions first. In the fourth quarter of 1998, this proved to be the case in Asia which showed three months of significant gain, joined by Latin America early in 1999. Fund exposure was heaviest in Singapore and Thailand (both 12% at year-end) as these two markets provide a good mix of potential rapid growth (Thailand) and significant long-term growth potential (Singapore). Brazil, Mexico and South Africa made up the second tier of holdings at 9% each. Again the focus was on growth, with Mexico promising to benefit greatly from its growing ties to the United States. Brazil is expected to recover, following the resolution of its debt and currency issues, and South Africa is likely to benefit from an expected recovery in commodity prices.

North America

35. Since its inception in August 1998, the investment manager has consistently outperformed the benchmark. Both stock selection and industry allocations had a positive impact on portfolio returns. The best results were achieved in the consumer goods, health care and information technology sectors. The finance sector proved disappointing and detracted from overall results.

III. RATE OF RETURN

Overall Portfolio Performance

36. Investment income in 1998 amounted to USD 187 899 000 equivalent (1997 – USD 163 940 000 equivalent). In line with market practice, capital gains and losses include both realized and unrealized gains and losses. All amounts are included on an accruals basis. Table 1 summarizes net investment income earned during the period under review.

Table 1: Investment Income
(USD '000 equivalent)

	1998	**1997**
Interest from fixed income investments and bank accounts	112 668	128 779
Dividend income from equities	5 654	94
Realized capital gains	40 846	21 535
Unrealized capital gains	36 111	19 657
Subtotal: Gross investment income	195 279	170 065
Securities lending income	905	463
Investment management and custody fees	(7 739)	(5 457)
Other investment expenses	(546)	(1 131)
Net investment income	187 899	163 940

37. After taking custodian and management fees into account, the overall rate of return of the portfolio in 1998 was 8.50% (1997 - 7.54%), net of movements on exchange. Returns in 1998 were supported by the strong performance in global bond markets, especially in the third quarter, and were affected by the weak performance of the equities markets in the earlier part of the year. This was followed by a strong rally in the fourth quarter.

38. The performance of the various sections of the investment portfolio is measured against pre-assigned independent benchmarks which indicate the return that could be expected through passive management of a defined segments of the market. Table 2 compares the return of each of the major sections of the portfolio with the appropriate benchmark rate of return. Table 2 shows an overall outperformance of 153 basis points in 1998 against the aggregate benchmark of the portfolio for 1998 (1997 – outperformance of 47 basis points) .

Table 2: 1998 Performance Compared with Benchmarks

	Rate of Return %		Out/(Under)
Portfolio	Portfolio	Benchmark	Performance
Internally managed portfolio	4.00	4.00	0.00
Global fixed income	12.40	11.00	1.40
Diversified fixed income (funded 8/98)	3.40	2.77	0.63
Total fixed income	11.52	10.23	1.29
Equities Japan	(7.12)	(6.62)	(0.50)
Equities Asia and Australasia (excluding Japan)	(0.42)	(6.12)	5.70
Equities Emerging Markets	(21.91)	(21.51)	(0.40)
Equities North America (funded 8/98)	13.79	10.58	3.21
Total equities	(7.05)	(10.03)	2.98
Overall portfolio (gross of fees)	8.83	7.30	1.53
Less management fees, etc.	(0.33)	(0.33)	0.00
Overall portfolio (net of fees)	8.50	6.97	1.53

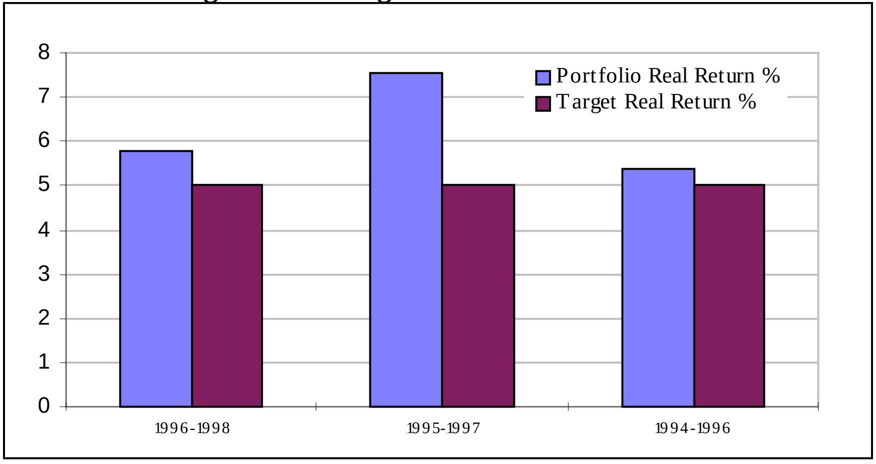
39. The overall performance of the portfolio is also compared with IFAD's target of achieving an average real rate of return of five per cent or more over three-year rolling periods. Table 3 shows the real rate of return of the portfolio from 1994 onwards, and indicates that the target has been met and exceeded in each of the last three-year rolling periods.

Table 3: Real Returns on IFAD's Overall Portfolio

	IFAD Nominal Rate of Return	SDR Inflation Rate	IFAD Real Rate of Return	Average three-year real rate of return
1998	8.5%	1.3%	7.2%	5.8%
1997	7.5%	2.0%	5.5%	7.6%
1996	6.7%	2.0%	4.7%	5.4%
1995	14.6%	1.9%	12.7%	na
1994	1.3%	2.1%	-0.8%	na

40. A comparison between actual performance and the target is shown graphically in Figure 1:

Figure 1: Average Returns in Real Terms



Internally Managed Portfolio

41. The main purpose of the internally managed portfolio is to ensure the availability of liquid funds to meet loan and grant disbursements and the payment of administrative expenses. The portfolio assets consist mainly of cash and short-term deposits. Total flows relating to the internally managed portfolio are outlined in Table 4.

Table 4: Movements in Cash and Investments under Internal Management
(USD ‘000 equivalent)

	1998	1997
Opening balance	188 015	398 858
Net transfers between portfolios	82 274	(183 584)
Gross income	5 374	19 463
Securities lending income	905	463
Fees, charges and taxes	(8 285)	(6 588)
Other net outflows	(138 775)	(39 213)
Movements on exchange	5 618	(1 384)
Closing balance	135 126	188 015

42. In January 1998, an amount of USD 100 million was transferred from the internally managed portfolio to fund the Emerging Markets Equities portfolio. In the fourth quarter, an amount of USD 120 million was transferred to the internally managed portfolio in order to fund, early in 1999, European mandates for which managers had been appointed during the course of 1998. In addition, some USD 62 274 000 was transferred to the internally managed portfolio to provide liquidity for loan and grant disbursements and the payment of administrative expenses.

43. Gross income of the internally managed portfolio consists entirely of interest from time deposits and current accounts with banks. The volume of income has fallen sharply compared to 1997 due to the reduction in the size of the portfolio.

Externally Managed Portfolio – Global Bonds

44. This portfolio comprises eight sub-portfolios, each managed by a different external investment manager and consists of bonds issued by governments of developed countries and international development institutions, as well as cash and time-deposits for operating purposes.

45. During 1998, there were three major transfers from the global bonds portfolio to fund other mandates. In the third quarter, as part of the diversification programme, USD 200 million was transferred to the diversified fixed-income portfolio and USD 80 million to the North American Equities portfolio. In the fourth quarter, also as part of the diversification programme, USD 120 million was transferred to the internally managed portfolio for the future funding of European Equities mandates. In addition, some USD 62 274 000 was transferred to the internally managed portfolio to provide liquidity for disbursements of loans and grants and payment of administrative expenses. Total flows relating to the global bonds portfolio are outlined in Table 5.

Table 5: Movements in Cash and Investments under External Management – Global Bonds Portfolio
(USD '000 equivalent)

	1998	1997
Opening balance	1 795 698	1 783 365
Transfers between portfolios	(462 274)	0
Gross investment income	201 153	159 287
Movements on exchange	51 175	(146 954)
Closing balance	1 585 752	1 795 698

46. As indicated in Table 2, the rate of return in 1998 for the global bonds portfolio was 12.40%, compared with a benchmark rate of 11.00%. Overall performance was positively affected by underweighting bonds denominated in Japanese yen and overweighting bonds denominated in United States dollars and European currencies. However, gains against the benchmark were largely offset by losses against the benchmark due to the underweight position in Japanese yen when the Japanese currency appreciated sharply in the second half of the year against the United States dollar and European currencies. Another contributing factor was the portfolio's long duration compared to benchmark, which led to higher than benchmark returns when bond markets rallied. The duration of the portfolio compared to the benchmark duration at 31 December 1998 is shown in Table 6.

Table 6: Duration of the Externally Managed Global Bonds Portfolio
(years)

	31 December 1998	31 December 1997
Global bonds portfolio	6.01	5.18
Global bonds benchmark	5.89	5.43

Externally Managed Portfolio – Diversified Fixed Income

47. Two mandates, each of which amounted to USD 100 million, were funded in August 1998 for investment in diversified fixed income. The asset classes comprise United States Treasury bonds, government bonds denominated in other currencies than United States dollars (hedged into United States dollars), corporate bonds, emerging-market debt denominated in United States dollars, mortgage-backed securities, asset-backed securities and private placements. Total flows related to the portfolio are outlined in Table 7.

Table 7: Movements in Cash and Investments under External Management – Diversified Fixed Income
(USD '000 equivalent)

	1998	1997
Opening balance	-	-
Transfers between portfolios	200 000	-
Gross investment income	6 475	-
Movements on exchange	366	-
Closing balance	206 841	-

48. As indicated in Table 2, the rate of return for the aggregated, diversified fixed-income portfolio was 3.40%, since inception in August. This is to be compared with the benchmark return of 2.77% for the Salomon Brothers Broad Investment Grade (BIG) Index. The managers benefited from the

tightening spreads for corporate bonds and mortgage-backed securities and from being invested on a selective basis in Emerging Markets. The portfolio had a longer duration than benchmark, as shown in Table 8.

