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IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board – Seventy-Seventh Session

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REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR THE THIRD QUARTER OF 2002

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the three-month period ending 30 September 2002 and includes comparative figures for year-to-date 2002 and earlier years.

2. The report documents implementation of the new investment policy, asset allocation, investment income, rate of return and performance comparison, currency composition and risk measurement.

II. IMPLEMENTATION OF THE NEW INVESTMENT POLICY

3. The new investment policy, adopted in December 2001, is compared with the former policy in Annex I.

4. During the first quarter of 2002, some 52% of IFAD's equity holdings were sold during a market rally, bringing the remaining equity holdings to some USD 370 million or 19.4% of the overall amount of the investment portfolio. Poor market conditions resulted in declines in the value of equity holdings in both the second and third quarters of 2002.

5. An exercise was carried out in September 2002 to consolidate the mandates comprising European, North American and global equities into two mandates covering European and North American equities, thereby eliminating those managers in this group that had shown a pattern of underperformance against their benchmarks.

6. The consolidation of the equity mandates in the third quarter of 2002 is illustrated in Table 1.

Table 1: Consolidation of Equity Mandates in the Third Quarter of 2002

Portfolio	30 June 2002			30 September 2002		
	Number of Mandates	USD '000 Equivalent	% of Overall Portfolio	Number of Mandates	USD '000 Equivalent	% of Overall Portfolio
Emerging markets equities	1	74 137	3.8	1	63 204	3.1
Currency overlay	1	10 849	0.6	1	10 909	0.5
North American equities	3	62 273	3.2	1	111 001	5.4
European equities	3	81 465	4.2	1	89 358	4.4
Global equities	3	111 482	5.7	–	–	–
Total	**11**	**340 206**	**17.5**	**4**	**274 472**	**13.4**

7. Equity markets rallied in October 2002, and the emerging markets mandate (whose manager had underperformed the benchmark), the currency overlay mandate and 20% of the European equities mandate were liquidated at that time. This brought the cumulative proceeds for equities mandates sold during the implementation of the new investment policy to a total of USD 537.4 million. This compares with an initial amount of USD 533.4 million invested in these equity mandates. Cumulative income for these mandates of USD 53.0 million was offset by exchange losses of USD 49.0 million. Thus, on an aggregate basis, no capital losses were incurred on these sales. This brought holdings of equities to approximately 9.8% of the overall portfolio, or just below the ratio of 10% included in the new investment policy, thus completing the transition from 45% to 10% in equity holdings.

8. For fixed-interest investments, the credit floor of AA- entered into force on 1 August 2002. On the same date, the diversified fixed-interest mandate was funded with USD 220 million, bringing the ratio of the diversified fixed-interest mandate close to 23%, which is the allocation percentage specified in the new investment policy.

III. ASSET ALLOCATION

9. Table 2 compares actual asset allocation of the portfolio's major asset classes to their policy allocations. In the third quarter, a transfer amounting to USD 220 million was made from the internally managed portfolio to the diversified fixed-interest portfolio, as noted in the previous paragraph. Another significant movement during the quarter was the net inflow of USD 99 168 000 equivalent to the internally managed portfolio, representing cash receipts and encashments of Member States' contributions, less disbursements for loans, grants and administrative expenses. Net income, particularly from government bonds, and net losses on equities had an important impact on the ratios of the various asset classes.

Table 2: Summary of Movements in Cash and Investments – Third Quarter 2002
(USD '000 equivalent)

