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REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR 2002

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the year ending 31 December 2002 and includes comparative figures for the year ending 31 December 2001 and earlier years. In addition, Annex XXIII includes a report on the performance of the investment portfolio during the fourth quarter of 2002.

2. The report includes the following nine sections: highlights, investment conditions, implementation of the new investment policy, asset allocation, investment income, rate of return and performance comparison, composition of the portfolio, and risk measurement.

II. HIGHLIGHTS

3. Investments in 2002 reflected fears of a global recession, negative corporate news, threats of further terrorist activities and the possibility of a war. As a result, there was a flight to quality assets such as government bonds, and overall sentiment towards equity investments remained negative.

4. In aggregate, net investment income amounted to USD 26 170 000 equivalent (excluding income from Supplementary Funds amounting to USD 47 000 equivalent). This represented an average net rate of return of 1.26% and an average underperformance of 125 basis points against the benchmark.

5. IFAD's fixed-interest portfolio was favoured by the investment conditions during most of the year. It achieved a rate of return of 7.22%, which matched the benchmark return. IFAD's equities portfolio, on the other hand, was negatively affected by the investment conditions and, despite positive returns both in the first and last quarters, it returned -21.56% in 2002, underperforming its benchmark by 390 basis points.

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6. The amount of the investment portfolio increased from USD 1 917 089 000 equivalent at the end of 2001 to USD 2 093 993 000 equivalent at the end of 2002. The increase was due to positive movements from investment income, exchange movements and other net flows.

7. IFAD's new investment policy, adopted in December 2001, introduced two main changes: the reduction of equity holdings from 45 to 10% and an increase in the credit floor to AA- for fixed-interest investments. The new policy was fully implemented in 2002 with the exception of the asset class of inflation-indexed bonds, which due to market conditions remained unfunded as of 31 December 2002, with the unfunded amount held in cash and time deposits.

8. A new global custodian was selected in November 2002, and the transition will take place on 1 April 2003.

III. INVESTMENT CONDITIONS

9. This section reviews the economic and investment environment prevailing in 2002.

A. Economic Background

10. Annex I shows the percentage change in real gross domestic product (GDP) for the countries whose currencies are included in the Special Drawing Rights (SDR) valuation basket, namely, the United States, Japan, the euro-zone countries and the United Kingdom. GDP rates generally fell in 2002, except in the United States where the economy recovered in 2002 and grew 2.4% with the support of record-low interest rates, tax cuts and government spending. The United States economy is forecast to continue growing in 2003. The Japanese economy still had difficulties in recovering from its long recession and contracted by 0.2% in 2002, although forecasts expect some moderate growth in 2003. In the euro zone, the economy grew by only 0.8% in 2002, down from 1.4% in 2001; growth is expected to improve mainly in the second half of 2003. The United Kingdom's economy grew 1.8% in 2002, which is somewhat lower than in 2001; its economy is forecast to improve in 2003.

11. Annex II shows the inflation figures for the countries whose currencies are in the SDR valuation basket. In 2002, inflation fell in the United States and is anticipated to rise only slightly despite the increase in energy prices and a weaker United States dollar. Japan's prices fell further in 2002, and the deflationary trend is predicted to continue in 2003. Inflation also fell in the euro zone due to weak economic growth and the stronger currency, and the trend of falling inflation is expected to continue. In the United Kingdom, inflation fell in 2002, but is predicted to rise as a result of stronger economic growth.

12. Annex III shows unemployment rates as a percentage of the labour force for countries whose currencies are included in the SDR valuation basket. In 2002, unemployment rates rose in the United States and Japan due to the prevailing economic conditions, while they remained unchanged in the euro zone and the United Kingdom. Unemployment rates are broadly expected to rise somewhat in the future as companies struggle to improve profits.

13. Annex IV shows the evolution of central bank interest rates for countries whose currencies are included in the SDR valuation basket. The United States Federal Reserve Bank lowered the federal funds rate once in 2002, from 1.75% to the 40-year low of 1.25%, in another effort to support business and consumer confidence. The Bank of Japan continued its zero-rate policy and is expected to maintain this policy until consumer prices register at least a zero percent change year on year. The European Central Bank lowered its refinancing rate once, from 3.25 to 2.75%, to reduce the impact of the global economic slowdown and to bolster weak business and consumer confidence. Further cuts were, however, held back by inflation, which was above the central bank's target. In the United Kingdom, the Bank of England maintained its base rate at 4.0% in 2002.

14. Annex V illustrates month-end exchange rates for the United States dollar against the four currencies in the SDR valuation basket. The United States dollar depreciated strongly against the other three currencies, and especially against the euro.

15. Annex VI shows the budget deficit as a percentage of GDP for countries whose currencies are included in the SDR valuation basket. The United States showed a budget deficit for 2002, as corporate tax payments decreased due to the economic downturn; the deficit is forecast to grow further in 2003. Japan's budget deficit decreased slightly and is forecast to decrease further. However, the deficit remains high. Most euro-zone countries showed a deficit, and their aggregate deficit is expected to increase somewhat. The United Kingdom also showed a deficit in 2002, which is expected to increase in 2003.

B. Financial Market Background

16. Annex VII shows the evolution of short- and long-term interest rates for countries whose currencies are included in the SDR valuation basket. While short-term rates fell in the United States and the euro zone, reflecting the lowering of central bank interest rates, they remained broadly unchanged in Japan and the United Kingdom. Long-term interest rates fell significantly in the United States during the second half of 2002, as a result of investors' desire for quality assets such as government bonds. The same trend was seen in the euro zone, the United Kingdom and Japan, but with more moderate falls in long-term interest rates.

17. Annex VIII shows bond market returns for countries included in the J.P. Morgan Global Government Bonds Traded Index. The benchmark index includes both coupon and capital gains and losses, in line with market practice. With the exception of the Japanese bond market, which showed a moderate return, all other bond markets posted strong positive returns reflecting the development of long-term interest rates. The United States and several euro-zone countries significantly outperformed the overall bond markets.

18. Annex IX shows the performance of the J.P. Morgan Global Government Bonds Traded Index (reweighted for currency matching purposes) in local currency terms compared with the benchmark for diversified fixed-interest investments. The latter includes both United States Treasury bonds and mortgages and corporate bonds denominated in United States dollars, including emerging market and corporate bonds with a credit rating below AA- prior to 1 August 2002. During the first half of 2002, diversified fixed-interest investments, and especially the mortgage bond sector, outperformed government bonds. However, the return gap was closed in the third quarter of 2002, when government bonds were strongly favoured by investors. The fourth quarter showed minimal return differences between government bonds and diversified fixed-interest investments, due principally to the implementation of the increase in the minimum credit rating of the diversified fixed-interest investments required by IFAD's new investment policy, which reduced the differences in return and the volatility between the two asset classes.

19. Annex X shows the developments of North American and European equity markets. These are the only two remaining equity markets in which IFAD is invested. Aside from a few equity rallies (mainly in March and October-November), the year 2002 was overall very negative for equity investments. Fears of a global recession, weak corporate earnings, corporate governance scandals, together with threats of further terrorist activities and the possibility of war were the main factors driving negative equity sentiment and causing several equity sell-offs during the year.

IV. IMPLEMENTATION OF THE NEW INVESTMENT POLICY

20. The composition and characteristics of the new investment policy, adopted in December 2001, are shown in Annex XI.

21. Implementation of the new investment policy began in January 2002 with the introduction of dividend repatriation, whereby all dividends earned on equity investments are moved into a cash account within the internally managed portfolio. This replaces the previous practice of dividends being reinvested in equities by the external investment managers.

22. In early March 2002, the equity markets rallied strongly and provided an opportunity to liquidate five equity portfolios without incurring losses. The initial funding of the mandates amounted to USD 384.5 million equivalent, and the final sales proceeds amounted to USD 423.8 million equivalent. These sales corresponded to some 54% of IFAD's equity holdings at the beginning of 2002.

23. The proceeds of the equity sales in March were transferred to the internally managed portfolio, where they were invested in time deposits, and to IFAD's accounts with central banks, pending further investment in fixed-interest instruments.

24. For fixed-interest investments, the credit floor of AA- specified in the new investment policy was implemented on 1 August 2002 through the issuance of revised investment guidelines for external investment managers handling IFAD's diversified fixed-interest portfolio. On the same date, the diversified fixed-interest mandates were funded with USD 220 million, bringing the ratio of the diversified fixed-interest portfolio close to 23%, the allocation percentage specified in the new investment policy.

25. In July 2002, IFAD appointed a transition manager mandated to consolidate the equity mandates comprising European, North American and global equities into two mandates covering European and North American equities. The consolidation exercise, carried out in September 2002, resulted in a reduction in the number of investment managers from eleven to four, through the elimination of investment managers that had shown a pattern of underperformance against their benchmarks.

26. In October 2002, equity markets experienced a new rally, and the emerging markets mandate (whose manager had underperformed against the benchmark), the currency overlay mandate and 20% of the European equities mandate were liquidated at that time. This reduced IFAD's equities portfolio to the two remaining mandates for North American and European equities. The equities sold in October brought the final, cumulative proceeds from equities mandates sold during the implementation of the new investment policy to a total of USD 534.8 million. This compares with an initial amount of USD 533.4 million invested in these equities mandates. Cumulative income of USD 61.0 million from sold mandates was largely offset by exchange losses of USD 59.7 million. The equity sales in October 2002 brought holdings of equities to approximately 10% of the overall portfolio, thus completing the transition from 45% to 10% in equity holdings as required by the new investment policy.

27. Annex XII shows details of sales proceeds for each equity portfolio sold during the implementation of IFAD's new investment policy.

28. On the basis of an international tender and an internal evaluation process, a new global custodian was selected in November 2002, and preparatory work was begun to implement the transition on 1 April 2003.

29. The new investment policy was fully implemented in 2002 with the exception of the asset class

of inflation-indexed bonds, which in view of currently low yields remained unfunded as of 31 December 2002, with the unfunded amount being held in cash and time deposits.

V. ASSET ALLOCATION

30. Table 1 shows the movements affecting the investment portfolio's major asset classes in year 2002 and compares the portfolio's actual asset allocation to the policy allocation. As part of the implementation of the new investment policy, a total amount of USD 523 946 000 equivalent was transferred out of the equities portfolio (2001 – USD 14 200 000), consisting of proceeds from equity sales and the repatriation of dividends earned on equity investments. As a result, equity holdings amounted to 9.5% of the overall portfolio at year-end, which is the equity allocation percentage specified in the new investment policy. Annex XIII gives further details on the movements in the equities portfolio and on the balances in equity holdings at year-end.

Table 1: Summary of Movements in Cash and Investments – Year 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 (31 December 2001)	**70 020**	**841 484**	-	**220 107**	**785 478**	**1 917 089**
Gross investment income	4 205	87 926	-	24 287	(82 820)	33 598
Income from securities lending and commission recapture	-	79	-	34	323	436
Fees, charges and taxes	(123)	(2 464)	-	(1 396)	(3 881)	(7 864)
Net investment income	**4 082**	**85 541**	-	**22 925**	**(86 378)**	**26 170**
Transfers due to allocation[2]	303 946	-	-	220 000	(523 946)	-
Transfers due to expenses	(6 855)	2 370	-	1 145	3 340	-
Transfers among portfolios	**297 091**	**2 370**	-	**221 145**	**(520 606)**	-
Other net flows [3]	12 306	-	-	-	-	12 306
Movements on exchange	24 638	92 983	-	41	20 766	138 428
Closing balance (31 December 2002)	**408 137**	**1 022 378**	-	**464 218**	**199 260**	**2 093 993**
Actual allocation (%)	19.5	48.8	-	22.2	9.5	100.0
Policy allocation (%)	5.0	44.0	18.0	23.0	10.0	100.0
Difference in allocation (%)	**14.5**	**4.8**	**(18.0)**	**(0.8)**	**(0.5)**	**0.0**

[1] The policy allocates 18% to inflation-indexed bonds. The asset class was unfunded as of 31 December 2002.
[2] These transfers refer to cash transfers due to sales or purchases of securities and to repatriation of dividends earned on equity holdings.
[3] These net flows consist of cash received from Member States, less disbursements for loans, grants and administrative expenses.

31. Out of the proceeds from equity sales, USD 220 000 000 was transferred to the diversified fixed-interest mandate on 1 August 2002. Since then, the allocation of the diversified fixed-interest mandate has been close to 23%, which is the allocation percentage specified in the new investment policy.

32. The balance of the transfers from the equities portfolio, i.e. USD 303 946 000 equivalent, was kept in the internally managed portfolio, where it was invested in time deposits and IFAD's accounts with central banks, pending reinvestment in fixed-interest instruments and particularly in inflation-indexed bonds. As a result, the allocation to the internally managed portfolio exceeded the policy allocation at year-end. Also the allocation to government bonds exceeded the policy allocation at year-end, following the strong surge in market values of government bonds during the year.

33. Changes in allocation ratios also reflect differences in income, and large positive movements on exchange due to the appreciation of most currencies against the United States dollar. Additionally, there was a net inflow of USD 12 306 000 equivalent to the overall portfolio, consisting of cash received from Member States, less disbursements for loans, grants and administrative expenses.