Table 8: Duration of the Externally Managed Diversified Fixed-Income Portfolio
(years)

	31 December 1998	31 December 1997
Diversified fixed-income portfolio	5.06	-
Salomon Brothers (BIG) benchmark	4.56	-

Externally Managed Portfolio – Equities

49. The portfolio comprised four different mandates by the end of 1998. As part of the diversification process, two equity mandates were funded in 1997, namely, the Japan mandate and the Asia and Australasia (excluding Japan) mandate. These mandates amounted to USD 103.6 million and USD 80 million, respectively, at inception. In January 1998, the Emerging Markets mandate was funded in the amount of USD 100 million. The fourth mandate, the North America mandate, was funded in the amount of USD 80 million in August 1998. An analysis of movements by mandate is shown in Annex X, while total flows related to the portfolio are outlined in Table 9.

Table 9: Movements in Cash and Investments under External Management – Equities
(USD '000 equivalent)

	1998	1997
Opening balance	167 017	-
Transfers between portfolios	180 000	183 584
Gross investment income	(17 723)	(8 685)
Movements on exchange	11 282	(7 882)
Closing balance	340 576	167 017

50. As indicated in Table 2, in 1998, the overall return for the equity portfolio was -7.05% and the return for the aggregate benchmark was -10.03%, resulting in an aggregate outperformance of 2.98%. Two equity sub-portfolios, Asia and Australasia and North America, outperformed their respective benchmarks, while the other two, Japan and Emerging Markets, underperformed the benchmark. The Asia and Australasia sub-portfolio outperformed significantly by 5.70%, due mainly to conservative strategy during the year. The North American sub-portfolio outperformed by 3.21%, mainly due to positive stock selection. The Japan and the Emerging Markets sub-portfolios underperformed by 0.50% and 0.40%, respectively, due to sector allocation.

51. The use of derivative products in 1998 was limited to forward foreign exchange contracts for currency hedging purposes and to exchange traded futures securities contracts with respect to the Asia and Australasia equities mandate. Details of the use of futures contracts is provided in Annex XI.

IV. COMPOSITION OF THE PORTFOLIO

General

52. As of 31 December 1998, IFAD's investment portfolio amounted to USD 2 268 295 000 equivalent (31 December 1997 – USD 2 150 730 000 equivalent), excluding amounts subject to restriction provided by donors for participation in specific IFAD projects and activities.

53. In 1998, prior to taking into account the effect of movements in exchange rates, the portfolio value increased by USD 49 124 000 equivalent (1997 – USD 124 727 000 equivalent). The analysis of cash flows is presented in Annex XII and summarized in Table 10.

Table 10: Analysis of Cash Flows in the Overall Portfolio
(USD '000 equivalent)

	12 Months to 31 December 1998	12 Months to 31 December 1997
Opening balance	2 150 730	2 182 223
Net investment income	187 899	163 940
Other inflows	245 638	299 375
Outflows	(384 413)	(338 588)
Increase, prior to exchange adjustments	49 124	124 727
Exchange movement	68 441	(156 220)
Closing balance	2 268 295	2 150 730

Composition of the Portfolio by Type of Mandate and by Instrument

54. IFAD's portfolio is divided into four main sections by type of mandate:

(a) An internally managed liquidity portfolio, which is managed by IFAD Treasury. As of 31 December 1998, this portfolio consisted of short-term instruments such as cash and time-deposits held, pending payments for administrative expenses and loan and grant disbursements over the near term. As of 31 December 1998, the portfolio also included some USD 120 million for funding of European equity mandates for which managers had been appointed.

(b) An externally managed global bonds portfolio, whose management has been entrusted since 1994 to a number of external investment managers under investment guidelines provided by IFAD. Instruments consist of bonds issued by sovereign states and international development institutions, and pools of cash and time deposits used for operating purposes.

(c) An externally managed diversified fixed-income portfolio, entrusted since funding of the mandate in August 1998 to external investment managers under investment guidelines provided by IFAD. Instruments consist of United States Treasury bonds, government bonds denominated in other currencies than United States dollars (hedged into United States dollars), corporate bonds, emerging-market debt denominated in United States dollars, mortgage-backed securities, asset-backed securities and private placements.

(d) An externally managed equities portfolio, under which four mandates (Asia and Australasia (excluding Japan), Emerging Markets, Japan and North America) have been entrusted to external investment managers under investment guidelines provided by IFAD.

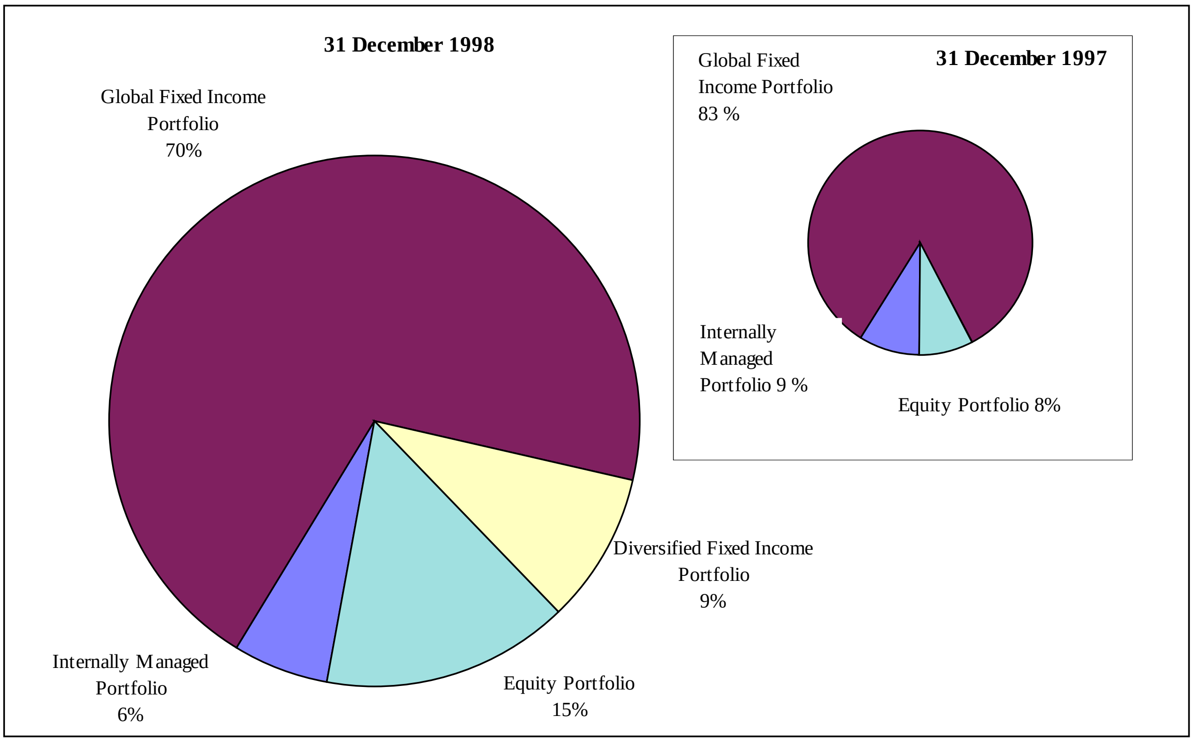
55. Table 11 provides an analysis of the instruments held in each of the main sections of the investment portfolio at 31 December 1998. Figure 2 provides a graphic illustration and comparison with 1997. An analysis of the composition of the overall portfolio, which provides fuller details of open trades, etc., and comparative figures at 31 December 1997 is found in Annex XIII.

Table 11: Analysis of the Portfolio by Type of Mandate and by Instrument at 31 December 1998

(USD '000 equivalent)

Instruments	Internally Managed Portfolio	Global Fixed-Income Portfolio	Diversified Fixed-Income Portfolio	Equities Portfolio	Overall Portfolio
Cash	20 969	37 322	(840)	3 397	60 848
Time-deposits	112 250	40 188	43 024	5 980	201 442
Treasury bills	173				173
Global bonds		1 479 813	65 519		1 545 332
Emerging market bonds			13 603		13 603
Mortgage backed securities			90 440		90 440
Asset backed securities			1 965		1 965
Corporate bonds			52 669	29	52 698
Equities				324 500	324 500
Futures				422	422
Open trades		(2 310)	(61 737)	(35)	(64 082)
Accrued interest income	656	30 739	2 198	-	33 593
Dividends receivable				407	407
Non-convertible currencies	1 078			5 876	6 954
Total	135 126	1 585 752	206 841	340 576	2 268 295
%	6.0%	69.9%	9.1%	15.0%	100.0%

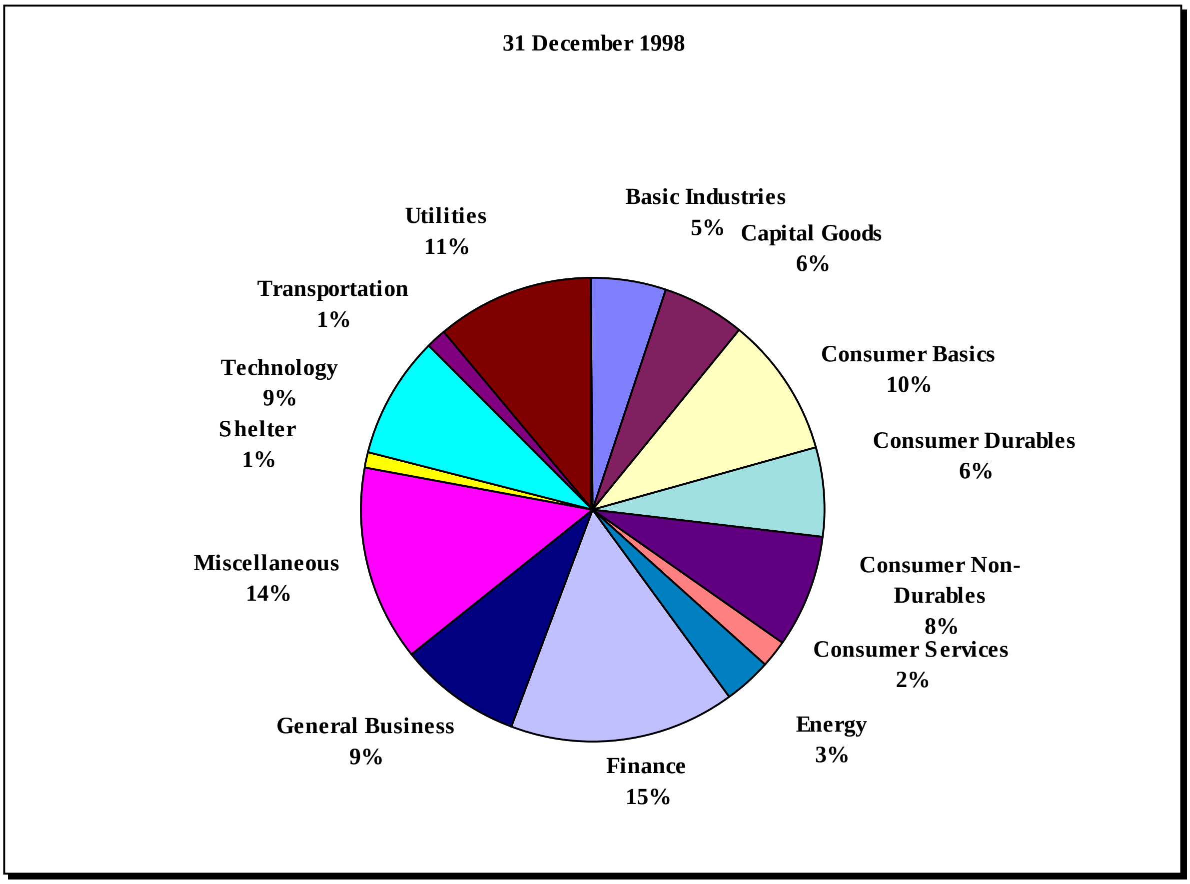
Figure 2: Analysis of the Portfolio by Type of Mandate at 31 December 1998