	Internally Managed Portfolio	Government Bonds Portfolio	Inflation-Indexed Bonds Portfolio[1]	Diversified Fixed-Interest Portfolio	Equities Portfolio	Overall Portfolio
Opening balance (30 June 2002)	**458 783**	**927 331**	-	**224 848**	**340 206**	**1 951 168**
Gross investment income (loss)	1 051	48 756	-	14 198	(64 161)	(156)
Income from securities lending and commission recapture	(52)	21	-	7	181	157
Fees, charges and taxes	(32)	(492)	-	(461)	(991)	(1 976)
Net investment income (loss)	**967**	**48 285**	-	**13 744**	**(64 971)**	**(1 975)**
Transfers due to allocation	(218 091)	-	-	220 000	(1 909)	-
Transfers due to expenses	(1 639)	484	-	419	736	-
Transfers between portfolios	**(219 730)**	**484**	-	**220 419**	**(1 173)**	-
Other net flows[2]	99 168	-	-	-	-	99 168
Movements on exchange	(2 501)	(159)	-	(26)	410	(2 276)
Closing balance (30 September 2002)	**336 687**	**975 941**	-	**458 985**	**274 472**	**2 046 085**
Actual ratio (%)	16.5	47.7	-	22.4	13.4	100.0
Policy allocation (%)	5.0	44.0	18.0	23.0	10.0	100.0
Difference in allocation (%)	11.5	3.7	(18.0)	(0.6)	3.4	-

[1] The policy allocates 18% to global inflation-indexed bonds. The asset class was unfunded as of 30 September 2002.
[2] These net inflows consist of cash received from Member States, less disbursements for loans, grants and administrative expenses.

IV. INVESTMENT INCOME

10. Market conditions during the third quarter of 2002 continued to be driven by many of the same investor concerns as in the second quarter, including fears of a global recession, corporate governance issues, threats of further terrorist activities and the possibility of war. The negative sentiment caused a continued sell-off in equity markets, which in turn was the major factor behind a sharp rally in government bond markets.

11. Table 3 shows investment income for the four major asset classes. Aggregate net investment income in the third quarter of 2002 amounted to a loss of USD 1 975 000, which, added to the loss of USD 9 108 000 equivalent in the first six months of 2002, amounted to a loss of USD 11 083 000 equivalent for the first nine months of 2002 (in 2001 the loss was of USD 42 982 000 equivalent).

Table 3: Net Investment Income by Asset Classes
(USD '000 equivalent)

Portfolio	3rd Quarter 2002	2nd Quarter 2002	1st Quarter 2002	Year-to-Date 2002	2001	2000	1999	1998	1997
Internally managed	967	1 383	468	2 818	2 050	3 654	3 114	4 834	18 633
Government bonds	48 285	26 715	(4 493)	70 507	41 471	74 625	(43 977)	195 506	154 228
Diversified fixed-interest	13 744	3 116	960	17 820	13 783	17 615	3 832	6 130	-
Equities	(64 971)	(50 286)	13 029	(102 228)	(100 286)	(143 744)	231 500	(18 571)	(8 921)
Overall portfolio	**(1 975)**	**(19 072)**	**9 964**	**(11 083)**	**(42 982)**	**(47 850)**	**194 469**	**187 899**	**163 940**

12. Table 4 provides details of net investment income earned during the third quarter of 2002 by major sectors of the portfolio.

Table 4: Investment Income on the Overall Portfolio – Third Quarter 2002
(USD '000 equivalent)

	Fixed-Interest Portfolio	Equities Portfolio	Overall Portfolio
Interest from fixed-interest investments and bank accounts	15 658	62	15 720
Dividend income from equities	-	1 481	1 481
Realized capital gains (losses)	6 119	(69 320)	(63 201)
Unrealized capital gains	42 228	3 616	45 844
Subtotal: Gross investment income (loss)	**64 005**	**(64 161)**	**(156)**
Income from securities lending and commission recapture	(24)	181	157
Investment manager fees	(574)	(648)	(1 222)
Custody fees	(218)	(197)	(415)
Financial advisory and other investment management fees	(171)	(51)	(222)
Taxes	19	(90)	(71)
Other investment expenses	(41)	(5)	(46)
Net investment income (loss)	**62 996**	**(64 971)**	**(1 975)**

13. Table 5 shows net investment income for the various sectors of the fixed-interest portfolio in the third quarter of 2002. In aggregate, net income from fixed-interest investments amounted to USD 62 996 000 equivalent in the third quarter of 2002. All sectors of the fixed-interest portfolio, and in particular global government bonds, contributed positively.