VI. INVESTMENT INCOME

34. According to IFAD's financial statements for 2002, investment income amounted to USD 26 217 000 equivalent (2001 – loss USD 42 857 000). This amount takes into account income from Supplementary Funds amounting to USD 47 000 (2001 – USD 125 000).

35. Excluding income deriving from Supplementary Funds, net investment income in 2002 amounted to USD 26 170 000 equivalent (2001 – loss USD 42 982 000). In line with market practice, capital gains and losses include both realized and unrealized gains and losses. All amounts are included on an accrual basis. Table 2 shows net investment income for the year 2002 and earlier years for the major asset classes.

Table 2: Net Investment Income by Asset Class
(USD '000 equivalent)

Portfolio	2002	2001	2000	1999	1998	1997
Internally managed portfolio	4 082	2 050	3 654	3 114	4 834	18 633
Government bonds portfolio	85 541	41 471	74 625	(43 977)	195 506	154 228
Inflation-indexed bonds portfolio[1]	-	-	-	-	-	-
Diversified fixed-interest portfolio	22 925	13 783	17 615	3 832	6 130	-
Equities portfolio	(86 378)	(100 286)	(143 744)	231 500	(18 571)	(8 921)
Overall portfolio	**26 170**	**(42 982)**	**(47 850)**	**194 469**	**187 899**	**163 940**

[1] The asset class was unfunded as of 31 December 2002.

36. Table 3 shows details of the net investment income earned during the period under review and for the years 1997 to 2001.

Table 3: Investment Income –Year 2002 and Prior Years
(USD '000 equivalent)

	2002							
	Total Fixed-Interest Portfolio	**Total Equity Portfolio**	**Overall Portfolio**	**2001 Overall Portfolio**	**2000 Overall Portfolio**	**1999 Overall Portfolio**	**1998 Overall Portfolio**	**1997 Overall Portfolio**
Interest from fixed-interest investments and bank accounts	61 241	284	61 525	59 241	68 819	90 253	112 668	128 779
Dividend income from equities	-	7 652	7 652	13 614	11 760	8 684	5 654	94
Realized capital gains/(losses)	12 141	(101 261)	(89 120)	(74 793)	8 264	3 861	40 846	21 535
Unrealized capital gains/(losses)	43 036	10 505	53 541	(31 400)	(125 724)	101 272	36 111	19 657
Subtotal: Gross investment income/(loss)	**116 418**	**(82 820)**	**33 598**	**(33 338)**	**(36 881)**	**204 070**	**195 279**	**170 065**
Income from securities lending and Commission recapture	113	323	436	841	440	539	905	463
Investment manager fees	(2 375)	(2 491)	(4 866)	(7 037)	(7 993)	(7 192)	(5 660)	(3 708)
Custody fees	(807)	(814)	(1 621)	(2 103)	(2 581)	(1 870)	(1 469)	(1 066)
Financial advisory and other investment management fees	(569)	(222)	(791)	(688)	(515)	(508)	(610)	(683)
Taxes	-	(365)	(365)	(606)	(167)	(286)	(129)	(1 131)
Other investment expenses	(232)	11	(221)	(51)	(153)	(284)	(417)	-
Net investment income/(loss)	**112 548**	**(86 378)**	**26 170**	**(42 982)**	**(47 850)**	**194 469**	**187 899**	**163 940**

37. As of 31 December 2002, the fixed-interest portfolio consisted of three sub-portfolios: the internally managed portfolio, and the externally managed government bonds and diversified fixed-interest portfolios. In aggregate, the net income from fixed-interest investments in 2002 amounted to USD 112 548 000 equivalent, as shown in Table 4. All sections of the fixed-interest portfolio and particularly the government bonds portfolio contributed positively to income.

Table 4: Investment Income on the Fixed-Interest Portfolio – Year 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	4 205	44 474	12 562	61 241
Dividend income from equities	-	-	-	-
Realized capital gains	-	6 013	6 128	12 141
Unrealized capital gains	-	37 439	5 597	43 036
Subtotal: Gross investment income	**4 205**	**87 926**	**24 287**	**116 418**
Income from securities lending and commission recapture	-	79	34	113
Investment manager fees	-	(1 589)	(786)	(2 375)
Custody fees	(123)	(422)	(262)	(807)
Financial advisory and other investment management fees	-	(438)	(131)	(569)
Taxes	-	-	-	-
Other investment expenses	-	(15)	(217)	(232)
Net investment income	**4 082**	**85 541**	**22 925**	**112 548**

38. At the beginning of 2002, the equities portfolio comprised seven externally managed sub-portfolios. These were Japanese equities, Asian and Australasian equities, emerging markets equities, a currency overlay mandate, North American equities, European equities and global equities. By 31 December 2002, following the liquidation and consolidation of the equities portfolio undertaken in 2002, the two remaining sub-portfolios consisted of North American and European equities. In aggregate, the net income from equities investments in 2002 amounted to a loss of USD 86 378 000 equivalent, as shown in Table 5. Four sub-portfolios contributed negatively, namely global equities followed by European equities, North American equities and emerging market equities. Their negative contribution was partly offset by Japanese equities, Asian and Australasian equities, and the currency overlay mandate, which all produced positive income prior to their liquidation in 2002.

Table 5: Investment Income on the Equities Portfolio – Year 2002
(USD '000 equivalent)

	Japanese Equities[1]	Asian and Australasian Equities[1]	Emerging Markets Equities[2]	Currency Overlay[2]	North American Equities	European Equities	Global Equities[3]	Total Equities Portfolio
Interest from fixed-interest investments and bank accounts	-	55	48	161	5	10	5	284
Dividend income from equities	13	889	2 019	-	1 432	1 658	1 641	7 652
Realized capital gains/(losses)	(9 662)	14 520	(6 055)	-	(14 768)	(33 402)	(51 894)	(101 261)
Unrealized capital gains/(losses)	16 586	(8 379)	(6 815)	-	(7 076)	2 363	13 826	10 505
Subtotal: Gross investment income/(loss)	**6 937**	**7 085**	**(10 803)**	**161**	**(20 407)**	**(29 371)**	**(36 422)**	**(82 820)**
Income from securities lending and commission recapture	9	37	75	-	62	62	78	323
Investment manager fees	(84)	(151)	(759)	-	(558)	(432)	(507)	(2 491)
Custody fees	(13)	(56)	(180)	(30)	(181)	(167)	(187)	(814)
Financial advisory and other investment management fees	(11)	(12)	(35)	(5)	(50)	(49)	(60)	(222)
Taxes	-	(15)	(98)	-	(2)	(164)	(86)	(365)
Other investment expenses	-	3	-	-	-	6	2	11
Net investment income/(loss)	**6 838**	**6 891**	**(11 800)**	**126**	**(21 136)**	**(30 115)**	**(37 182)**	**(86 378)**

[1] The portfolio was liquidated in March 2002.
[2] The portfolio was liquidated in October 2002.
[3] Part of the portfolio was liquidated in March 2002, and the remainder was consolidated with North American and European equities in September 2002.

39. Annex XIV includes a comparison of gross income since 1997 for the major portions of the portfolio, indicating the ratios of income earned through capital gains, interest income and dividends. During the six-year period shown, the overall gross income corresponded mostly to interest and dividend income rather than to capital gains.

VII. RATE OF RETURN AND PERFORMANCE COMPARISON

Overall Rate of Return

40. There was an overall positive return of 1.26% in year 2002 (2001 – negative -2.26 %), net of investment expenses and movements on exchange. Fixed-interest markets contributed strongly, despite a slightly negative performance in the first quarter. However, overall returns in 2002 were affected by the negative performance in equities markets, especially in the second and third quarters of the year.

Portfolio Performance Compared with Benchmark

41. The performance of the various mandates of the investment portfolio is measured against pre-assigned independent benchmarks, indicating the return that would be expected through passive management of defined sectors of the market. The indices used as of 31 December 2002 were the J.P. Morgan Global Government Bonds Traded Index for government bonds, Lehman Brothers United States Aggregate Index for diversified fixed-interest bonds, Standard & Poor's (S&P) 500 for North American equities and the Morgan Stanley Capitalization Index for European equities.

42. Table 6 compares the return of each major section of the portfolio with the appropriate benchmark rate of return. The overall portfolio showed an underperformance of 125 basis points in 2002 (2001 – underperformance of 9 basis points). This information is presented graphically in Annex XV.

Table 6: Performance Compared with Benchmarks – Year 2002

Portfolio	Rate of Return %		Out/(Under) Performance
	Portfolio	Benchmark	
Internally managed portfolio	1.33	1.33	0.00
Government bonds portfolio	9.98	9.34	0.64
Diversified fixed-interest portfolio	6.46	9.23	(2.77)
Total fixed-interest	**7.22**	**7.22**	**0.00**
Japanese equities	7.32	6.42	0.90
Asian and Australasian equities (excluding Japan)	7.54	7.99	(0.45)
Emerging markets equities	(14.11)	(7.98)	(6.13)
North American equities	(25.22)	(18.53)	(6.69)
European equities	(32.92)	(26.30)	(6.62)
Global equities	(27.30)	(26.02)	(1.28)
Total equities	**(21.56)**	**(17.66)**	**(3.90)**
Overall portfolio gross rate of return	**1.64**	**2.89**	**(1.25)**
Less expenses	**(0.38)**	**(0.38)**	**0.00**
Overall portfolio net rate of return	**1.26**	**2.51**	**(1.25)**

43. As indicated in Table 6, the overall return for the fixed-interest portfolio was 7.22%, which matched the aggregated benchmark return.

44. Within the fixed-interest portfolio, the government bonds portfolio returned 9.98% in 2002, outperforming its benchmark by 64 basis points. A performance attribution for the portfolio is shown in Annex XVI for the total year and by quarter. In summary:

- Some 20 basis points of outperformance were due to managers' country weightings. The major gain arose from managers' underweighting of Japanese bonds, which underperformed other bond markets.
- Some 10 basis points of underperformance arose from bond selection and duration, although the managers' overall duration was approximately in line with benchmark, as shown in Table 7. However, managers did not fully benefit from the strong rally in the United States' bond markets in the second and third quarters.
- Some 50 basis points of outperformance remained unattributed, mainly due to timing impact.

Table 7: Duration of Global Government Bonds and Diversified Fixed-Interest
(Years)

	31 December 2002 (years)	31 December 2001 (years)
Global government bonds portfolio[1]	5.7	6.3
Global government bonds benchmark	6.2	6.0
Diversified fixed-interest portfolio[2]	2.2	4.6
Diversified fixed-interest benchmark	4.4	4.8

[1] The duration of fixed-interest securities, excluding cash and cash equivalents, was 6.1 years as of 31 December 2002.
[2] The duration of fixed-interest securities, excluding cash and cash equivalents, was 3.2 years as of 31 December 2002. The duration of 2.2 years in the above table reflects the large amount of cash and cash equivalents held in the portfolio at 31 December 2002 due to amounts payable for securities purchased.

45. Also within the fixed-interest portfolio, the diversified fixed-interest portfolio returned 6.46%, underperforming its benchmark by 277 basis points. A performance attribution for the diversified fixed-interest portfolio is shown in Annex XVII for the total year and by quarter. In summary:

- Some 210 basis points of underperformance were due to sector allocation, mainly the result of managers' underweighting of United States government bonds, which strongly outperformed other types of bonds.
- Some 270 basis points of underperformance were due to managers' bond selection, including impact from duration and credit quality, and arose mainly from corporate bonds, mortgages and, to a smaller extent, from emerging markets bonds, which were included in the portfolio prior to the change of investment guidelines on 1 August 2002. The negative impact was concentrated in the second and third quarters, a period favouring government bonds instead of bonds with lower credit quality. The portfolio's overall duration, compared to benchmark, is shown in Table 7 above.
- Some 200 basis points of outperformance remained unattributed, mainly due to timing impact and cash holdings.

46. As was indicated in Table 6, the overall equities portfolio returned -21.56%. This is compared to the aggregate benchmark return of -17.66%, resulting in an underperformance of 390 basis points for the overall equities portfolio. The Japanese equities mandate outperformed, but all other equities mandates underperformed. A performance attribution analysis for the different equities mandates is shown in Annex XVIII by quarter and aggregated for year 2002, although unattributed impact remained high for some portfolios because of the significant equity transactions that took place during the implementation of the new investment policy. In summary:

- Prior to their liquidation in March 2002, the Japanese and the Asian and Australasian equities mandates benefited from their sector allocations, but stock selection did not prove positive in this short period.
- Prior to its liquidation in October 2002, the emerging markets equities mandate largely underperformed as a result of its country allocation, which implied some heavy over- and underweighting of countries compared to benchmark.
- The North American equities mandate underperformed its benchmark significantly and this was especially due to stock selection in the two sub-portfolios containing medium and small capitalization stocks. In these sub-portfolios, selection in the sectors of information technology and consumer discretionary goods had the biggest underperformance. In September 2002, the above mentioned sub-portfolios were eliminated through the consolidation of all North American equities into one portfolio.
- The European equities portfolio also underperformed significantly, with the underperformance pertaining particularly to stock selection in two sub-portfolios containing small capitalization stocks. These sub-portfolios were eliminated in September 2002 through the consolidation of all European equities into one portfolio.