Composition of the Equities Portfolio

56. As of 31 December 1998, investments in equities (including equities amounting to USD 3 875 000 denominated in Malaysian ringgits, whose convertibility was suspended in 1998) amounted to USD 328 375 000 equivalent (1997 – USD 108 748 000 equivalent), comprising 502 different stocks denominated in 19 currencies. The composition of the equity portfolio by industry sector at 31 December 1998 is provided in Figure 3.

Figure 3: Composition of the Total Equity Portfolio by Industry Sector at 31 December 1998



Composition of the Portfolio by Currency

57. The majority of IFAD's commitments are expressed in SDR. Consequently, IFAD's overall assets are maintained in such a way as to ensure that, to the extent possible, commitments for undisbursed loans and grants denominated in SDR are matched by assets denominated in the currencies and in the 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 United States dollars.

58. Every five years, the Executive Board of the IMF reviews the valuation basket of the SDR in order to determine which currencies should be part of the basket, and which percentage weight should apply to each currency at the date of the reweighting.

59. The last such review was made in September 1995 and weights were determined for each of the five component currencies that were applied to the reweighting of the valuation basket on

1 January 1996. The units of each currency that constitute the valuation basket for the five-year period 1 January 1996 to 31 December 2000 were determined on the basis of the agreed weights and market exchange rates on 31 December 1995. The units and weights applicable to the SDR valuation basket at 31 December 1998 and 31 December 1997 are shown in Table 12.

Table 12: Units and Weights Applicable to the SDR Valuation Basket

	31 December 1998		31 December 1997	
Currency	**Units**	**Percentage Weight**	**Units**	**Percentage Weight**
USD	0.582	41.5	0.582	43.1
DEM	0.446	19.0	0.446	18.4
JPY	27.200	16.8	27.200	15.5
FRF	0.813	10.3	0.813	10.1
GBP	0.105	12.4	0.105	12.9
		100.0		100.0

60. With the creation of the Euro on 1 January 1999, the IMF has confirmed that henceforth the Euro will be included within the valuation basket as the currency of both France and Germany. The new units applicable as of 1 January 1999 are shown in Table 13. The slight change in United States dollar units is due to the need to keep the value of the old and new baskets as close as possible.

Table 13: Units and Weights Applicable to the SDR Valuation Basket as of 1 January 1999

	1 January 1999	
Currency	Units	Percentage Weight
USD	0.5821	41.5
EUR	0.3519	29.3
JPY	27.200	16.8
GBP	0.105	12.4
		100.0

61. During the course of the two-year period 1999-2000, the IMF will discuss the various options for the future of the valuation basket, which include the possibility of a tri-polar SDR comprising the Euro, the Japanese yen and the United States dollar, or a larger basket of currencies.

62. As of 31 December 1998, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth Replenishment amounted to USD 2 889 006 000 equivalent (1997 – USD 2 782 721 000 equivalent). An analysis showing the cash and investments, promissory notes and amounts receivable from contributors in currency terms is found in Annex XIV. The alignment of assets with the currency composition of the SDR valuation basket at 31 December 1998 is shown in Table 14.

Table 14: Alignment of Assets with the Currency Composition of the SDR Valuation Basket at 31 December 1998
(USD '000 equivalent)

Currency	Investment Portfolio, Promissory Notes and Amounts Receivable	Less: USD Commitment [a/]	Assets Subject to Alignment with SDR		Composition of SDR Valuation Basket %
			Amount	%	
USD	1 192 020	155 940	1 036 080	43.9	41.5
JPY	307 637	-	307 637	13.0	16.8
GBP	332 075	-	332 075	14.1	12.4
Euro-zone currencies	683 882	-	683 882	29.0	29.3
Subtotal	2 515 614	-	2 359 674	100.0	100.0
Other convertible currencies	363 750	-	-	-	-
NCC	9 642	-	-	-	-
Total	2 889 006	-	-	-	-

[a/] Consists of the balance of General Reserve (USD 95 000 000) and the undisbursed balance of grants denominated in USD (USD 60 940 000).

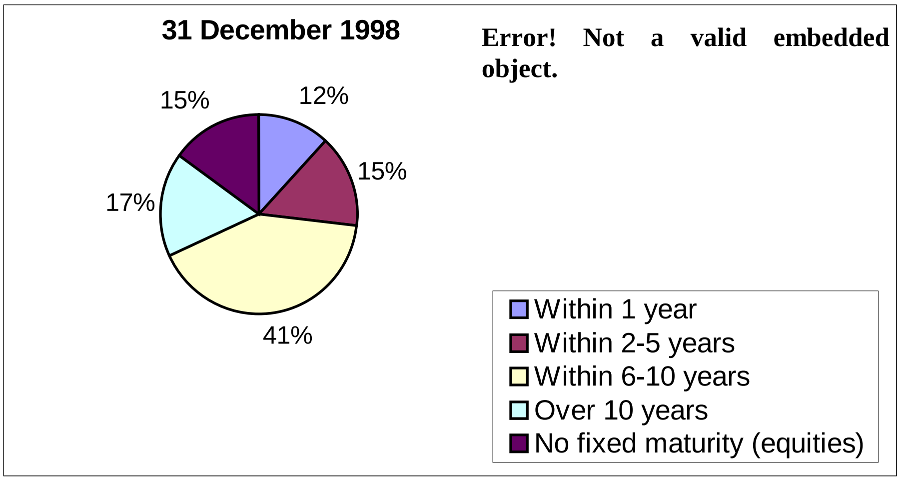
63. As of 31 December 1998, there were shortfalls in holdings of Japanese yen and of Euro-zone currencies, and excess holdings of United States dollars and British pounds sterling. The shortfall in holdings of Japanese yen reflects the aggregate unhedged, underweight position for bonds denominated in Japanese yen held in the global bonds portfolio.

64. As of 31 December 1998, net resources available for commitment denominated in freely convertible currencies amounted to USD 371 345 000 equivalent. Adding to this the amounts receivable from contributors under the Fourth Replenishment of USD 161 430 000, one arrives at a gross amount of USD 532 775 000 equivalent, representing assets against which commitments have not yet been made. This amount exceeds IFAD's holdings of convertible currencies not included in the SDR valuation basket by USD 169 025 000 equivalent (31 December 1997 – USD 194 534 000 equivalent), indicating that the exchange rate risk arising from holdings of currencies not included in the SDR basket was fully covered.

Maturity of Investments

65. Annex XV provides details of the composition of the portfolio by maturity at 31 December 1998, while Figure 4 shows the maturity of the portfolio graphically.

Figure 4: Maturity Structure of the Investment Portfolio

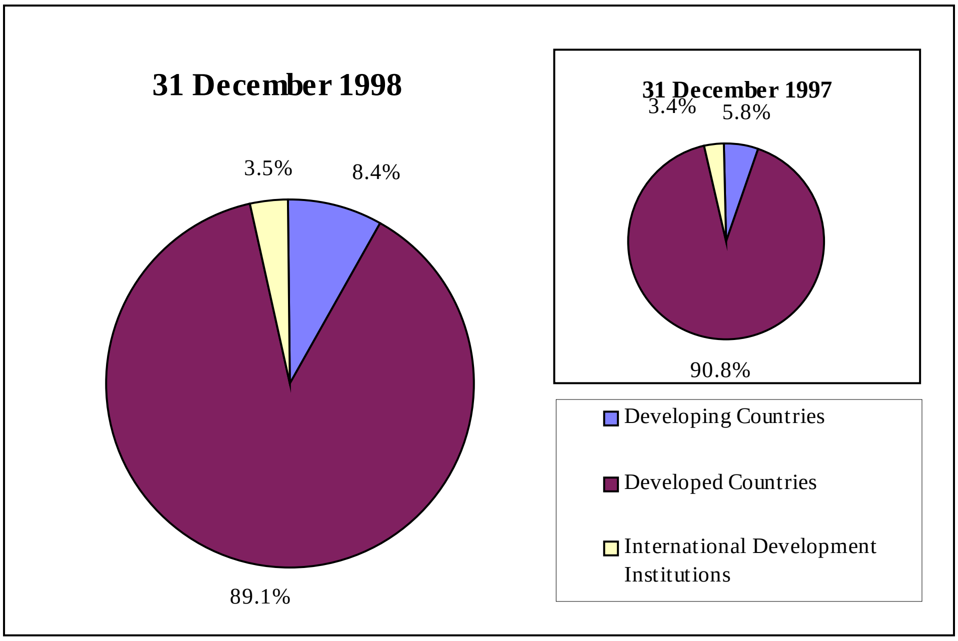


66. The average life to maturity at 31 December 1998 was eight years and three months (31 December 1997 – five years and six months).