Table 5: Investment Income on the Fixed-Interest Portfolio – Third Quarter 2002
(USD '000 equivalent)

	Internally Managed Portfolio	Government Bonds Portfolio	Diversified Fixed-Interest Portfolio	Total Fixed-Interest Portfolio
Interest from fixed-interest investments and bank accounts	1 051	11 275	3 332	15 658
Dividend income from equities	-	-	-	-
Realized capital gains	-	4 313	1 806	6 119
Unrealized capital gains	-	33 168	9 060	42 228
Subtotal: Gross investment income	**1 051**	**48 756**	**14 198**	**64 005**
Income from securities lending and commission recapture	(52)	21	7	(24)
Investment manager fees	-	(261)	(313)	(574)
Custody fees	(32)	(106)	(80)	(218)
Financial advisory and other investment management fees	-	(138)	(33)	(171)
Taxes	-	18	1	19
Other investment expenses	-	(5)	(36)	(41)
Net investment income	**967**	**48 285**	**13 744**	**62 996**

14. In aggregate, net losses from equity investments in the third quarter of 2002 amounted to USD 64 971 000 equivalent, as shown in Table 6 by subportfolio. With the exception of the currency overlay subportfolio, all sectors of the equities portfolio contributed negatively in the third quarter of 2002.

15. Pending further analysis of the results of the consolidation exercise carried out in the last week of September 2002, and the attribution of gains and losses to both liquidated mandates and to the two consolidated mandates, income for the third quarter has been shown on a consolidated basis for subportfolios other than emerging markets equities and currency overlay.

Table 6: Investment Income on the Equities Portfolio – Third Quarter 2002
(USD '000 equivalent)

	Emerging Markets Equities	Currency Overlay	Consolidated Equity Holdings	Total Equities Portfolio
Interest from fixed-interest investments and bank accounts	16	44	2	62
Dividend income from equities	634	-	847	1 481
Realized capital gains (losses)	(1 883)	-	(67 437)	(69 320)
Unrealized capital gains (losses)	(8 427)	-	12 043	3 616
Subtotal: Gross investment income (loss)	**(9 660)**	**44**	**(54 545)**	**(64 161)**
Income from securities lending and commission recapture	38	-	143	181
Investment manager fees	(224)	-	(424)	(648)
Custody fees	(55)	(7)	(135)	(197)
Financial advisory and other investment management fees	(11)	(2)	(38)	(51)
Taxes	(38)	-	(52)	(90)
Other investment expenses	-	-	(5)	(5)
Net investment income (loss)	**(9 950)**	**35**	**(55 056)**	**(64 971)**

V. RATE OF RETURN AND PERFORMANCE COMPARISON

16. There was an overall negative return of -0.10% in the third quarter of 2002, net of investment expenses and movements on exchange.

17. The performance of the various mandates of the investment portfolio is measured against preassigned independent benchmarks, indicating the return that would be expected through passive management of defined sectors of the market. The principal indexes used are the JP Morgan Global Government Bonds Index, Standard & Poor's 500 Index for North American equities and Morgan Stanley Capitalization Index for European equities.

18. Table 7 compares the return of each major section of the portfolio with the appropriate benchmark rate of return. The overall portfolio showed an underperformance of 25 basis points in the third quarter of 2002. The underperformance was mainly due to the equities portfolio and, to a lesser extent, to the fixed-interest portfolio.

Table 7: Performance Compared with Benchmarks

Portfolio	Third Quarter 2002			Year-to-Date 2002		
	Rate of Return %			Rate of Return %		
	Portfolio	Benchmark	Out (Under) Performance	Portfolio	Benchmark	Out (Under) Performance
Internally managed portfolio	0.24	0.24	0.00	0.94	0.94	0.00
Global government bonds	5.26	5.21	0.05	8.24	8.00	0.24
Diversified fixed-interest	3.03	4.29	(1.26)	5.21	8.03	(2.82)
Total fixed-interest	**3.71**	**3.82**	**(0.11)**	**5.93**	**6.15**	**(0.22)**
Japanese equities[1]	-	-	-	7.32	6.42	0.90
Asian and Australasian equities (excluding Japanese)[1]	-	-	-	7.54	7.99	(0.45)
Emerging markets equities	(13.17)	(12.47)	(0.70)	(16.51)	(10.93)	(5.58)
Consolidated equity holdings (composite)	(18.92)	(17.84)	(1.08)	(31.00)	(25.95)	(5.05)
Total equities	**(17.05)**	**(16.10)**	**(0.95)**	**(25.30)**	**(21.68)**	**(3.62)**
Overall portfolio gross rate of return	**(0.01)**	**0.24**	**(0.25)**	**(0.29)**	**1.12**	**(1.41)**
Less expenses	**(0.09)**	**(0.09)**	**0.00**	**(0.31)**	**(0.31)**	**0.00**
Overall portfolio net rate of return	**(0.10)**	**0.15**	**(0.25)**	**(0.60)**	**0.81**	**(1.41)**