- The global equities mandate underperformed mainly due to stock selection in the United States equities market, i.e. the mandate's biggest market. A part of the portfolio had been liquidated in March 2002, but in September 2002 the balance was consolidated with the two remaining mandates for North American and European equities.

Portfolio Performance Compared with Manager Universe

47. Table 8 shows a comparison of the 2002 performance of IFAD's externally managed mandates against a universe of investment managers provided by IFAD's financial advisors. The comparison uses returns in USD terms and includes an element of exchange gain and loss rather than local currency returns, which are used elsewhere in this report. The comparison is also of an indicative nature, since all portfolios have their own specific investment guidelines, which do not precisely match the guidelines used by IFAD. As indicated in Table 8, one mandate of IFAD's investment portfolio showed an outperformance against both the universe and its own benchmarks – the government bonds portfolio (2001 – Japanese equities and Asian Australasian equities, both liquidated in March 2002). Two mandates showed an underperformance against both the universe and their own benchmarks – North American equities and European equities (2001 – emerging markets equities, European equities and global equities). Other mandates showed an outperformance either against their own benchmark or against the indicative universe performance.

48. As of reporting date, performance comparison figures for year 2002 were not available from other international financial institutions. This information will be reported on when available.

Table 8: Portfolio Performance Compared with Manager Universe for Year 2002

	Rate of Return% in USD terms[1]				
Type of Mandate	**Median Universe Performance**	**IFAD Investment Portfolio**	**IFAD Benchmark**	**IFAD Out/(Under) Performance against Universe**	**IFAD Out/(Under) Performance against Benchmark**
Government bonds	18.0	21.5	20.6	3.5	0.9
Diversified fixed-interest[2]	2.5	6.5	9.2	4.0	(2.7)
Emerging markets equities[3]	(12.2)	(14.0)	(14.6)	(1.8)	0.6
North American equities[4]	(19.2)	(25.2)	(18.5)	(6.1)	(6.7)
European equities[5]	(16.7)	(21.1)	(15.5)	(4.4)	(5.6)
Global equities[6]	(26.3)	(25.9)	(23.5)	0.4	(2.4)

1 The differences between returns on IFAD's investment portfolio and its benchmarks in this table compared to other tables in this report are due to movements on exchange rates.
2 Universe performance refers to high-yield bonds, and is only an indicative comparison since high-yield bonds have a lower credit quality than IFAD's current investment policy. The new credit floor of AA- was implemented in IFAD's investment portfolio as of 1 August 2002.
3 Comparison is for first three quarters only since IFAD's emerging markets mandate was liquidated in October 2002.
4 Universe performance refers to 50% large capitalization stocks and 50% small capitalization stocks. In 2002, on average IFAD's investment portfolio had 71% large capitalization stocks and 29% medium and small capitalization stocks.
5 Universe performance refers to large capitalization stocks, and is only an indicative comparison. In 2002, on average IFAD's investment portfolio had 73% large capitalization stocks and 27% small capitalization stocks.
6 Comparison is for first three quarters only since the balance of IFAD's global equities mandate was consolidated with the North American and European equities mandates in September 2002.

VIII. COMPOSITION OF THE PORTFOLIO

General

49. As of 31 December 2002, the Fund's investment portfolio amounted to USD 2 093 993 000 equivalent (31 December 2001 – USD 1 917 089 000), excluding amounts subject to restrictions. In 2002, prior to movements in exchange rates, the amount of the portfolio increased by USD 38 476 000 equivalent (2001 – a decrease of USD 63 395 000 equivalent). An analysis of cash flows is provided in Annex XIX and is summarized in Table 9.

Table 9: Analysis of Cash Flows in the Overall Portfolio
(USD '000 equivalent)

	12 Months to 31 December 2002	12 Months to 31 December 2001
Opening balance	1 917 089	2 068 191
Net investment income	26 170	(42 982)
Other inflows	395 158	368 514
Outflows	(382 852)	(388 927)
Increase/(decrease), prior to exchange movements	38 476	(63 395)
Exchange movements	138 428	(87 707)
Closing balance	2 093 993	1 917 089

Composition of the Portfolio by Instrument

50. IFAD's portfolio is divided into fixed-interest and equities portfolios. Table 10 provides an analysis of the instruments found in each of the main sections of the investment portfolio, while a more detailed analysis of the fixed-interest portfolio is found in Annex XX.

Table 10: Analysis of the Portfolio by type of Mandate and by Instrument at 31 December 2002
(USD '000 equivalent)

Instruments	Total Fixed-Interest Portfolio 31.12.2002	Total Equities Portfolio 31.12.2002	Overall Portfolio 31.12.2002	Overall Portfolio 31.12.2001
Cash	322 043	856	322 899	71 702
Time deposits	379 746	3 213	382 959	131 922
Global government bonds	1 004 660	-	1 004 660	819 462
Emerging markets bonds	-	-	-	22 923
Mortgage-backed securities	315 606	-	315 606	78 187
Asset-backed securities	56 466	-	56 466	3 460
Corporate bonds	32 132	-	32 132	70 809
Equities	-	195 183	195 183	755 927
Futures	951	-	951	(39)
Options	(226)	-	(226)	530
Open trades	(238 569)	(187)	(238 756)	(58 018)
Accrued interest income	21 183	-	21 183	18 989
Dividends receivable	-	195	195	499
Non-convertible currencies	741	-	741	736
Total	**1 894 733**	**199 260**	**2 093 993**	**1 917 089**
Actual allocation (%)	90.5	9.5	100.0	100.0
Policy allocation (%)	90.0	10.00	100.0	100.0
Difference in allocation (%)	**0.5**	**(0.5)**	-	-

Composition of the Portfolio by Currency

51. The majority of IFAD's commitments are expressed in SDR. 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.

52. The International Monetary Fund (IMF) executive board 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 of the basket.

53. New units for each of the four currencies comprising the valuation basket were determined on 29 December 2000 in such a way 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 2001 and 31 December 2002, are shown in Table 11.

Table 11: Units and Weights Applicable to the SDR Valuation Basket

	1 January 2001		31 December 2002	
Currency	**Units**	**Percentage Weight**	**Units**	**Percentage Weight**
USD	0.577	44.3	0.577	42.5
EUR	0.426	30.4	0.426	32.9
JPY	21.000	14.0	21.000	12.9
GBP	0.0984	11.3	0.0984	11.7
Total		**100.0**		**100.0**

54. As of 31 December 2002, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth and Fifth Replenishments amounted to USD 2 392 210 000 equivalent (31 December 2001 – USD 2 325 733 000 equivalent), as indicated in Table 12 below.

Table 12: Currency Composition of Assets at 31 December 2002
(USD ’000 equivalent)

Currency Group	Cash and Investments	Promissory Notes	Amounts Receivable from Contributors	Total
USD	944 314	47 764	43 379	1 035 457
EUR	562 828	74 883	24 365	662 076
JPY	276 608	357	13 395	290 360
GBP	218 047	16 274	-	234 321
Other	92 196	58 611	19 189	169 996
Total	**2 093 993**	**197 889**	**100 328**	**2 392 210**

55. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 169 996 000 equivalent at 31 December 2002 (31 December 2001 – USD 401 647 000 equivalent). These are allocated to currency groups, as indicated in Table 13.

Table 13: Allocation of Assets to Currency Groups at 31 December 2002
(USD ’000 equivalent)

Currency Group	Currencies Included in SDR Basket	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	1 035 457	-	59 742	2 140	1 097 339
EUR	662 076	108 114	-	-	770 190
JPY	290 360	-	-	-	290 360
GBP	234 321	-	-	-	234 321
Total	**2 222 214**	**108 114**	**59 742**	**2 140**	**2 392 210**

56. The alignment of assets by currency group against the SDR valuation basket at 31 December 2002 is shown in Table 14. The balance of the General Reserve at 31 December 2002 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 63 749 000 respectively.

Table 14: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 31 December 2002
(USD '000 equivalent)

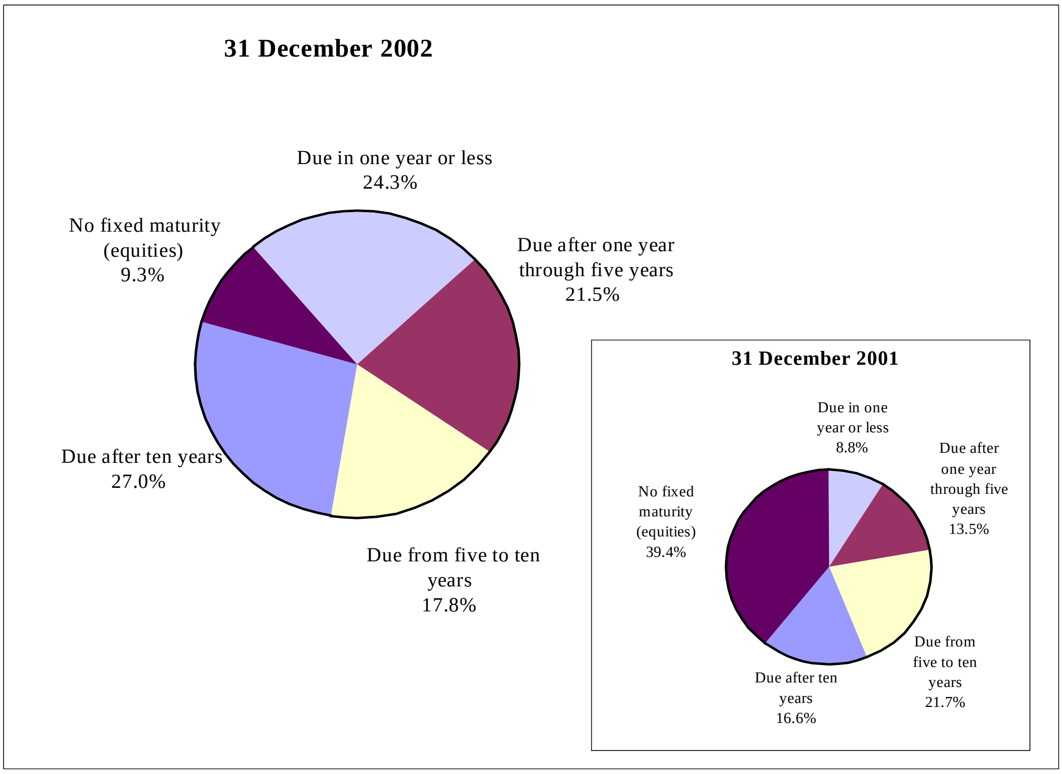
Currency Group	Amount per Currency Group	Less: Commitment Denominated in USD	Net Assets per Currency Group	Net Assets % 31.12.2002	Compare SDR Weights 31.12.2002
USD	1 097 339	(158 749)	938 590	42.0	42.5
EUR	770 190	-	770 190	34.5	32.9
JPY	290 360	-	290 360	13.0	12.9
GBP	234 321	-	234 321	10.5	11.7
Total	**2 392 210**	**(158 749)**	**2 233 461**	**100.0**	**100.0**

57. As of 31 December 2002, there were excess currency group holdings of euro and, to only a small extent, Japanese yen. The excess holdings were offset by shortfalls in currency group holdings of pound sterling and, to a lesser extent, United States dollars. The excess in Euro currency group holdings, which was the most significant variance at 31 December 2002, was due to government bonds managers' overweighting of euro-denominated government bonds.

Maturity of Investments

58. Annex XXI provides details of the composition of the portfolio by maturity as of 31 December 2002, while Figure 1 shows the maturity of the portfolio graphically. The average life to maturity at 31 December 2002 was ten years and nine months (31 December 2001 – ten years and six months).

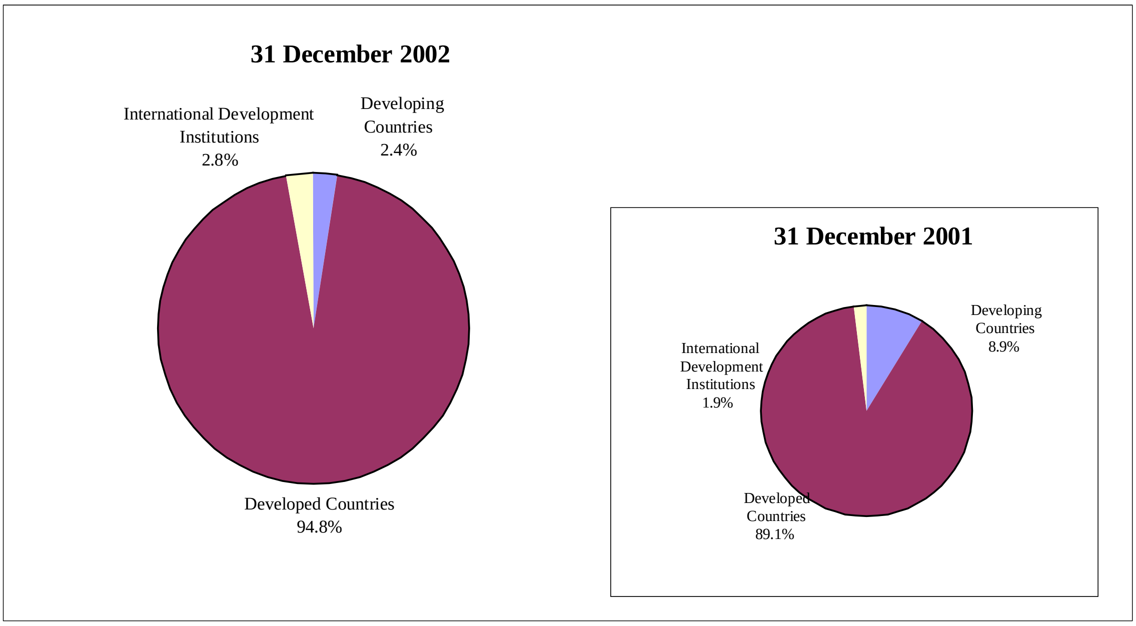
Figure 1: Maturity Structure of the Investment Portfolio



Diversification by Country

59. 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, and in obligations issued by eligible development-related intergovernmental institutions. Annex XXII provides details by type of instrument and by region in the case of developing countries, while Figure 2 shows the overall diversification by Member States graphically. The percentage of investments in developing countries at 31 December 2002 decreased from the previous year. The decrease was due to the implementation of the new investment policy, which required the implementation of the AA- credit floor for fixed-interest investments, and a reduction in equity holdings from 45 to 10% of the overall portfolio. The retained equity holdings were invested in North American and European equities as of 31 December 2002.