Diversification by Countries

67. It is IFAD's practice to diversify its investments with respect to countries. IFAD invests in suitable instruments issued by eligible institutions in both developed and developing Member States, as well as obligations issued by eligible development-related intergovernmental institutions. Annex XVI provides details by type of instrument, while Figure 5 shows the overall diversification by Member States graphically.

Figure 5: Diversification by Country



V. DIVERSIFICATION OF THE INVESTMENT PORTFOLIO

68. In early 1996, there was a growing awareness of the unlikelihood that IFAD would be able to maintain the high average rate of return that it had experienced during the first half of the decade if it continued to invest predominantly in government bonds issued by industrialized countries.

69. It was noted that returns on time deposits and government bonds had begun to decrease as the market no longer expected to pay a premium against the possible resurgence of inflation.

70. In May 1996, a symposium on investment policy was convened that brought together the members of the Investments Advisory Committee, IFAD's financial advisors and a number of external investment managers. The symposium addressed the question of the alternative asset classes that IFAD should consider for investment purposes in order to maintain its historical rate of return with an acceptable level of risk. The most attractive asset classes for this purpose proved to be corporate bonds and equities and the government bonds of Emerging Markets.

71. A study was subsequently carried out comparing the performance of equity and bond markets over a 15-year period. The study included an optimization exercise to construct a diversified portfolio that could reach the targeted real rate of return of approximately 5% per annum In order to achieve this target, the recommendation was that 45% of the portfolio be placed in equities and 10% in corporate bonds, while the remaining 45% of the portfolio would remain in global government bonds and in cash.

72. The study was reviewed by the Executive Board at its Fifty-Ninth Session in December 1996 (document EB 96/59/R.70) and was included in the document on diversification of the investment portfolio (document GC 20/L.8) that the Governing Council considered at its Twentieth Session.

73. The proposal on the diversification of the investment portfolio was considered in-depth by the Informal Working Group on Policy Issues that met on 19 February 1997, just before the meeting of the Governing Council. While recognizing that management of the investment portfolio falls under the authority of the President of IFAD, the working group expressed broad support for the diversification proposal and stressed the need for a prudent and gradual approach in the implementation of the proposal. Similar views were expressed at the Governing Council and by members of the Executive Board in their subsequent discussions.

74. In consultation with IFAD's financial advisors, a programme was drawn up in March 1997 for a phasing-in diversification over a three-year period. Some USD 1 000 million equivalent was allocated for investment in the equities markets, as indicated in Table 15.

Table 15: Allocation of the Equities Portfolio
(USD '000 equivalent)

Market	Amount
Global	360
North America	180
Europe	180
Japan	100
Emerging Markets	100
Asia and Australasia (excluding Japan)	80
Total	**1 000**

75. The global equities allocation is intended to cover investments in equities on a worldwide basis, while the other five equity allocations cover specific markets.

76. An allocation of USD 200 million was made for investment in a fixed-income portfolio comprising corporate bonds, emerging-market debt and government bonds. It was also decided to appoint a currency overlay manager, to be responsible for managing the portfolio's exposure to currency risk.

77. Implementation of the programme got under way with the appointment, in July 1997, of three external equity managers for the Asian and Australasian (excluding Japan), Emerging Market and Japanese mandates, for a total initial amount of USD 280 million. The three mandates were funded between 22 October 1997 and 21 January 1998, using funds that had been previously managed internally.

78. Following a rigorous selection process, in February 1998, five specialist managers were appointed to manage the North American equities portfolio for a total of USD 180 million, of which USD 80 million was funded in August 1998.

79. In addition, in February 1998, two managers were appointed to manage United States dollar-denominated, diversified fixed-income mandates for a total of USD 200 million. These mandates were funded on 3 August 1998, using the proceeds of the liquidation of part of the externally managed global bond portfolio.

80. During May 1998, a search was made for European equities managers. In June 1998, three managers were appointed to manage a total of USD 180 million equivalent, of which USD 60 million equivalent was funded in February 1999.

81. A currency overlay manager was appointed in November 1998 in order to manage IFAD's exposure to Emerging Market currencies. It is expected that the currency overlay manager will commence operations in April 1999.

82. In view of the volatility in the equities markets that became evident in mid-August 1998, the pace of funding of equities markets was slowed down in the latter part of 1998. Consequently, investments in equities as at 31 December 1998 amounted to 15% of the portfolio.

83. Notwithstanding the above, IFAD has proceeded with the preparation of contractual documentation for the remaining North America equities mandates and European equities mandates, so that funding may take place at an opportune time in the future.

84. The second annual seminar on investment diversification for members of the Executive Board focused on the equities markets and was held in December 1998.

85. The Executive Board is requested to note the information contained herein.

ANNEX I

REAL GDP ANNUAL PERCENTAGE CHANGE

Chart 1: Developed Countries

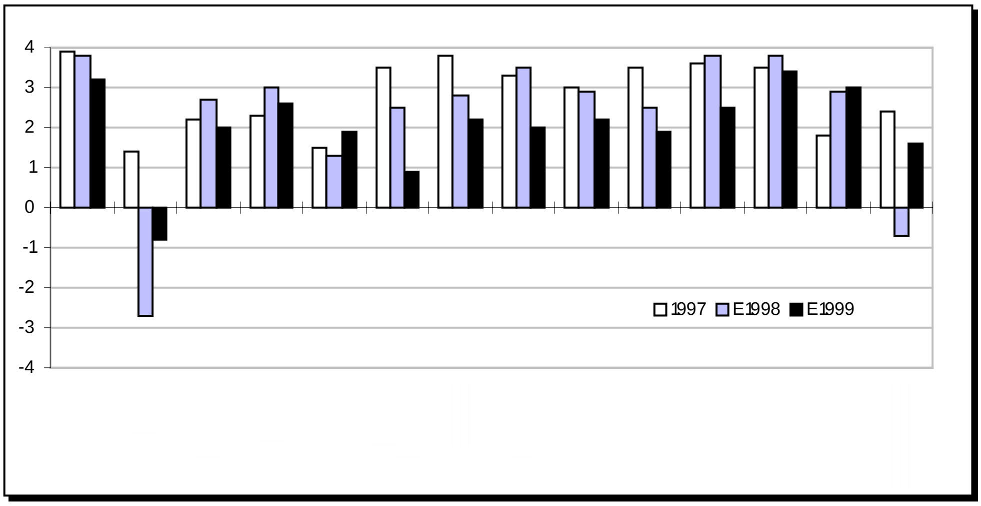


Chart 2: Asia

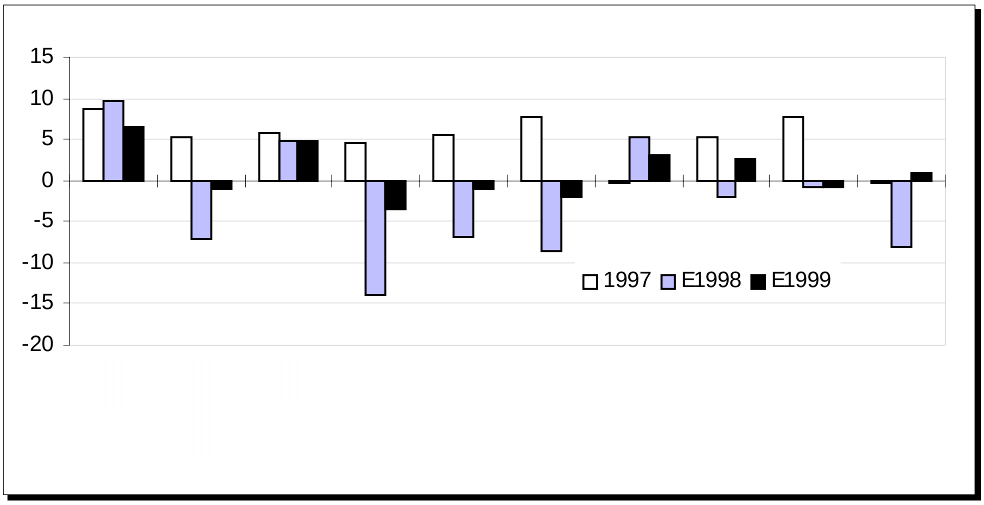
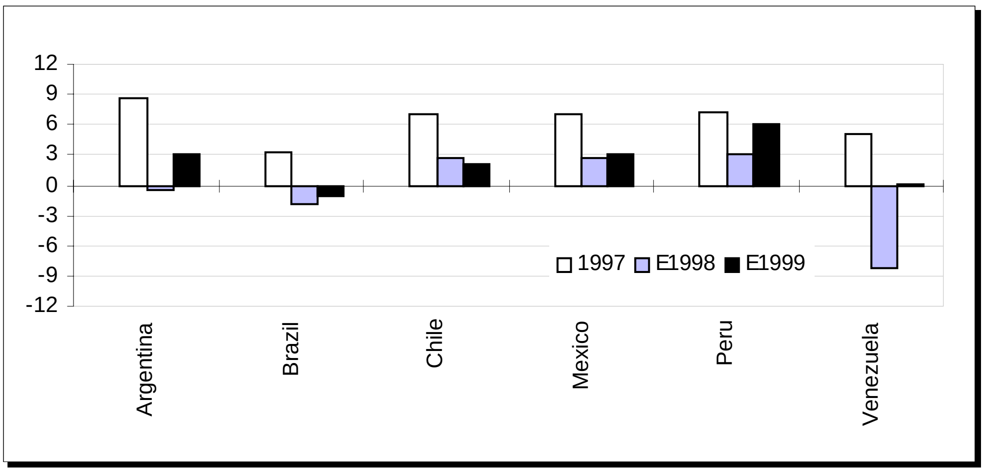


Chart 3: Latin America



Source: IMF World Economic Outlook and International Capital Markets, December 1998, The Economist