[1] The portfolio was liquidated in March 2002.

19. The total fixed-interest portfolio returned a positive 3.71% in the third quarter of 2002, but underperformed its benchmark by 11 basis points. The underperformance stemmed from the

diversified fixed-interest portfolio, due mainly to underweighting of government bonds, which rallied during the quarter.

20. The total equities portfolio returned a negative -17.05% in the third quarter of 2002, compared to a benchmark of -16.10%. The benchmark returns for the underlying equity mandates for the third quarter of 2002, which were consolidated at the end of the quarter, were as follows:

- benchmark for North American equities -17.69%
- benchmark for European equities -23.29%
- benchmark for global equities -18.52%

21. In aggregate, the equities portfolio underperformed its benchmark by 95 basis points. The underperformance stemmed particularly from North American and European small capitalization stocks. Emerging markets equities showed a return that was less negative than the other equity markets. However, the manager underperformed the benchmark due to negative country weighting.

22. Details of the performance in the nine-month period ending 30 September 2002 are presented in the form of graphs in Annex II.

VI. CURRENCY COMPOSITION

23. The majority of IFAD's commitments are expressed in Special Drawing Rights (SDRs). 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 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 the same currency.

24. The Executive Board of the International Monetary Fund (IMF) reviews the SDR valuation basket every five years 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.

25. New units for each of the four currencies comprising the valuation basket were determined on 29 December 2000 so that the value of the SDR was precisely USD 1.30291 in terms of both the old and the new units, which became effective on 1 January 2001. The units applicable, together with their weights as of 1 January and 30 September 2002, are shown in Table 8.

Table 8: Units and Weights Applicable to the SDR Valuation Basket

	1 January 2002		30 September 2002	
Currency	**Units**	**Percentage Weight**	**Units**	**Percentage Weight**
USD	0.5770	46.0	0.5770	43.6
EUR	0.4260	29.9	0.4260	31.7
JPY	21.000	12.7	21.000	13.1
GBP	0.0984	11.4	0.0984	11.6
Total		**100.0**		**100.0**

26. As of 30 September 2002, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth and Fifth Replenishments amounted to USD 2 357 915 000 equivalent (31 December 2001 – USD 2 325 733 000 equivalent), as indicated in Table 9.

Table 9: Currency Composition of Assets at 30 September 2002
(USD '000 equivalent)

Currency Group	Cash and Investments	Promissory Notes	Amounts Receivable from Contributors	Total
USD	858 746	57 180	46 072	961 998
EUR	480 398	54 683	41 491	576 572
JPY	312 827	377	13 213	326 417
GBP	234 422	20 502	-	254 924
Other	159 692	51 484	26 828	238 004
Total	**2 046 085**	**184 226**	**127 604**	**2 357 915**

27. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 238 004 000 equivalent at 30 September 2002 (31 December 2001 – USD 401 647 000 equivalent). These are allocated to currency groups, as indicated in Table 10.