Figure 2: Diversification of the Investment Portfolio by Country



IX. RISK MEASUREMENT

60. 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.

61. At 31 December 2002, the standard deviation of IFAD's policy allocation according to the new investment policy was 2.9%, compared to 2.2% for the actual portfolio, based on five years of historical monthly data.

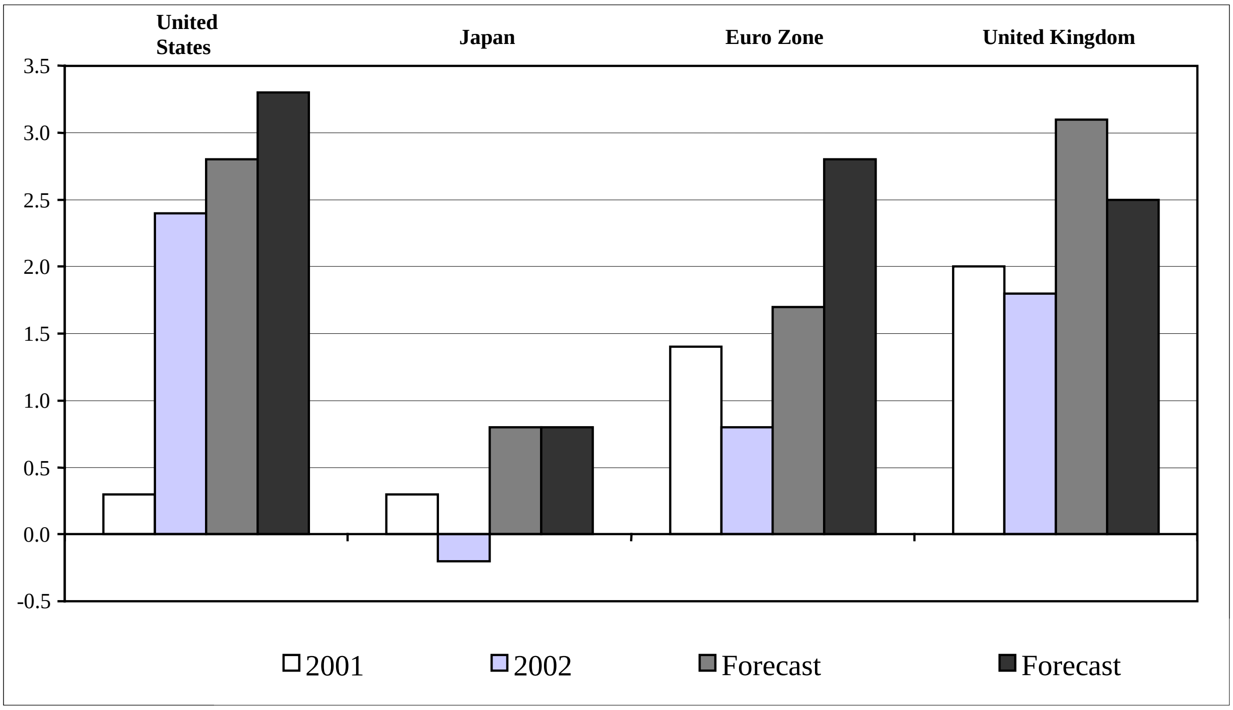
62. Value-at-risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount the portfolio could lose over a three-month time horizon, with a 95% confidence level. Table 15 shows the VaR of IFAD's actual portfolio and policy allocation, based on five years of historical monthly data. At 31 December 2002, the VaR of the actual portfolio was significantly lower than at previous year-end, reflecting the implementation of the new investment policy that took place in 2002. The VaR of the actual portfolio was also clearly lower than the policy VaR at year end. This was a result of the portfolio's currently high cash holdings, which are pending further investments in fixed-interest instruments.

Table 15: Value-at-Risk
(Forecast horizon three months, confidence level 95%)

	Portfolio		Policy [1]	
Date	**VaR %**	**Amount USD '000**	**VaR %**	**Amount USD '000**
31 December 2002	1.8	38 100	2.4	50 300
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

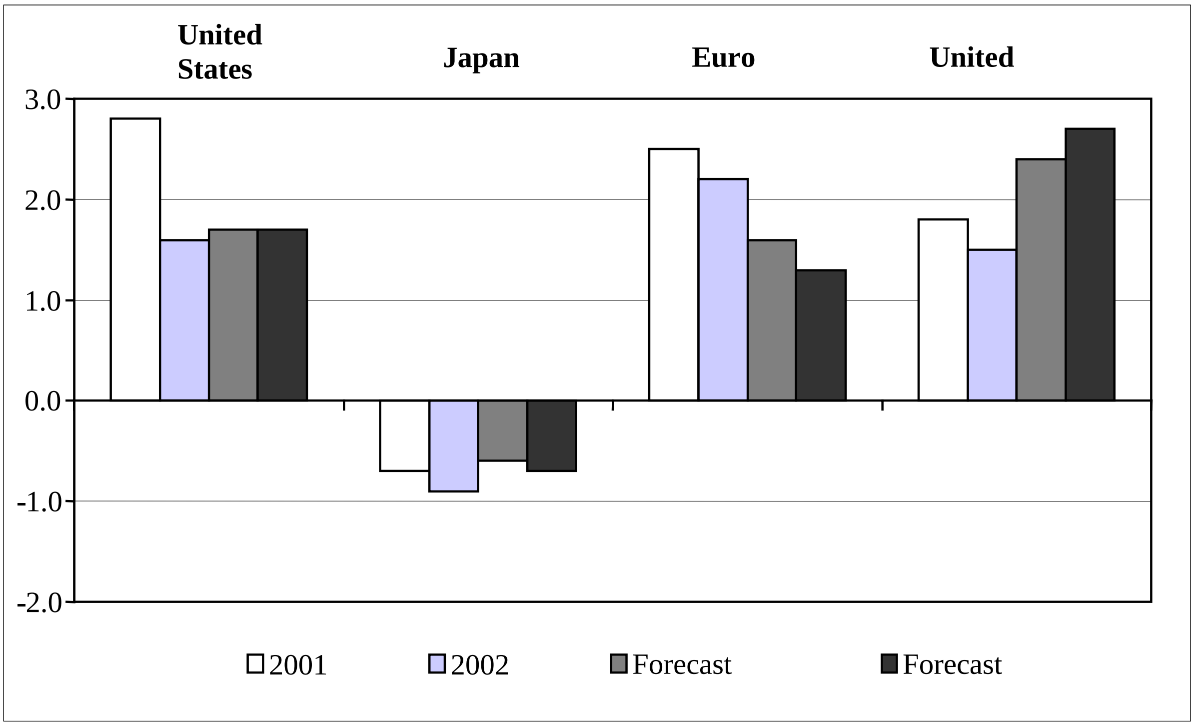
[1] The new investment policy is reflected in the policy VaR as of 31 March 2002.

PERCENTAGE CHANGE IN REAL GDP



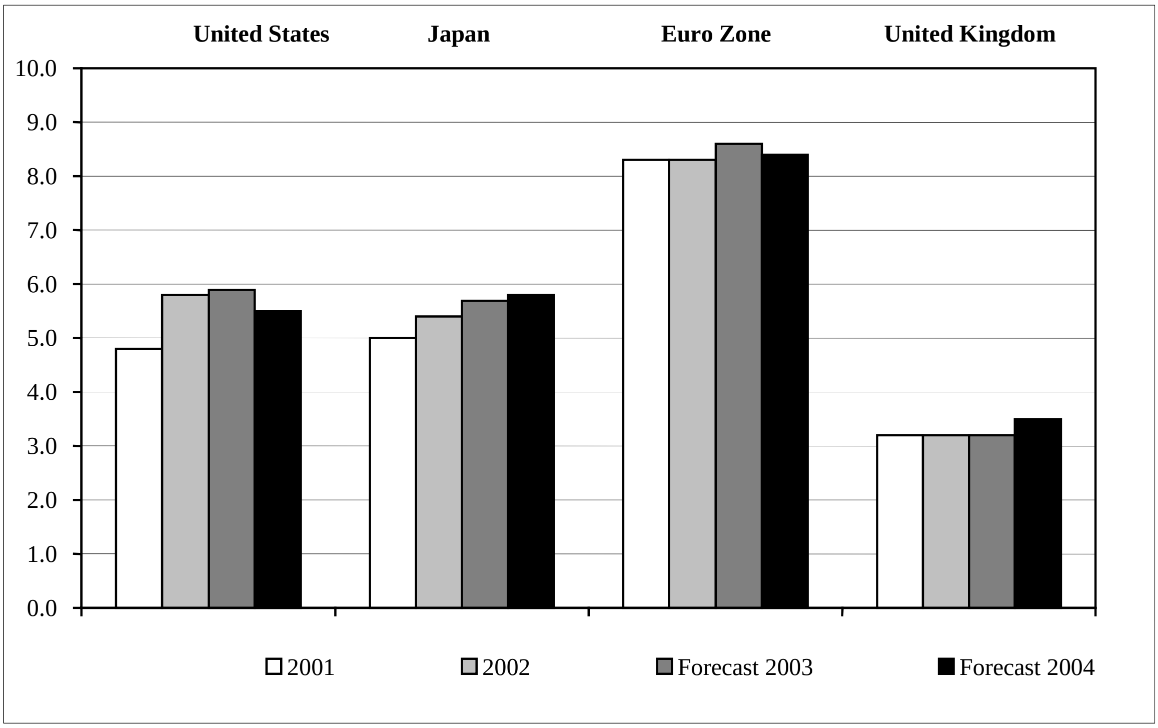
Source: J.P. Morgan

CONSUMER PRICE INDEX – ANNUALIZED RATES



Source: J.P. Morgan

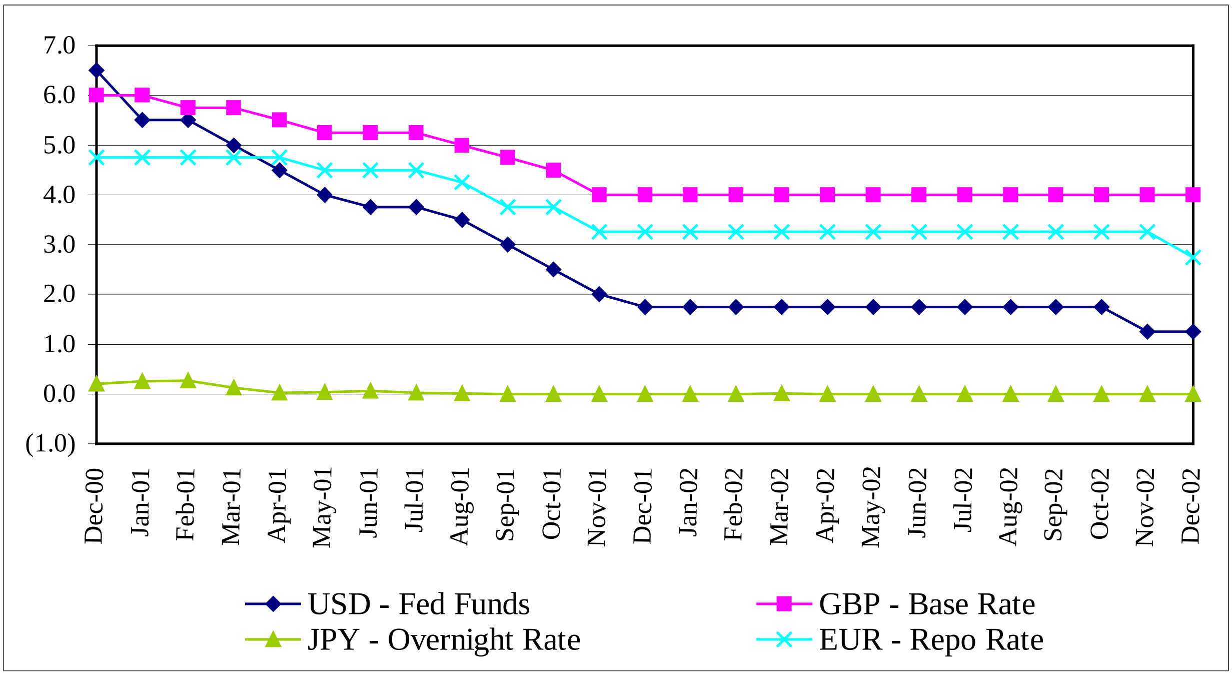
UNEMPLOYMENT RATE – PERCENTAGE OF LABOUR FORCE
(Annual average)