ANNEX II

CONSUMER PRICES

Annual Percentage Change

Chart 1: Developed Countries

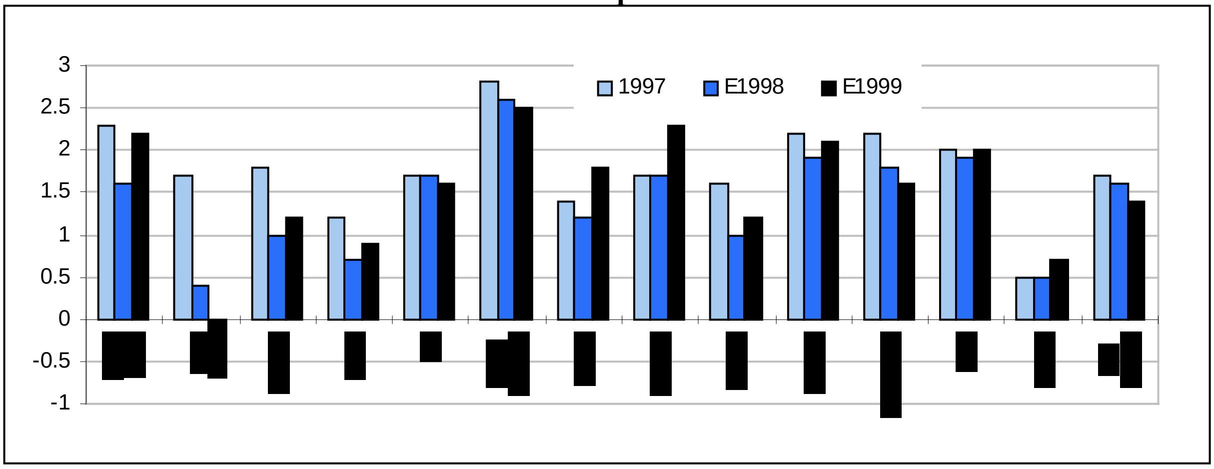


Chart 2: Asia

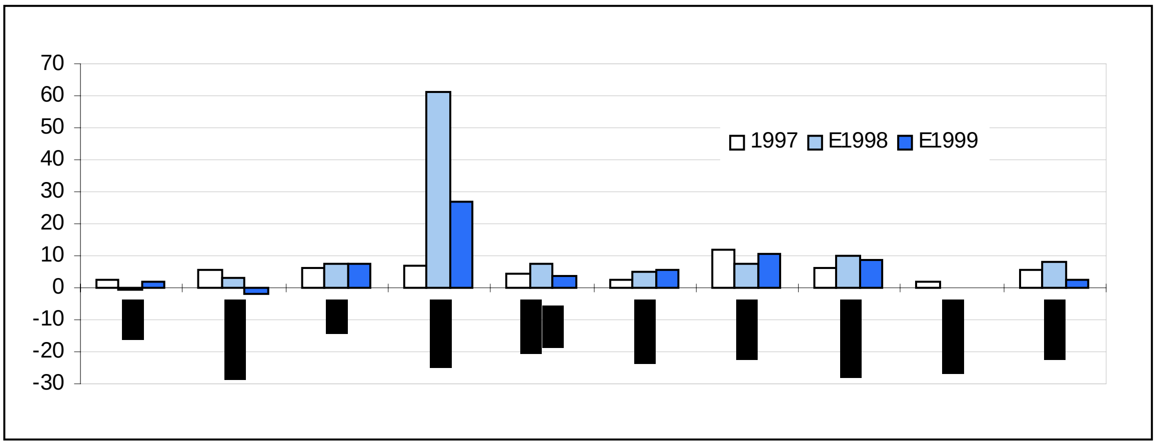
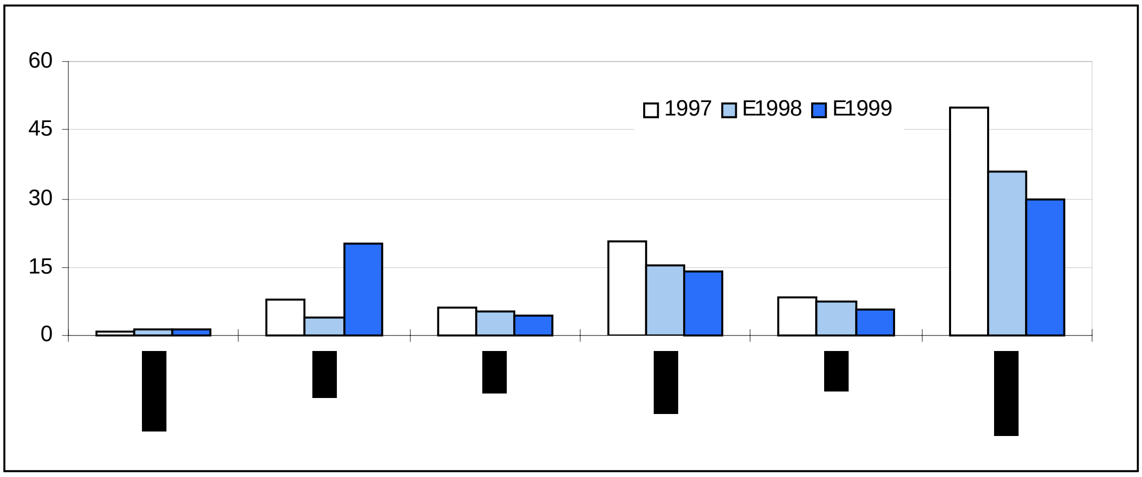


Chart 3: Latin America

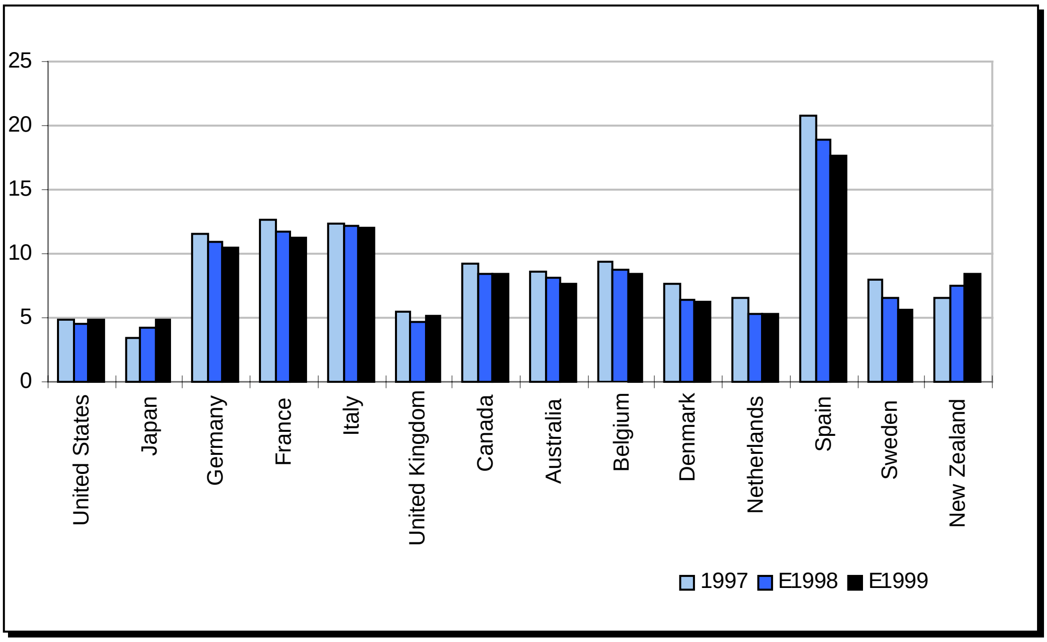


Source: IMF World Economic Outlook and International Capital Markets, December 1998, The Economist

ANNEX III

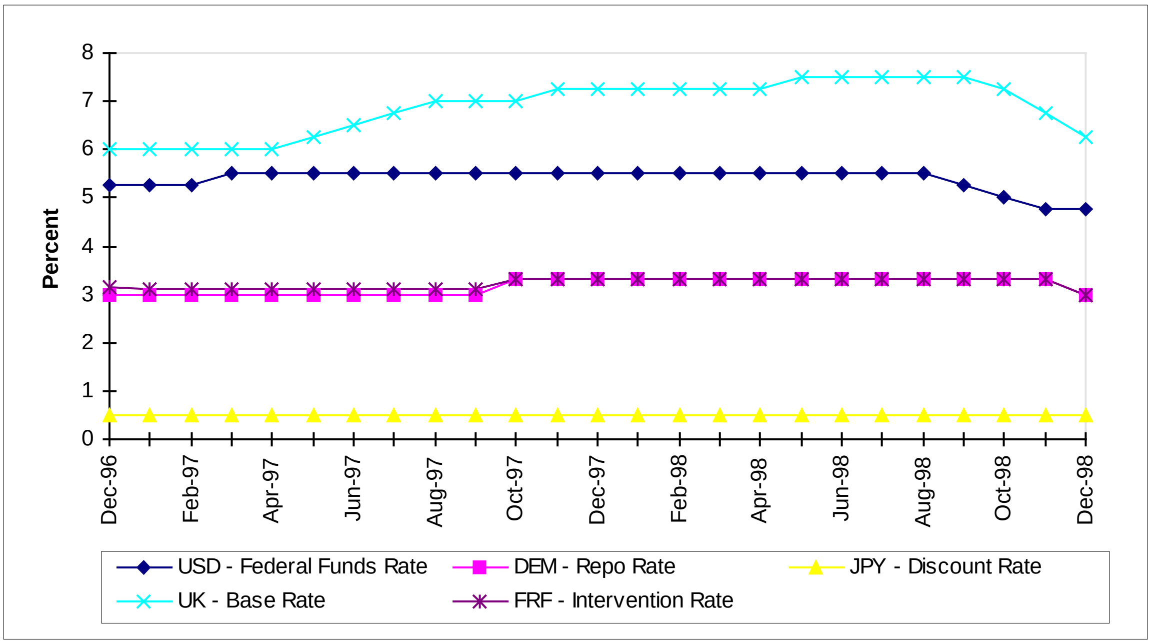
UNEMPLOYMENT RATES PERCENTAGE OF LABOUR FORCE

Developed Countries



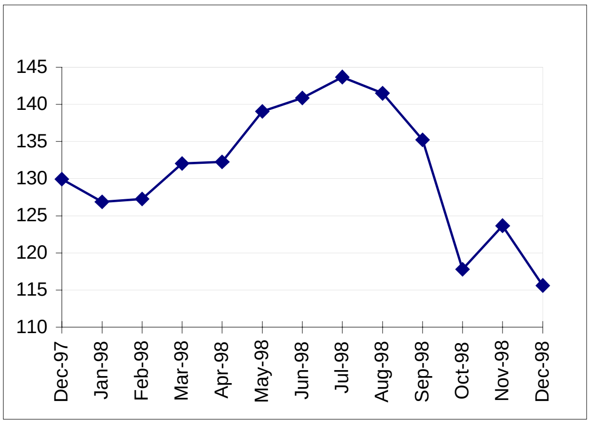
Source: IMF World Economic Outlook and International Capital Markets, December 1998