Table 10: Allocation of Assets to Currency Groups at 30 September 2002
(USD '000 equivalent)

Currency Group	Currencies Included in SDR Basket	Non-SDR Currencies Subject to Overlay Arrangements	European Currencies Not Included in the SDR Valuation Basket	Other Currencies Not Included in the SDR Valuation Basket	Non-Convertible Currencies	Total Currencies per Group
USD	961 998	50 182	-	66 407	2 121	1 080 708
EUR	576 572	-	119 294	-	-	695 866
JPY	326 417	-	-	-	-	326 417
GBP	254 924	-	-	-	-	254 924
Total	**2 119 911**	**50 182**	**119 294**	**66 407**	**2 121**	**2 357 915**

28. The alignment of assets by currency group against the SDR valuation basket at 30 September 2002 is shown in Table 11. The balance of the General Reserve at 30 September 2002 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 61 109 000 respectively.

Table 11: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 30 September 2002
(USD '000 equivalent)

Currency Group	Amount per Currency Group	Less: Commitment Denominated in USD	Net Assets per Currency Group	Net Assets % 30 September 2002	Compare SDR Weights % 30 September 2002
USD	1 080 708	(156 109)	924 599	42.0	43.6
EUR	695 866	-	695 866	31.6	31.7
JPY	326 417	-	326 417	14.8	13.1
GBP	254 924	-	254 924	11.6	11.6
Total	**2 357 915**	**(156 109)**	**2 201 806**	**100.0**	**100.0**

29. As of 30 September 2002, there were shortfalls in United-States-dollar currency group holdings and, to a smaller extent, euro currency group holdings. The shortfalls were offset by excess Japanese-yen currency group holdings. The excess holdings of Japanese yen are attributable to the overweighting of this currency by government bond managers.

VII. RISK MEASUREMENT

30. The investment portfolio is subject to fluctuations in returns due to economic and market conditions. Historically, different asset classes have shown different levels of volatility, often referred to as 'risk'. Volatility is measured in terms of standard deviations of portfolio returns from their mean.

31. At 30 September 2002, the standard deviation of IFAD's policy allocation according to the new investment policy was 2.9%, compared to 2.5% for the actual portfolio, based on five years of historical monthly data.

32. Value-at-risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount the portfolio could lose over a three-month time horizon, with a 95% confidence level. Table 12 shows the VaR of IFAD's actual portfolio and current policy allocation, based on five years of historical monthly data. At 30 September 2002, the VaR of the actual portfolio was lower than at the end of the previous quarter and was also below the policy VaR. This was partly due to the lower ratio of equities at 30 September 2002 as a result of lower market prices. Another factor that reduced risk was the implementation in August 2002 of a credit floor of AA- for the fixed-interest portfolio. Thirdly, the consolidation exercise in September 2002 eliminated equity mandates specialized in small capitalization stocks, which normally carry a higher risk.

33. The portfolio's relatively low VaR is also due to the high level of cash holdings in the internally managed portfolio, pending further investment in inflation-indexed bonds.

Table 12: Value-at-Risk

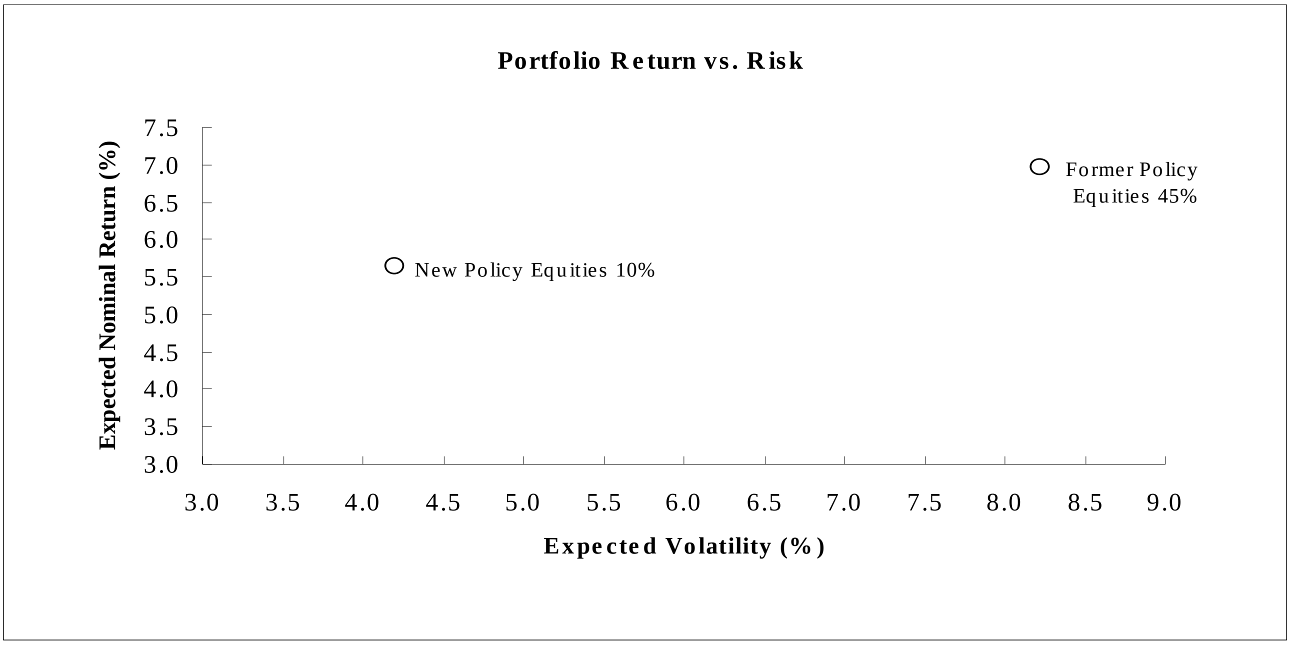
(Forecast horizon of three months; confidence level 95%)