Source: J.P. Morgan

ANNEX IV

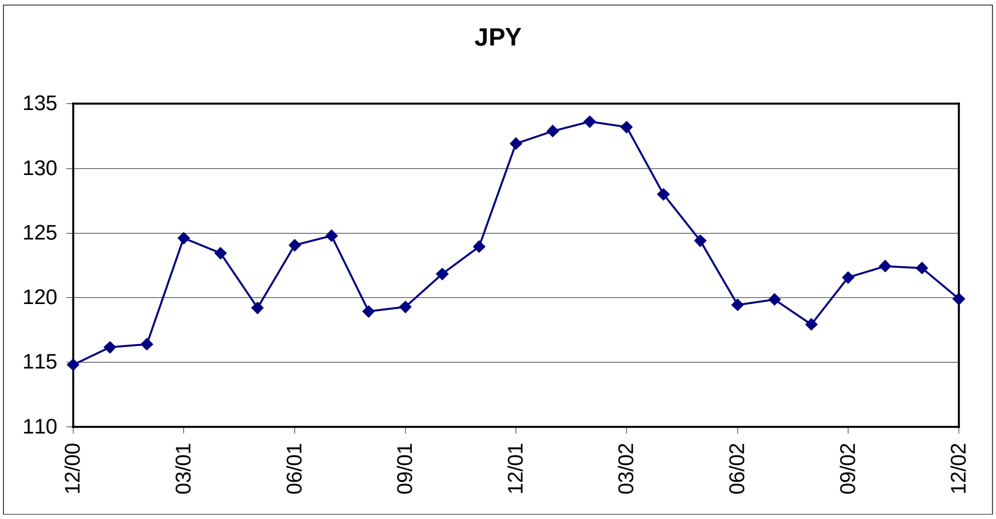
CENTRAL BANK INTEREST RATES

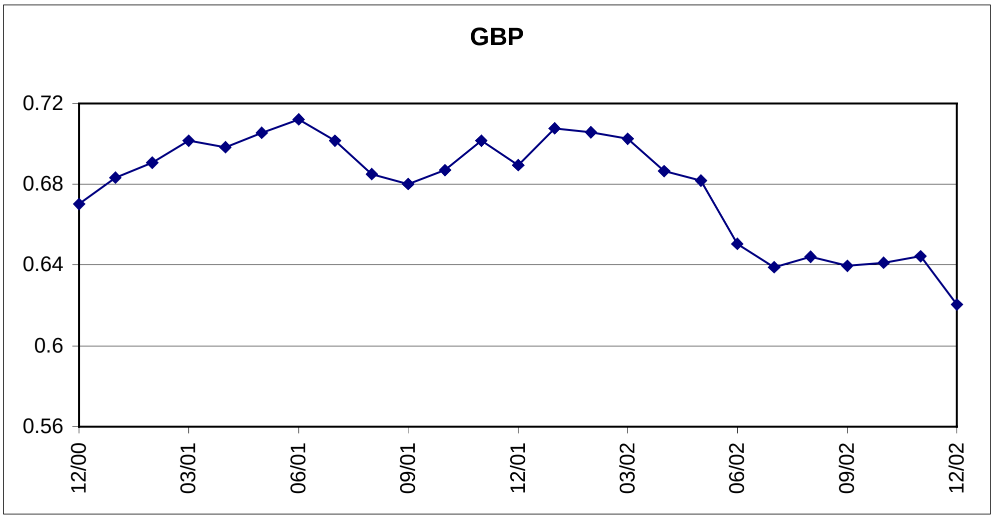


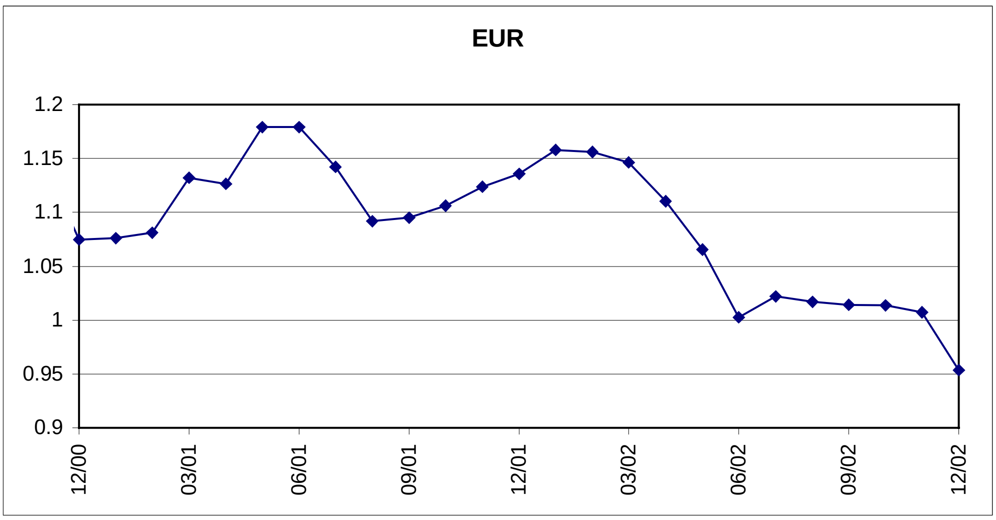
Source: Bloomberg

ANNEX V

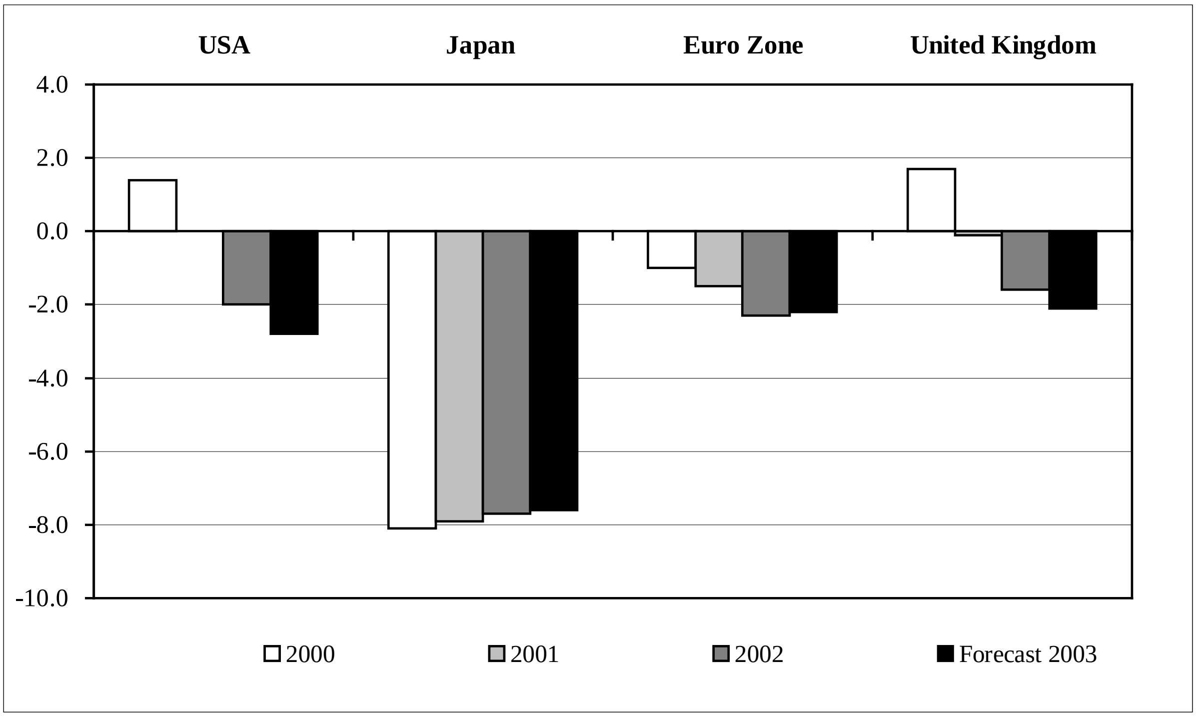
VALUE OF THE UNITED STATES DOLLAR AT IMF MONTH-END EXCHANGE RATES







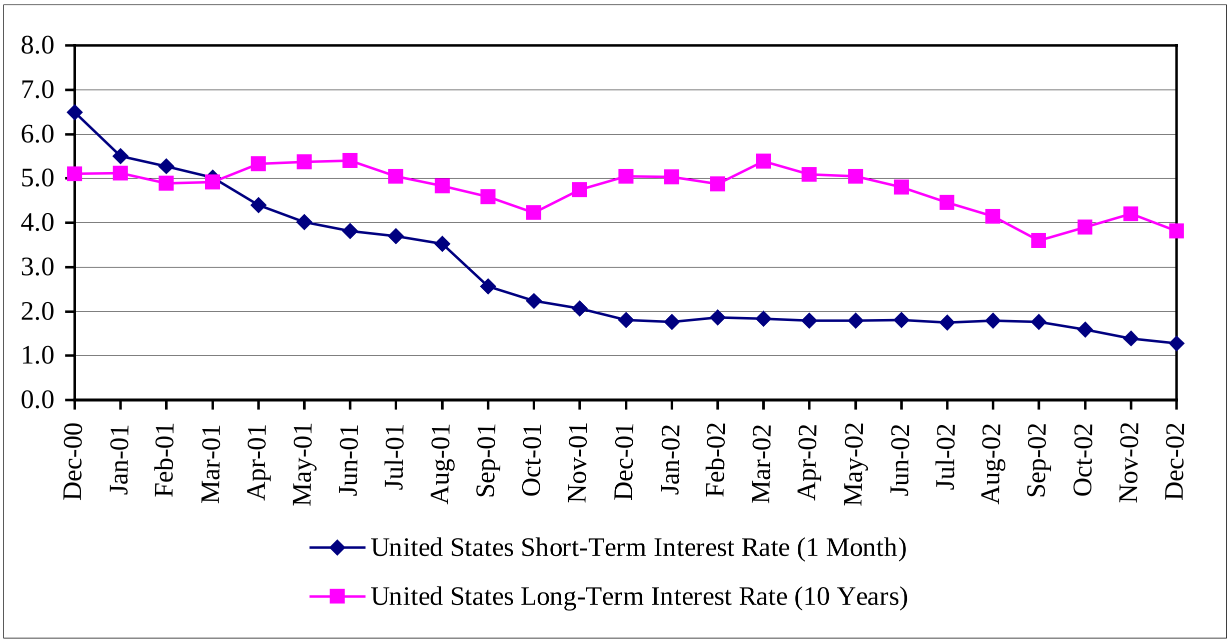
BUDGET DEFICITS AND SURPLUSES – PERCENTAGE OF GDP



Source: J.P. Morgan

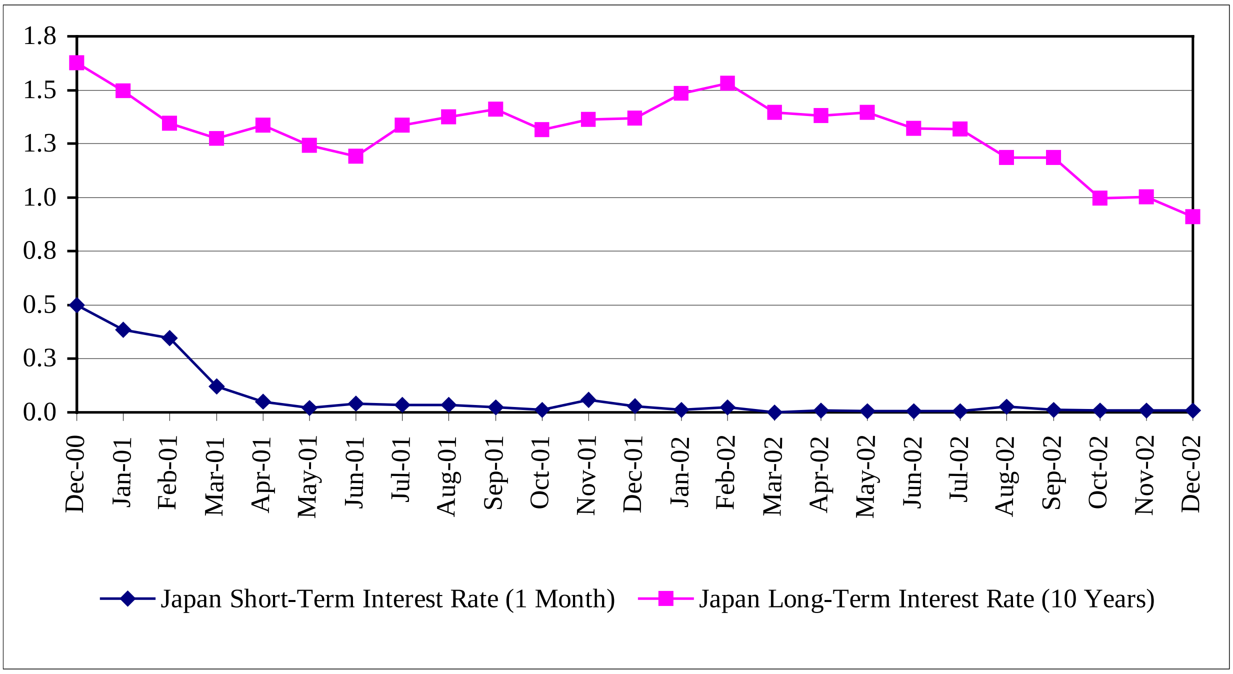
SHORT- AND LONG-TERM INTEREST RATES

United States



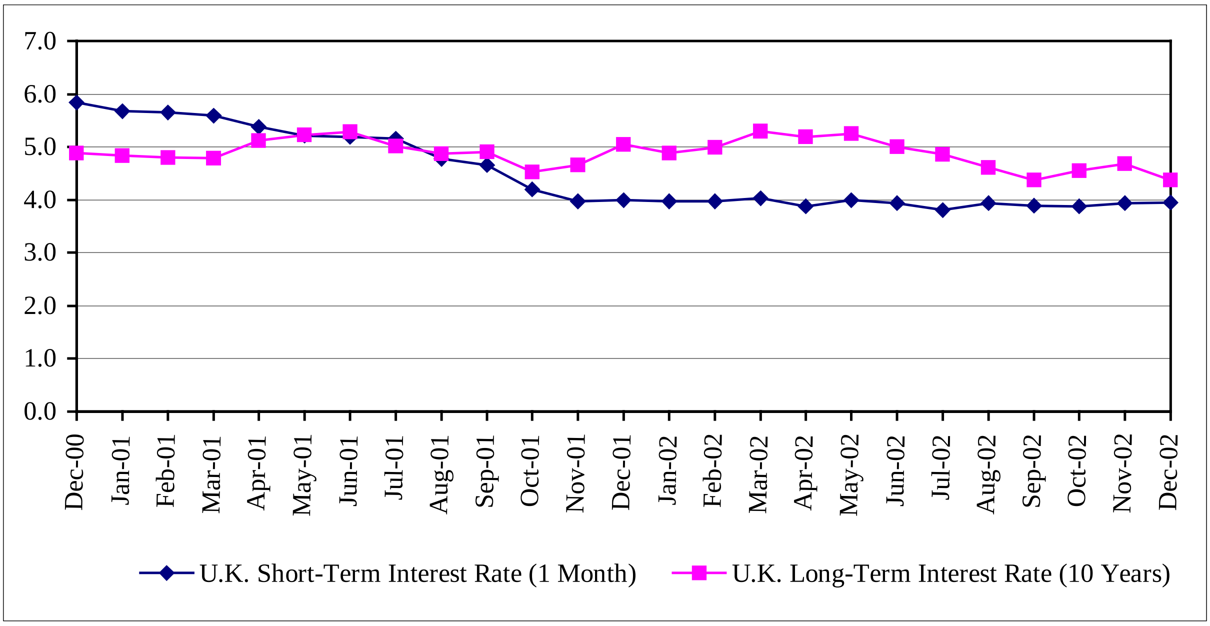
Source: Bloomberg

Japan



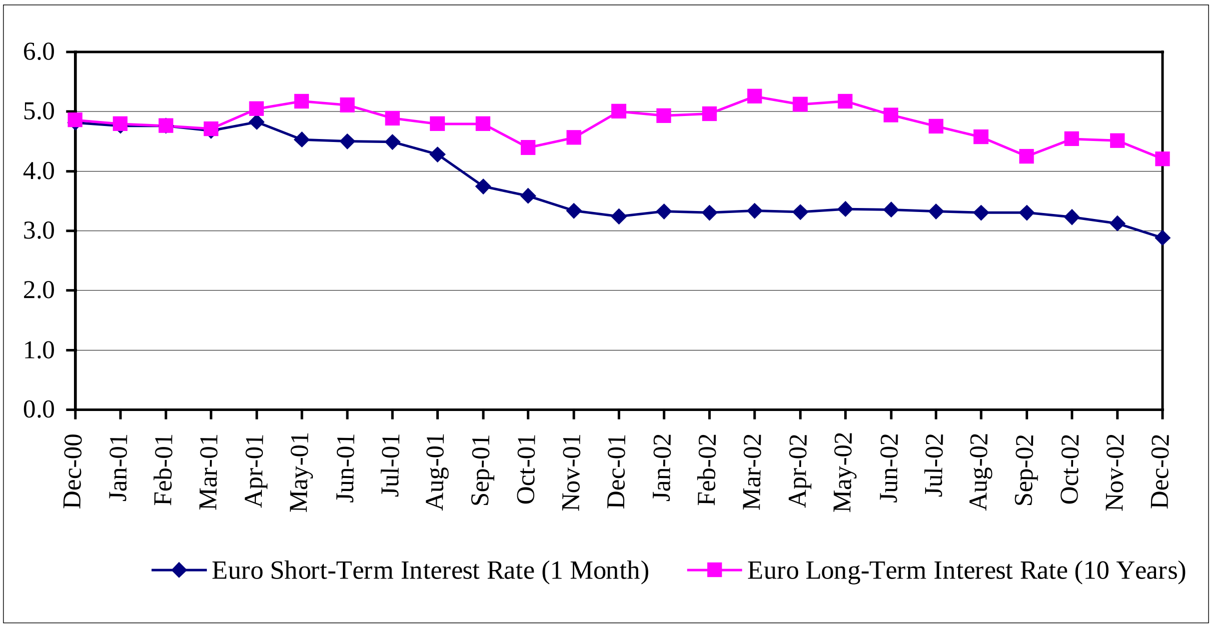
Source: Bloomberg

United Kingdom



Source: Bloomberg

Euro Zone



Source: Bloomberg

ANNEX VIII

GOVERNMENT BOND RETURNS PER COUNTRY INCLUDED IN THE J.P. MORGAN GLOBAL GOVERNMENT BOND TRADED INDEX

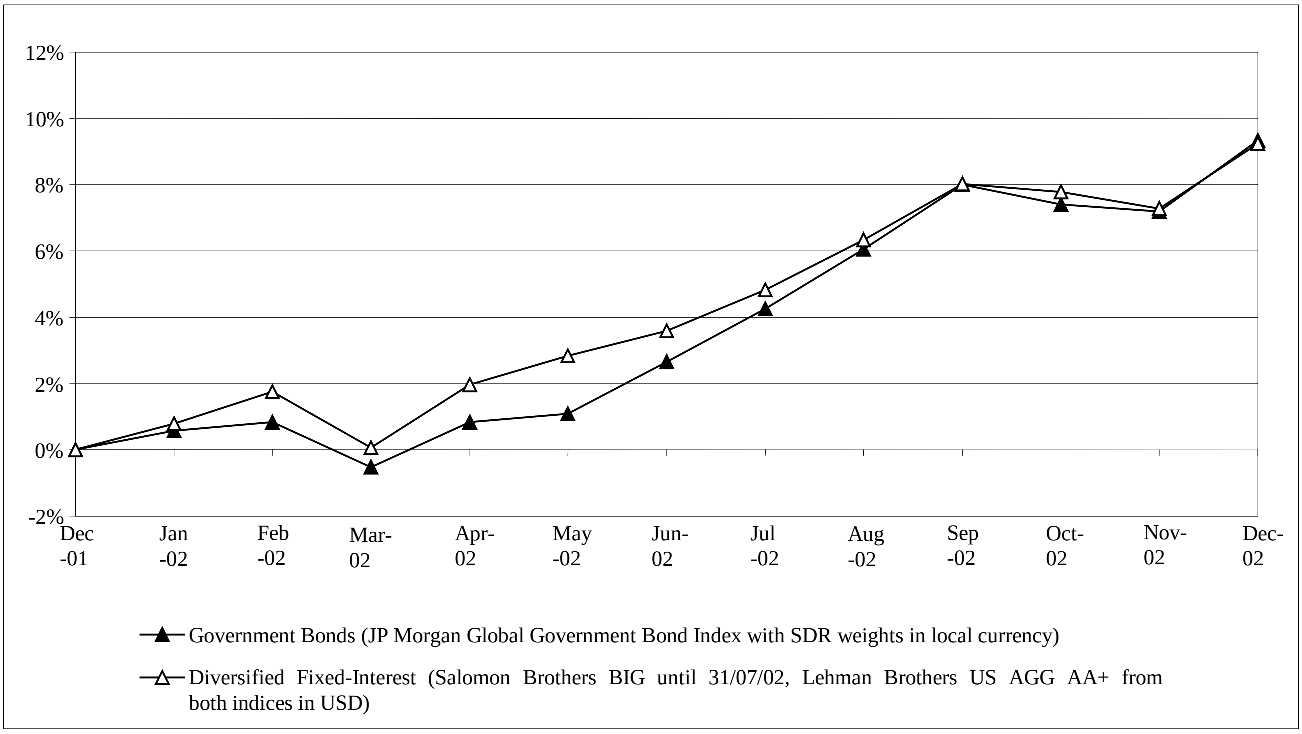