CENTRAL BANK AND GOVERNMENT-CONTROLLED INTEREST RATES

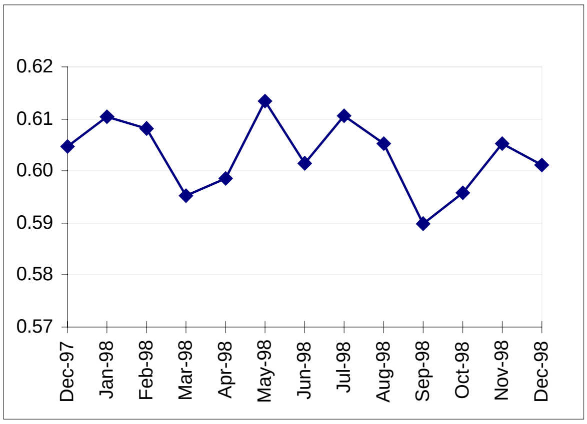


AT IMF MONTH-END EXCHANGE RATES VALUE OF THE UNITED STATES

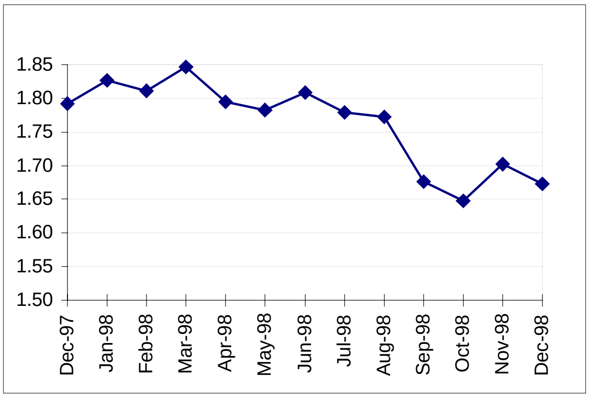
JPY



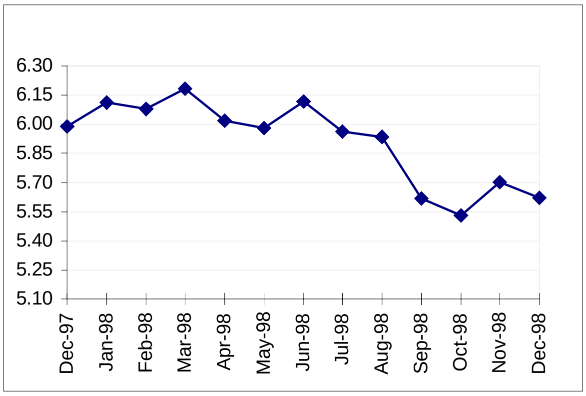
GBP



DEM

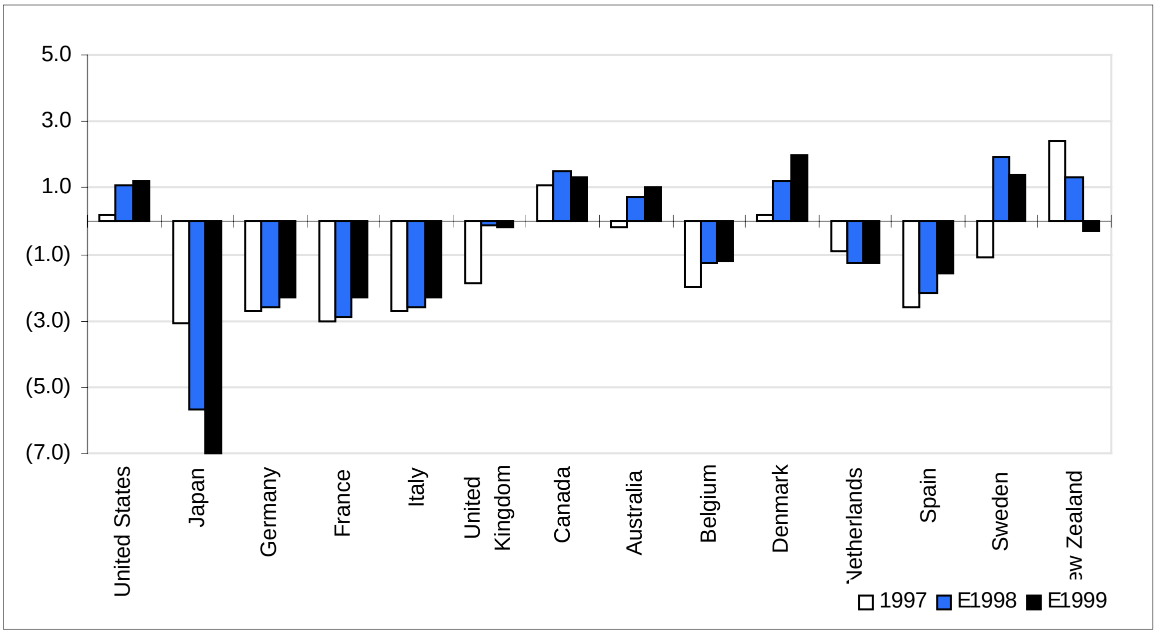


FRF



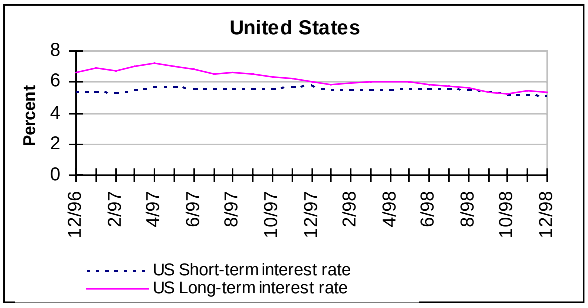
Source: IMF

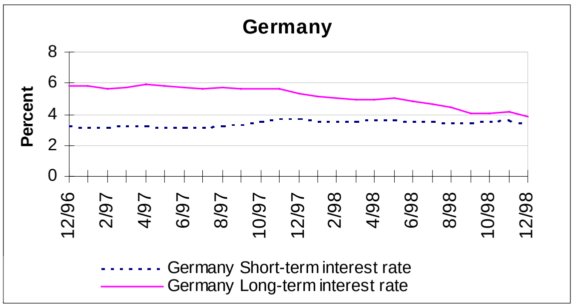
BUDGET DEFICITS – PERCENTAGE OF GDP

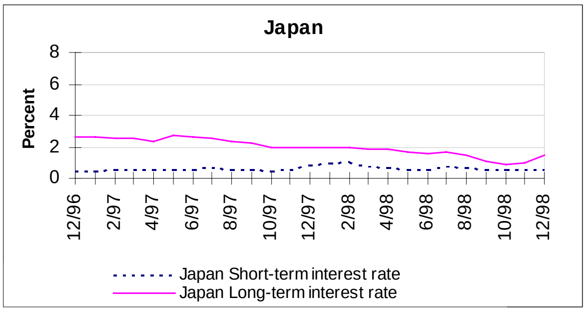


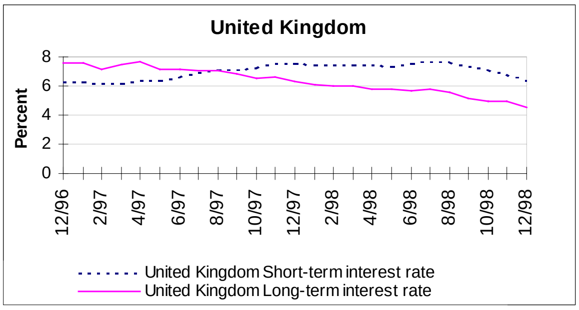
Source: IMF World Economic Outlook October 1998

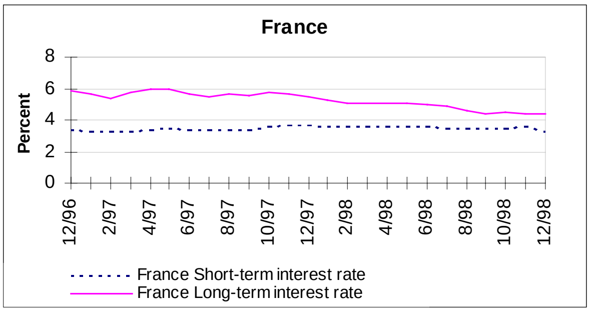
SHORT AND LONG-TERM INTEREST RATES











Source: OECD

BOND-MARKET RETURNS MEASURED IN TERMS OF LOCAL CURRENCY

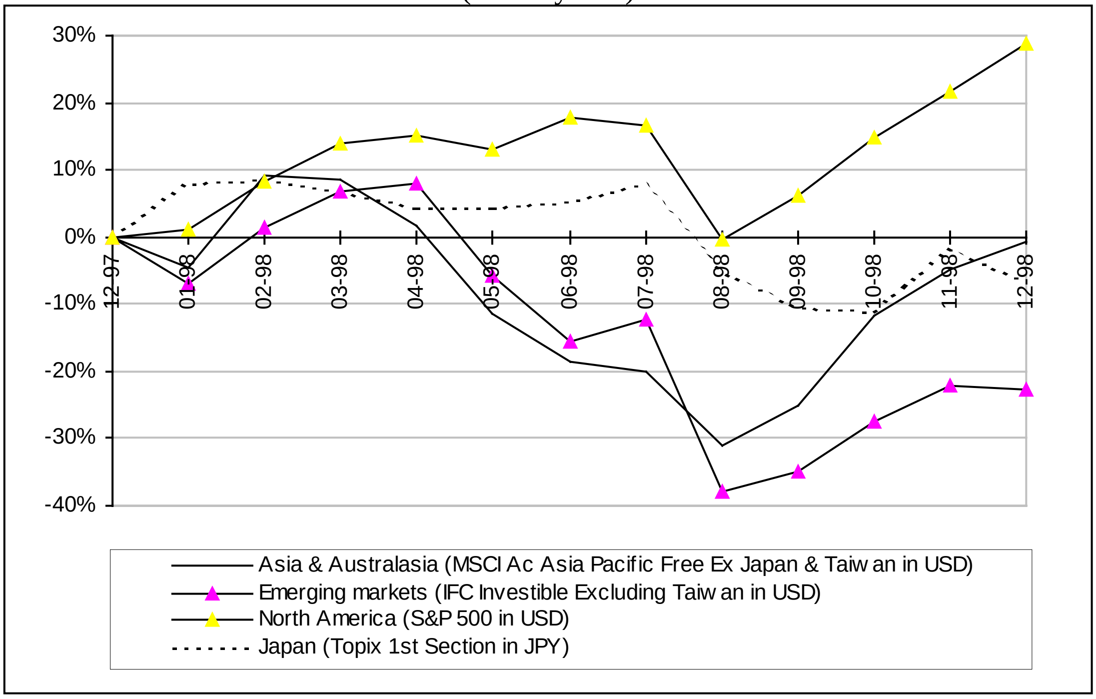
(per cent)