Date	Portfolio		Policy[1]	
	VaR %	Amount USD '000	VaR %	Amount USD '000
30 September 2002	2.1	42 500	2.4	49 100
30 June 2002	2.5	49 000	2.4	46 800
31 March 2002	2.9	54 700	2.4	45 700
31 December 2001	5.5	105 100	6.2	119 100

[1] The new investment policy is reflected in the policy VaR as of 31 March 2002.

SUMMARY OF PORTFOLIO CHARACTERISTICS –

NEW AND FORMER INVESTMENT POLICIES



Asset Class[1]	Assumptions		New Policy	Former Policy
	Nominal Return%	Volatility %		
Cash (%)	3.0	2.9	5.0	5.0
Government bonds (%)	5.3	5.6	44.0	40.0
Diversified fixed-interest (%)	5.6	6.0	23.0	10.0
Global inflation-indexed bonds (%)	5.3	2.8	18.0	-
Global equities (%)	9.2	15.9	10.0	45.0
Total (%)			100.0	100.0
Return				
(i) Expected coupon/dividend payments (USD million)[2]			98	74
(ii) Expected nominal return (%)			5.6	7.0
(iii) Probability % of achieving in 3 years a minimum average return of 3%			88	82
(iv) Cumulative returns over 3 years:				
Expected cumulative return (%)			17.9	22.4
Expected minimum cumulative return % (95% confidence level)			3.4	-6.1
Expected maximum cumulative return % (95% confidence level)			32.5	50.9
Risk				
(v) Expected volatility (%)			4.2	8.2
(vi) Expected value-at-risk (USD million)[3]			139	271
Risk-adjusted return				
(vii) Sharpe ratio			0.63	0.48

[1] The credit floor for fixed-interest investments is AA-.