(Percentage in Local Currency Terms)

Country	**Fourth Quarter 2002**	**Third Quarter 2002**	**Second Quarter 2002**	**First Quarter 2002**	**2002**	**2001**
Australia	2.53	4.59	2.75	(0.54)	9.59	4.19
Belgium	2.26	5.20	3.07	(0.41)	10.43	6.33
Canada	1.87	4.54	3.18	(1.42)	8.31	7.48
Denmark	2.28	4.56	2.75	(0.23)	9.64	5.61
Euro zone	2.07	4.94	2.96	(0.39)	9.85	5.90
France	2.01	4.88	2.93	(0.40)	9.68	5.56
Germany	1.64	4.92	3.02	(0.51)	9.31	5.14
Italy	2.24	4.71	2.89	(0.37)	9.75	6.68
Japan	1.14	0.95	1.01	0.23	3.38	3.63
Netherlands	2.08	4.98	3.05	(0.42)	9.96	5.50
Spain	2.28	5.18	2.87	(0.21)	10.43	6.26
Sweden	2.47	4.09	2.60	(0.35)	9.05	2.61
United Kingdom	0.61	5.83	3.46	(0.95)	9.11	3.17
United States	0.42	7.75	4.65	(0.91)	12.21	6.55
Global	**1.30**	**4.55**	**2.92**	**(0.43)**	**8.54**	**5.23**

Source: J.P. Morgan

ANNEX IX

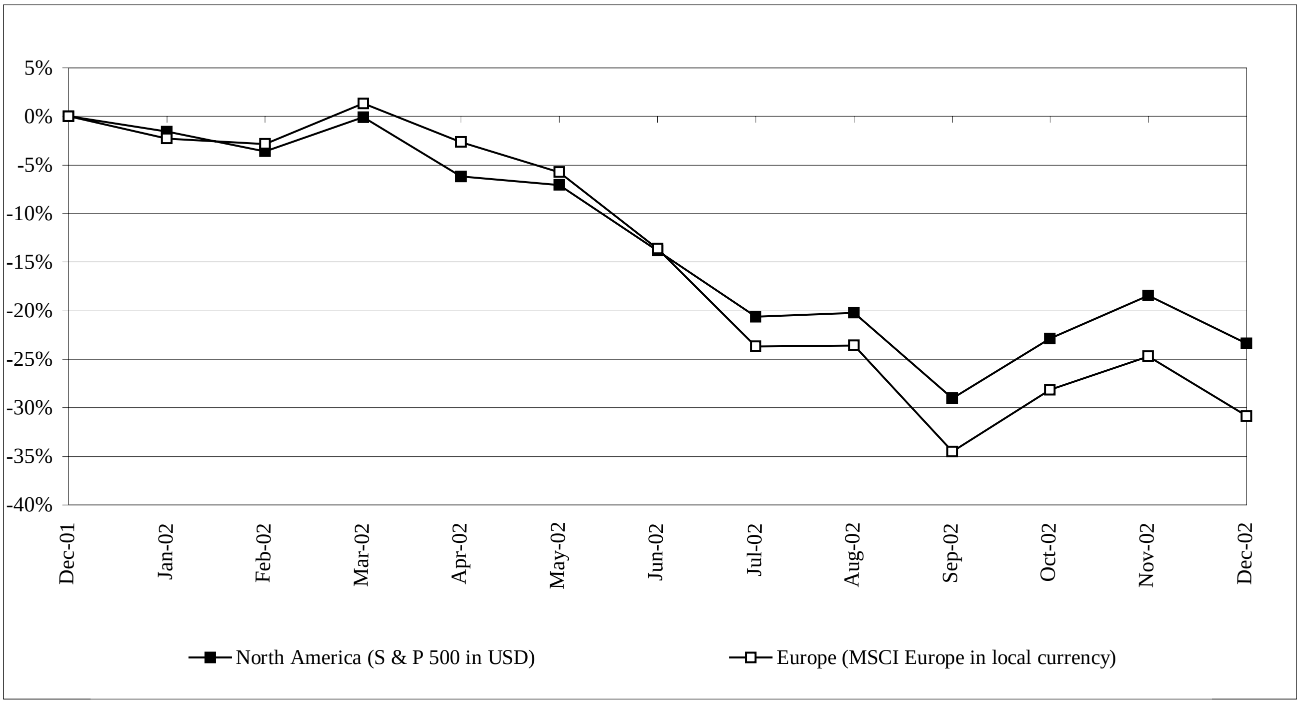
FIXED-INTEREST MARKET DEVELOPMENT IN 2002
(Monthly Data)