Currency	1 QTR 1998	2 QTR 1998	3 QTR 1998	4 QTR 1998	1998	1997
USD	1.49	2.73	5.89	(0.13)	10.25	10.00
DEM	2.97	1.76	4.42	1.80	11.40	6.28
JPY	0.83	1.75	4.46	(6.18)	0.55	7.22
FRF	2.99	1.90	5.09	2.06	12.58	7.64
GBP	4.05	1.83	8.04	4.63	19.79	14.85
AUD	2.85	1.77	3.84	1.48	10.29	13.00
BEF	3.01	1.70	4.81	1.99	11.99	6.87
CAD	2.62	1.65	3.32	1.68	9.58	9.39
DKK	3.33	1.86	2.05	3.23	10.86	7.42
ITL	3.22	(1.78)	4.14	3.01	12.71	14.45
NLG	3.03	1.79	4.78	1.73	11.79	6.69
ESP	3.03	(1.65)	4.42	2.76	12.61	10.90
SEK	4.29	3.10	2.04	4.03	14.13	7.96
GLOBAL	2.21	3.08	5.18	0.20	10.06	9.50

Source: J.P. Morgan

EQUITY MARKET DEVELOPMENT IN 1998

(monthly data)



MOVEMENTS IN INVESTMENTS UNDER EXTERNAL MANAGEMENT – EQUITIES

(USD '000 equivalent)

	Japanese Equities	Asian and Australasian Equities	Emerging Markets Equities	North American Equities	Total
Opening balance	87 923	79 094	-	-	167 017
New allocation	-	-	100 000	80 000	180 000
Interest income	-	821	1 195	92	2 108
Dividend income	670	1 947	2 626	411	5 654
Realized capital gains/(losses)	1 183	(7 201)	(5 206)	(1 804)	(13 028)
Unrealized capital gains/(losses)	(8 374)	4 109	(20 528)	12 336	(12 457)
Exchange gains/(losses)	13 754	(2 229)	(243)	-	11 282
Closing balance	95 156	76 541	77 844	91 035	340 576

FUTURES CONTRACTS IN 1998

(USD ‘000 equivalent)

Type of Future	**No. of Trades**	**Opening Value** (USD '000)	**Closing Value** (USD '000)	**Gain/(Loss)** (USD '000)
Sell	48	1 619	1 634	(15)
Buy	18	17 248	19 101	1 853
Total	66	18 867	20 735	1 838

ANALYSIS OF CASH FLOWS

(USD '000 equivalent)

	1998	1997
Balance at 1 January	2 150 730	2 182 223
Investment income	187 899	163 940
Other inflows:		
Loan income received	41 898	43 014
Loan principal repayments	123 358	115 618
Encashment of promissory notes	75 701	122 499
Contributions received in cash	4 681	18 244
Total inflows	245 638	299 375
Outflows:		
Loan disbursements	(298 948)	(259 808)
Grant disbursements	(25 212)	(21 569)
Payment of administrative expenses	(52 994)	(44 311)
Miscellaneous	(7 259)	(12 900)
Total outflows	(384 413)	(338 588)
Effects of movements in exchange rates	68 441	(156 220)
Balance at 31 December	2 268 295	2 150 730

COMPOSITION OF THE INVESTMENT PORTFOLIO

(USD '000 equivalent)

Type of Instrument	31 December 1998		31 December 1997	
	Amount	**%**	**Amount**	**%**
Freely Convertible Currencies				
Instruments				
Cash	60 848	2.68%	74 359	3.46%
Time-deposits	201 442	8.88%	279 748	13.01%
Treasury bills	173	0.01%	1 709	0.08%
Global bonds at market value	1 545 332	68.13%	1 659 213	77.15%
Emerging market bonds at market value	13 603	0.60%	-	-
Mortgage-backed securities at market value	90 440	3.99%	-	-
Asset-backed securities at market value	1 965	0.09%	-	-
Corporate bonds at market value	52 698	2.32%	-	-
Equities at market value	324 500	14.31%	108 748	5.06%
Futures at market value	422	0.02%	-	-
Subtotal: instruments	2 291 423	101.02%	2 123 777	98.75%
Open Trades	-	-	-	-
Payable for bonds bought	(164 671)	-	(19 253)	-
Receivable for bonds sold	95 929	-	4 427	-
	(68 742)	(3.03%)	(14 826)	-0.69%
Payable for equities bought	(1 416)	-	-	-
Receivable for equities sold	1 382	-	-	-
	(34)	0.00%	-	0.00%
Spot currency purchases	-	-	15 856	-
Spot currency sales	-	-	(15 927)	-
	-	0.00%	(71)	(0.03%)
Forward currency purchases	398 268	-	820 070	-
Forward currency sales	(393 574)	-	(817 270)	-
	4 694	0.21%	2 800	0.13%
Subtotal: open trades	(64 082)	(2.83%)	(12 097)	(0.56%)
Other Receivables	-	-	-	-
Accrued income	33 593	-	37 959	-
Dividends receivable	407	-	46	-
Subtotal: other receivables	34 000	1.50%	38 005	1.77%
Total freely convertible currencies	2 261 341	99.69%	2 149 685	99.95%
Non-Convertible Currencies	-	-	-	-
Cash	667	-	537	-
Time-deposits	6 287	-	508	-
Total non-convertible currencies	6 954	0.31%	1 045	0.05%
Grand Total	**2 268 295**	**100.00%**	**2 150 730**	**100.00%**

ANNEX XIV

CURRENCY COMPOSITION OF THE INVESTMENT PORTFOLIO, HOLDINGS OF PROMISSORY NOTES AND AMOUNTS RECEIVABLE FROM CONTRIBUTORS AT 31 DECEMBER 1998

(USD '000 equivalent)

Currency	Cash and Investments	Promissory Notes	Amounts Receivable	Total
USD	994 619	136 322	61 079	1 192 020
JPY	236 027	46 606	25 004	307 637
GBP	293 153	23 854	15 068	332 075
Subtotal	**1 523 799**	**206 782**	**101 151**	**1 831 732**
ATS	-	8 476	2 111	10 587
BEF	-	19 032	-	19 032
DEM	318 927	27 447	11 598	357 972
XEU (ECU)	46 139	-	-	46 139
ESP	24 267	-	-	24 267
FIM	-	7 037	983	8 020
FRF	89 990	46 834	8 124	144 948
IEP	-	-	255	255
ITL	24 706	-	20 397	45 103
LUF	-	418	122	540
NLG	-	26 253	-	26 253
PTE	-	312	454	766
Subtotal	**504 029**	**135 808**	**44 044**	**683 882**
ARS	2 921	-	-	2 921
AUD	46 961	7 277	-	54 238
CAD	40 248	22 945	5 943	69 136
CHF	-	12 217	-	12 217
DKK	33 443	32 743	-	66 186
EEK	20	-	-	20
HKD	21 798	-	-	21 798
HUF	1 345	-	-	1 345
IDR	4 585	-	-	4 585
INR	-	4 554	-	4 554
KRW	2 272	-	-	2 272
MXN	4 477	-	-	4 477
NOK	0	5 263	10 292	15 555
NZD	4 914	872	-	5 786
PHP	5 339	-	-	5 339
PKR	342	-	-	342
SEK	29 633	28 131	-	57 764
SGD	16 812	-	-	16 812
SKK	74	-	-	74
THB	9 492	-	-	9 492
TRL	2 243	-	-	2 243
ZAR	6 594	-	-	6 594
Subtotal	**233 513**	**114 002**	**16 235**	**363 750**
Total Convertible Currencies	**2 261 341**	**456 593**	**161 430**	**2 879 364**
Non-Convertible Currencies	6 954	2 688	-	9 642
Total	**2 268 295**	**459 281**	**161 430**	**2 889 006**

COMPOSITION OF THE PORTFOLIO BY MATURITY OF INVESTMENTS

(USD ‘000 equivalent)

Period	31 December 1998		31 December 1997	
	Amount	%	Amount	%
Within 1 year	277 886	12.3	421 244	19.6
Within 2-5 years	349 606	15.4	512 816	23.8
Within 6-10 years	930 691	41.0	916 809	42.6
Over 10 years	385 612	17.0	191 133	8.9
No fixed maturity (equities)	324 500	14.3	108 748	5.1
Total	2 268 295	100.0	2 150 730	100.0

DIVERSIFICATION OF THE INVESTMENT PORTFOLIO BY MEMBER COUNTRIES

31 December 1998

	Cash	Time Deposits	Fixed-Income Securities	Equities	Other Assets	Total	%
Latin America and Caribbean	19	-	12 998	23 720	61	36 798	1.6
Emerging Europe	-	-	1 486	2 199	7	3 692	0.2
North Africa, Near East	-	55 900	413	2 275	267	58 855	2.6
Sub-Saharan Africa	9	-	-	6 741	-	6 751	0.3
East and South Asia	717	492	1 963	81 354	12	84 538	3.7
Subtotal Developing Countries	745	56 392	16 860	116 289	347	190 633	8.4
Developed Countries	60 771	145 542	1 609 156	214 006	(30 249)	1 999 226	88.1
International Development Institutions	-	-	78 195	-	241	78 436	3.5
Total	61 516	201 934	1 704 211	330 295	(29 661)	2 268 295	100.0

31 December 1997

	Cash	Time Deposits	Fixed-Income Securities	Equities	Other Assets	Total	%
Developing Countries	546	100 508	10 000	12 212	524	123 790	5.8
Developed Countries	74 350	179 748	1 577 978	96 536	25 159	1 953 771	90.8
International Development Institutions	-	-	72 944	-	225	73 169	3.4
Total	74 896	280 256	1 660 922	108 748	25 908	2 150 730	100.0

ANNEX XVII

PERFORMANCE OF IFAD'S INVESTMENT PORTFOLIO FOR THE FOURTH QUARTER OF 1998

Investment Income

1. Net investment income for the fourth quarter of 1998 amounted to USD 69 292 thousand equivalent. Table 1 summarizes net investment income earned during the period under review and compares to other periods.