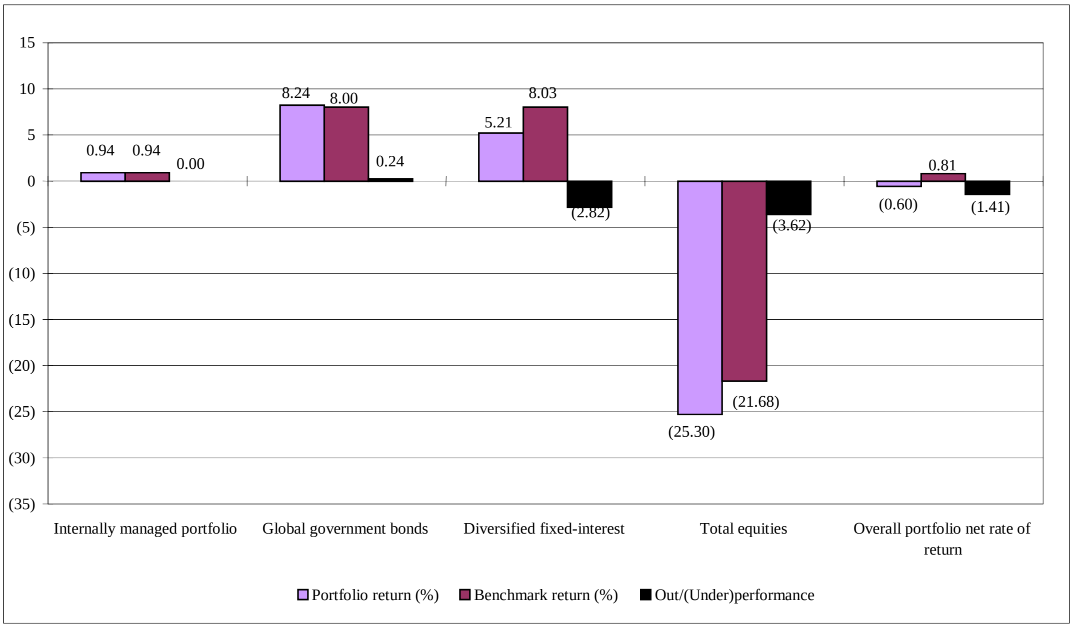
[2] Calculated for a total portfolio of USD 2 billion.

[3] Calculated in USD million with a one-year horizon and 95% confidence level, on the basis of a total portfolio of USD 2 billion.

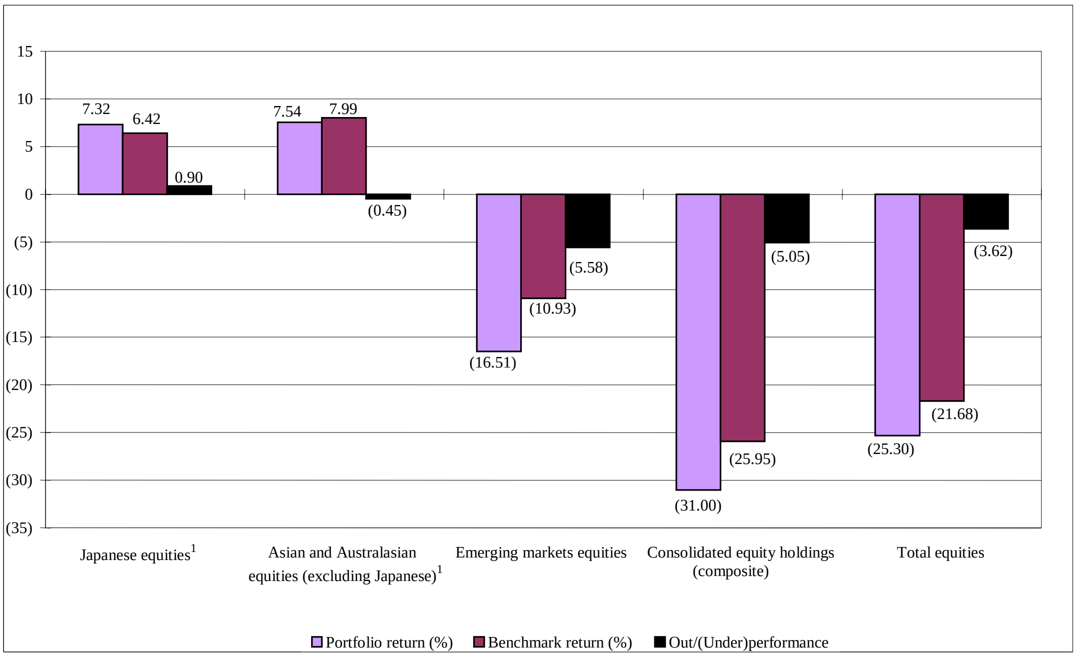
ANNEX II

PERFORMANCE YEAR-TO-DATE 2002

OVERALL PORTFOLIO



EQUITIES PORTFOLIO



[1] The portfolio was liquidated in March 2002.