Source: State Street Analytics

ANNEX X

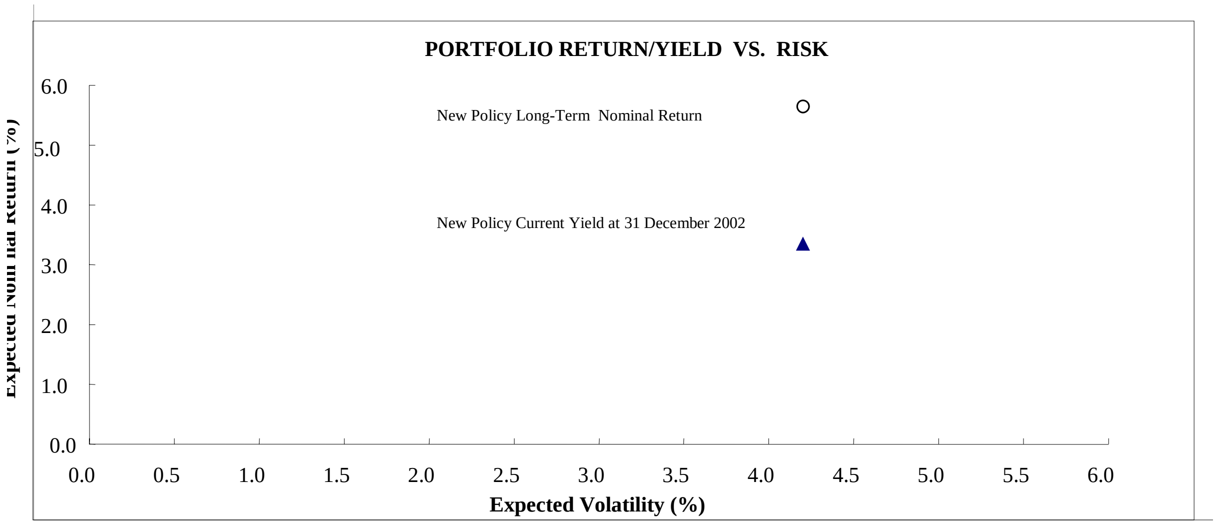
EQUITY MARKET DEVELOPMENT IN 2002
(Monthly Data)



Source: State Street Analytics
Note: Morgan Stanley Capital International (MSCI)
Standard & Poor(S&P)

ANNEX XI

NEW INVESTMENT POLICY – SUMMARY OF PORTFOLIO CHARACTERISTICS



	Return & Risk Assumptions			New Policy Allocations/Characteristics	
Asset[1]	**Long-Term Nominal Return %**	**31 December 2002 Current Yield %**[4]	**Long-Term Volatility %**	**Return = Long-Term Nominal Return %**	**Return = 31 December 2002 Current Yield**[4]
Cash	3.0	1.8	2.9	5.0	5.0
Global government bonds	5.3	3.6	5.6	44.0	44.0
Diversified fixed-interest	5.6	3.7	6.0	23.0	23.0
Global inflation indexed bonds	5.3	3.6	2.8	18.0	18.0
Global equities	9.2	1.9	15.9	10.0	10.0
Total %	5.6	3.4	4.2	100.0%	100.0%
Return					
i) Expected coupon/dividend payments (USD million)[2]				98	98
ii) Expected nominal return %				5.6	3.4
iii) Probability % of achieving in 3 years a minimum average return of 3 %				88%	56%
iv) Cumulative returns 3 years:					
Expected cumulative return %				17.9	10.4
Expected minimum cumulative return % (95% confidence level)				3.4	(4.1)
Expected maximum cumulative return % (95% confidence level)				32.5	25.0
Risk					
v) Expected volatility %				4.2	4.2
vi) Expected Value-at-Risk[3]				139	139
Risk-adjusted return					
vii) Sharpe Ratio				0.63	0.37

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.
4 The yields do not include capital gains which is an element in the nominal return assumption, e.g. the yields shown for equities is the dividend rate

ANNEX XII

CUMULATIVE PROCEEDS FROM EQUITY SALES
(USD million)

Account	Mandate Type	Year of Funding	Date of Sales	Initial Funding	Cumulative Income	Cumulative Exchange Adjustments	Total proceeds
U777	North American small capitalization equities	2000	August 2001	10.0	4.2	0.0	14.2
U770	Japanese equities	1997	March 2002	103.6	11.0	(13.9)	100.7
U771	Asian and Australasian equities	1997	March 2002	80.0	30.6	(8.9)	101.7
U773	North American large capitalization equities	1998	March 2002	80.0	25.6	-	105.6
U782	European large cap equities	1999	March 2002	60.0	5.9	(9.6)	56.3
U786	Global equities	2000	March 2002	60.9	1.1	(2.5)	59.5
U772	Emerging Markets equities	1997	October 2002	100.0	(11.5)	(22.2)	66.3
U780	European equities (20%)	1999	October 2002	28.9	(7.4)	(2.0)	19.5
U790	Currency Overlay	1999	October 2002	10.0	1.5	(0.6)	10.9
Total				**533.4**	**61.0**	**(59.7)**	**534.8**

SUMMARY OF MOVEMENTS IN CASH AND INVESTMENTS IN THE EQUITIES PORTFOLIO – YEAR 2002

(USD ’000 equivalent)

	Japanese Equities [1]	Asian and Australasian Equities [1]	Emerging Markets Equities [2]	Currency Overlay [2]	North American Equities	European Equities	Global Equities [3]	Total Equities Portfolio
Opening balance (31 December 2001)	**94 717**	**94 240**	**75 298**	**9 811**	**183 739**	**142 501**	**185 172**	**785 478**
Gross investment income (loss)	6 937	7 085	(10 803)	161	(20 407)	(29 371)	(36 422)	(82 820)
Income from securities lending and commission recapture	9	37	75	-	62	62	78	323
Fees, charges and taxes	(108)	(231)	(1 072)	(35)	(791)	(806)	(838)	(3 881)
Net investment income (loss)	**6 838**	**6 891**	**(11 800)**	**126**	**(21 136)**	**(30 115)**	**(37 182)**	**(86 378)**
Transfers due to allocation [4]	(100 709)	(101 694)	(66 315)	(10 917)	(41 919)	(50 288)	(152 104)	(523 946)
Transfers due to expenses	99	182	899	35	727	662	736	3 340
Transfers among portfolios	**(100 610)**	**(101 512)**	**(65 416)**	**(10 882)**	**(41 192)**	**(49 626)**	**(151 368)**	**(520 606)**
Other net flows	-	-	-	-	-	-	-	-
Movements on exchange	(945)	381	1 923	945	-	15 084	3 378	20 766
Closing balance (31 December 2002)	**-**	**-**	**5**	**-**	**121 411**	**77 844**	**-**	**199 260**
Actual allocation (%)	-	-	-	-	5.8	3.7	-	9.5

[1] The portfolio was liquidated in March 2002.
[2] The portfolio was liquidated in October 2002.
[3] Part of the portfolio was liquidated in March 2002, and the remainder was consolidated with North American and European equities in September 2002.
[4] These transfers refer to cash receipts from sales of equities and to repatriation of dividends earned on equity investments.

GROSS INCOME 1997-2002

Overall Portfolio

	2002	2001	2000	1999	1998	1997	Total Cumulative
Capital gains/(losses)	(35 579)	(106 193)	(117 460)	105 133	76 957	41 192	(35 950)
Interest income	61 525	59 241	68 819	90 253	112 668	128 779	521 285
Dividends	7 652	13 614	11 760	8 684	5 654	94	47 458
Total gross income/(loss)	**33 598**	**(33 338)**	**(36 881)**	**204 070**	**195 279**	**170 065**	**532 793**

Fixed-Interest Portfolio

	2002	2001	2000	1999	1998	1997	Total Cumulative
Capital gains/(losses)	55 177	2 136	31 959	(121 637)	104 229	50 315	122 179
Interest income	61 241	58 356	67 228	89 333	108 773	128 779	513 710
Dividends	-	-	-	114	-	-	114
Total gross income/(loss)	**116 418**	**60 492**	**99 187**	**(32 190)**	**213 002**	**179 094**	**636 003**

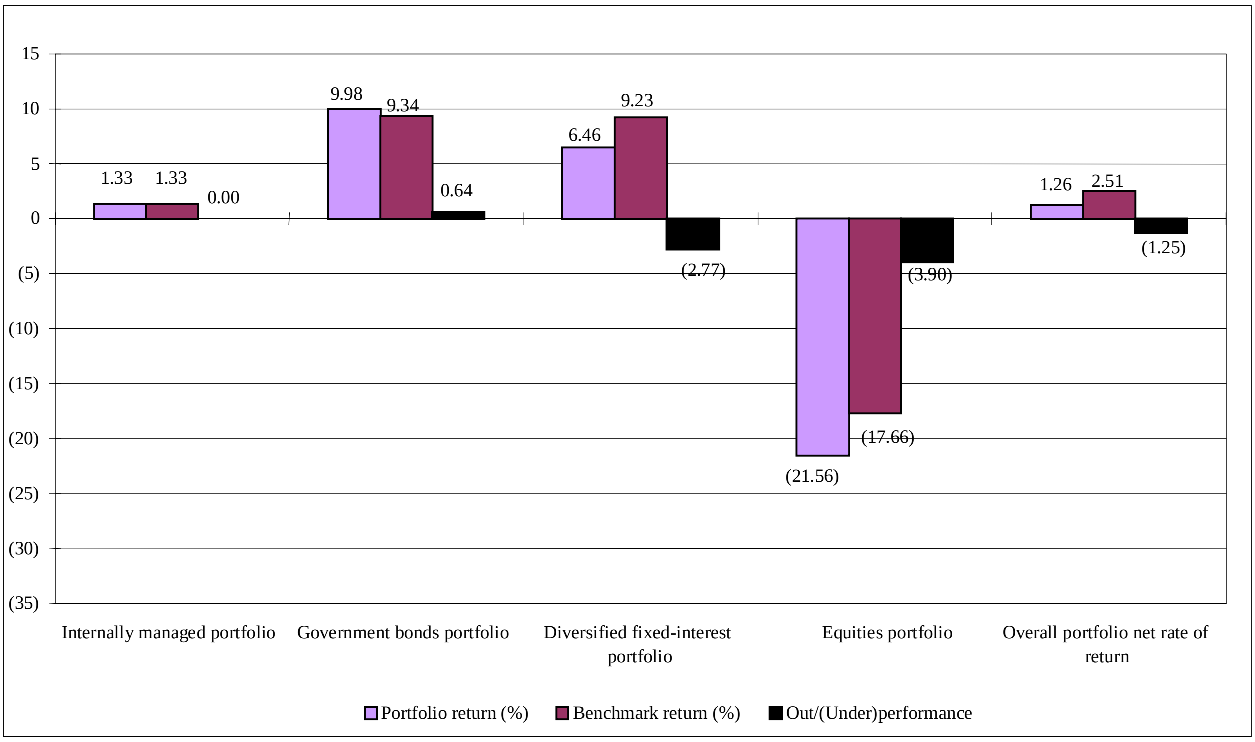
Equities Portfolio

	2002	2001	2000	1999	1998	1997	Total Cumulative
Capital gains/(losses)	(90 756)	(108 329)	(149 419)	226 770	(27 272)	(9 123)	(158 129)
Interest income	284	885	1 591	920	3 895	0	7 575
Dividends	7 652	13 614	11 760	8 570	5 654	94	47 344
Total gross income/(loss)	**(82 820)**	**(93 830)**	**(136 068)**	**236 260**	**(17 723)**	**(9 029)**	**(103 210)**