Table 1: Investment Income
(USD '000 equivalent)

	Fourth Quarter 1998	First and Third Quarters 1998	1998	1997
Interest from fixed-income investments and bank accounts	26 035	86 633	112 668	128 779
Dividend income from equities	996	4 658	5 654	94
Realized capital gains	24 136	16 710	40 846	21 535
Unrealized capital gains	20 440	15 671	36 111	19 657
Subtotal: gross investment income	71 607	123 672	195 279	170 065
Securities lending income	276	629	905	463
Investment management and custody fees	(2 576)	(5 163)	(7 739)	(5 457)
Other investment expenses	(15)	(531)	(546)	(1 131)
Net investment income	69 292	118 607	187 899	163 940

2. After taking account of custodian and management fees, the overall rate of return in the fourth quarter of 1998 was 3.11% net of movements on exchange. The good return in the fourth quarter was due mainly to the strong performance of the equity markets, triggered by world-wide interest rates cuts. In aggregate bonds performed weakly, although there were notable variations between markets as indicated in Annex VIII.

Performance

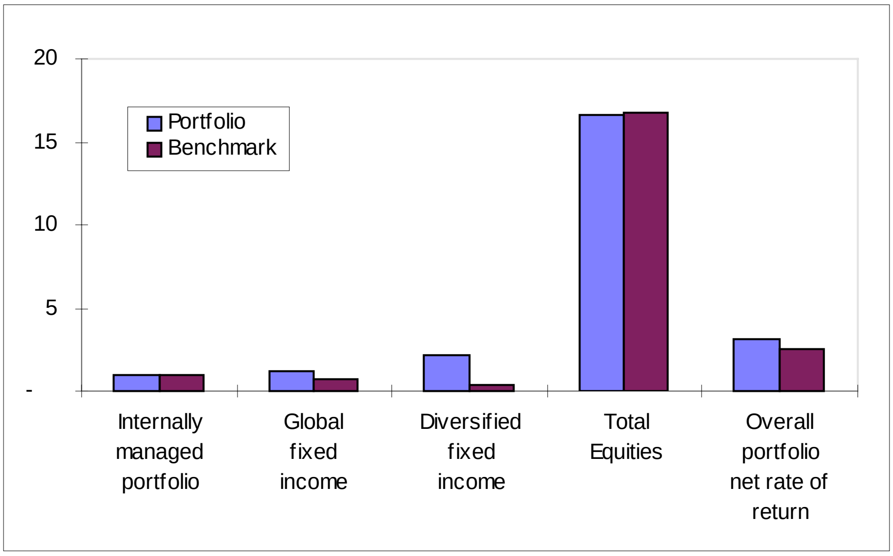
3. The performance of internally and externally managed portfolios (both fixed-income and equity) is measured against pre-assigned independent benchmarks that indicate the return that could be expected through passive management of a defined market segment. Table 2 compares the return of each major section of the portfolio with the return of the appropriate benchmark. Table 2 shows an overall outperformance of 58 basis points for the fourth quarter.

Table 2: Performance of the Fourth Quarter Compared with Benchmarks

	Rate of Return %		Out/(Under)
Portfolio	Portfolio	Benchmark	Performance
Internally managed portfolio	1.00	1.00	0.00
Global fixed income	1.20	0.70	0.50
Diversified fixed income	2.20	0.41	1.79
Total fixed income	1.35	0.67	0.68
Equities Japan	3.80	4.40	(0.60)
Equities Asia and Australasia (excluding Japan)	15.80	25.90	(10.10)
Equities Emerging Markets	29.10	17.50	11.60
Equities North America	24.90	21.30	3.60
Total equities	16.61	16.80	(0.19)
Overall portfolio gross rate of return	3.27	2.69	0.58
Less management fees, etc.	(0.16)	(0.16)	0.00
Overall portfolio net rate of return	3.11	2.53	0.58

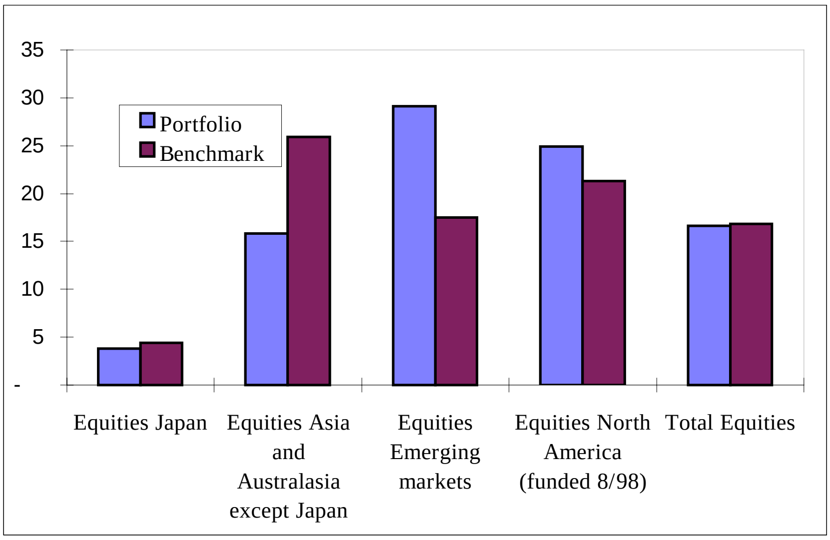
4. Figure 1 shows graphically the performance of the portfolio's main mandates compared to their benchmarks.

Figure 1: Fourth Quarter Performance by Mandates Compared to Benchmarks



5. Figure 2 shows the performance of the various equities sub-portfolios compared to their respective benchmarks. The emerging market and North America sub-portfolios outperformed strongly on the basis of stock selection by 11.60% and 3.60% respectively. The underperformance of 6.60% by the Japan sub-portfolio was due to stock selection. The conservative approach adopted by the Australia and Australasia manager led to an underperformance of 10.10% in the fourth quarter, although the approach was successful for the year as a whole.

Figure 2: Fourth Quarter Performance of Equity Mandates Compared to Benchmark



Analysis of Cash Flows

6. Table 3 shows the cash flows relating to the investment portfolio during the fourth quarter of 1998.

Table 3: Movements in Cash and Investments

	Internally Managed Portfolio	Global Bonds Portfolio	Diversified Fixed-Income Portfolio	Equities Portfolio	Overall Portfolio
Opening Balance 30 September 1998	48 820	1 666 133	202 385	273 586	2 190 924
Transfers between portfolios	120 000	(120 000)	-	-	-
Gross investment income	2 038	20 060	4 073	45 436	71 607
Securities lending income	276	-	-	-	276
Fees, charges and taxes	(2 591)	-	-	-	(2 591)
Other net outflows	(38 440)	-	-	-	(38 440)
Movements on exchange	5 023	19 559	383	21 554	46 519
Closing balance 31 December 1998	135 126	1 585 752	206 841	340 576	2 268 295

INTERNATIONAL STANDARDS ORGANIZATION CURRENCY CODES

ARS	Argentine peso	ITL	Italian lira
ATS	Austrian schilling	JPY	Japanese yen
AUD	Australian dollar	KRW	Republic of Korea won
BEF	Belgian franc	LUF	Luxembourg franc
CAD	Canadian dollar	MXN	Mexican peso
CHF	Swiss franc	NLG	Netherlands guilder
CNY	Chinese yuan renminbi	NOK	Norwegian krone
DEM	Deutsche mark	NZD	New Zealand dollar
DKK	Danish krone	PHP	Philippine peso
EEK	Estonian kroon	PKR	Pakistani rupee
ESP	Spanish peseta	PTE	Portuguese escudo
FIM	Finnish markka	SEK	Swedish kron
FRF	French franc	SGD	Singapore dollar
GBP	British pound sterling	SKK	Slovak koruna
HKD	Hong Kong dollar	THB	Thai baht
HUF	Hungarian forint	TRL	Turkish lira
IDR	Indonesian rupiah	USD	United States dollar
IEP	Irish pound	XEU	European currency unit
INR	Indian rupee	ZAR	South African rand

DEFINITIONS

Duration

1. Duration is the weighted average term-to-maturity of a security's cash flows.

2. Duration is commonly used by investors to estimate the change in value of a single security or of a whole portfolio relative to a change in bond yields. The greater the duration of a bond, the greater its price volatility.

Forward Contracts

3. A currency forward contract is an agreement for the future delivery of an amount of currency at a specified price at a designated time. Unlike futures contracts, which are traded in organized changes, a forward contract is traded by direct contact between buyer and seller.

Futures Contracts

4. A futures contract is an agreement to buy or sell a specific amount of a bond or currency at a specific price at a designated time. Such contracts are traded in organized exchanges for standard lots.

Options

5. An option is a contract in which the seller of the option grants the buyer the right to purchase at a specified price and at a specified time. The seller grants this right to the buyer in exchange for a certain sum of money called the premium.

6. A call option gives the buyer the right to buy a specific amount of a bond or currency at a specified price. A put option gives the buyer the right to sell a specific amount of a bond or currency at a specified price. The buyer of an option has the right but not the obligation to exercise the option.

7. IFAD's investment guidelines only permit the use of exchange-traded options. Tailor-made or over-the-counter options may not be used.

Hedge

8. A hedge is the use of techniques and/or financial instruments to manage or reduce foreign exchange or market risk. Forward exchange contracts are normally used to limit exposure to foreign exchange risk. Losses incurred on forward exchange contracts offset higher levels of interest income earned through investing in markets other than that of the base currency, and are referred to as "hedging costs".

9. Futures and options contracts are normally used to manage market risk.

Leverage

10. Leverage or gearing is the effect of multiplying profits and losses on financial transactions by obligating more funds than one owns.