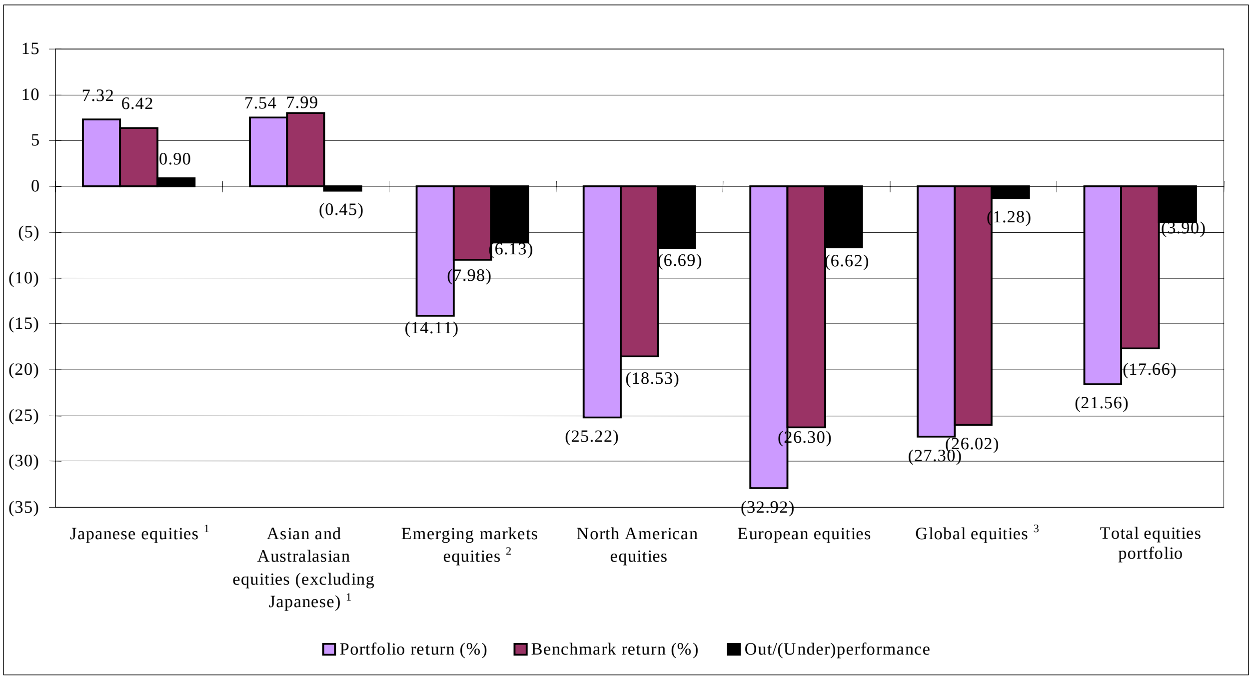
ANNEX XV

PERFORMANCE 2002

Overall Portfolio



Equities Portfolio

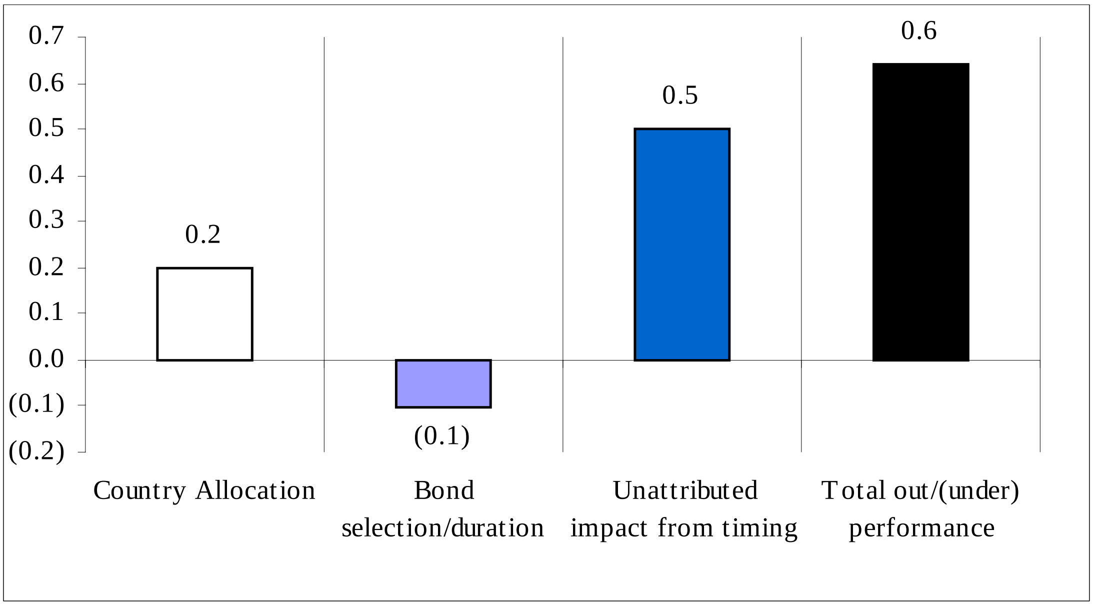


[1] The portfolio was liquidated in March 2002.
[2] The portfolio was liquidated in October 2002.
[3] Part of the portfolio was liquidated in March 2002, and the remainder was consolidated with North American and European equities in September 2002.

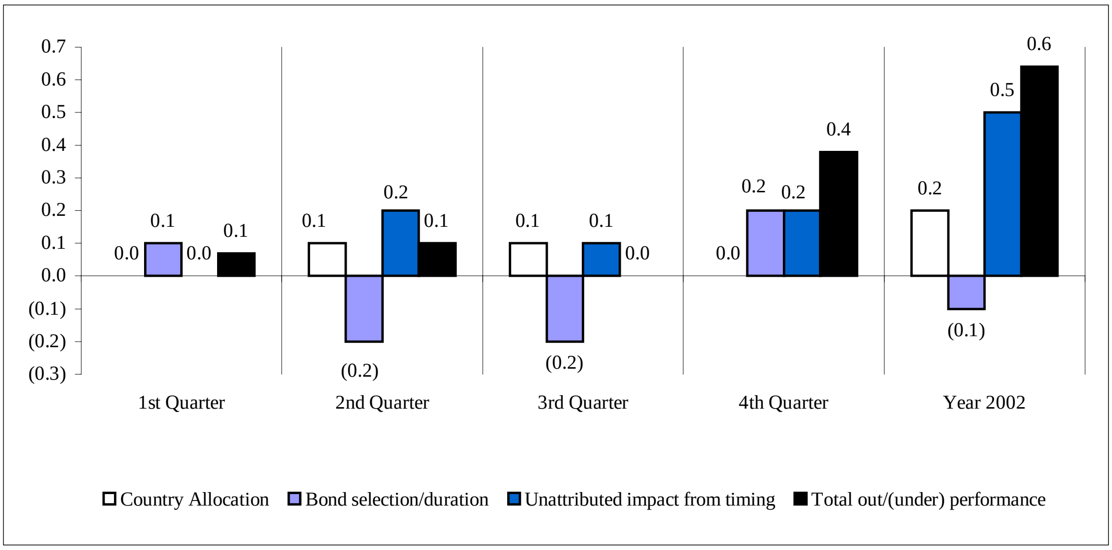
ANNEX XVI

PERFORMANCE ATTRIBUTION FOR THE GLOBAL FIXED-INTEREST PORTFOLIO

Year 2002

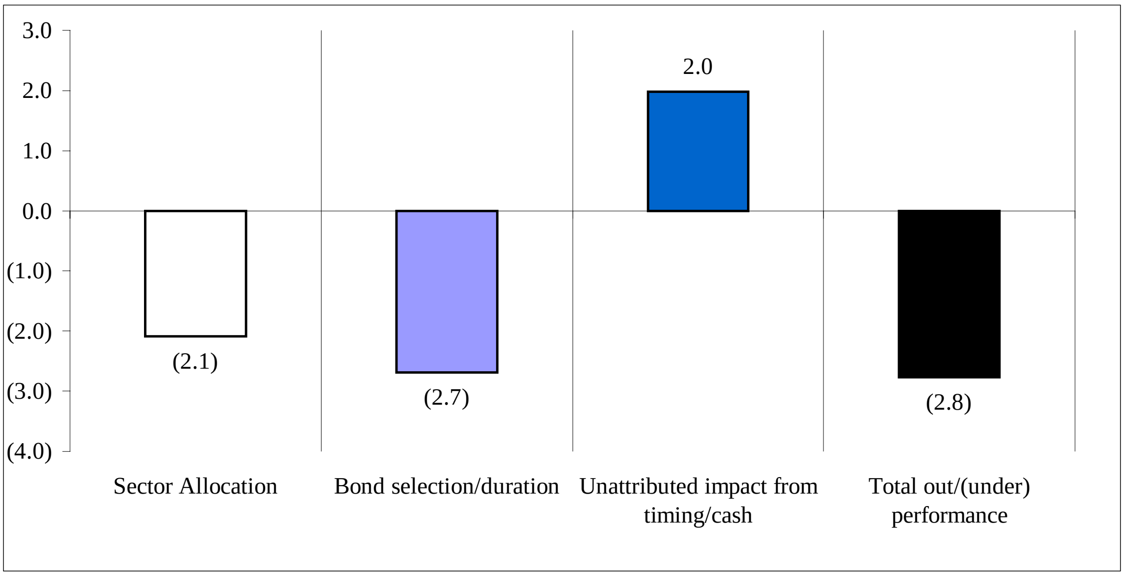


Year 2002 – Quarterly Analysis

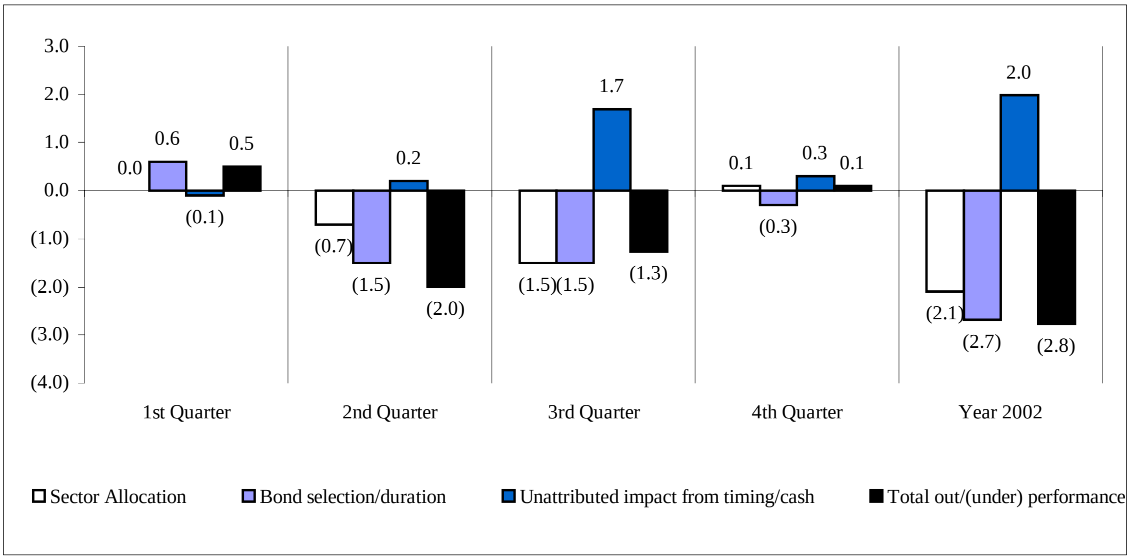


PERFORMANCE ATTRIBUTION FOR THE DIVERSIFIED FIXED-INTEREST PORTFOLIO

Year 2002

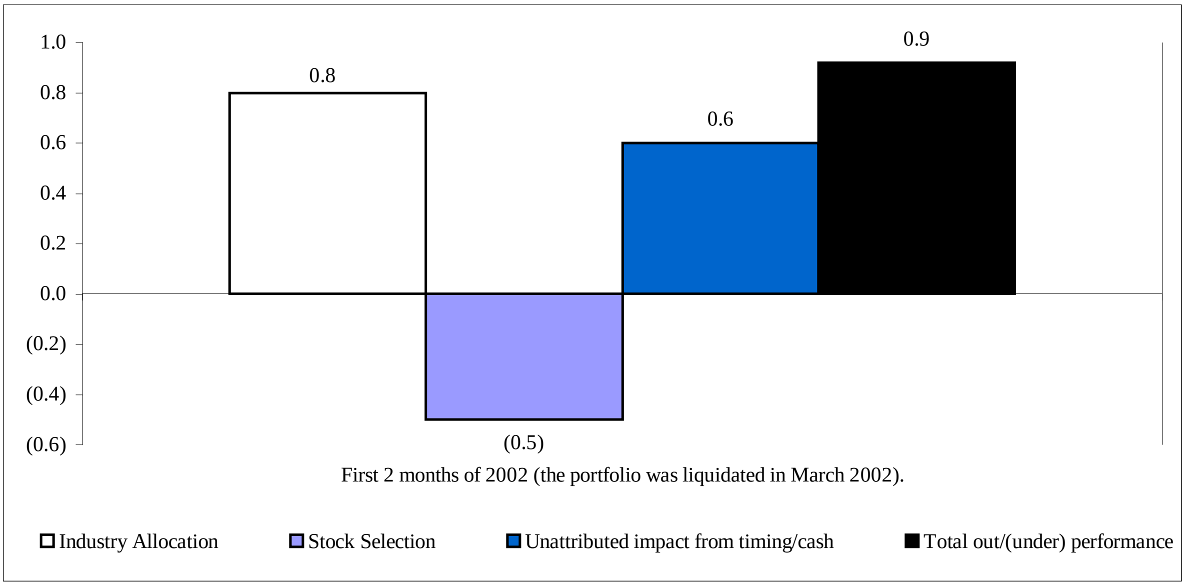


Year 2002 – Quarterly Analysis

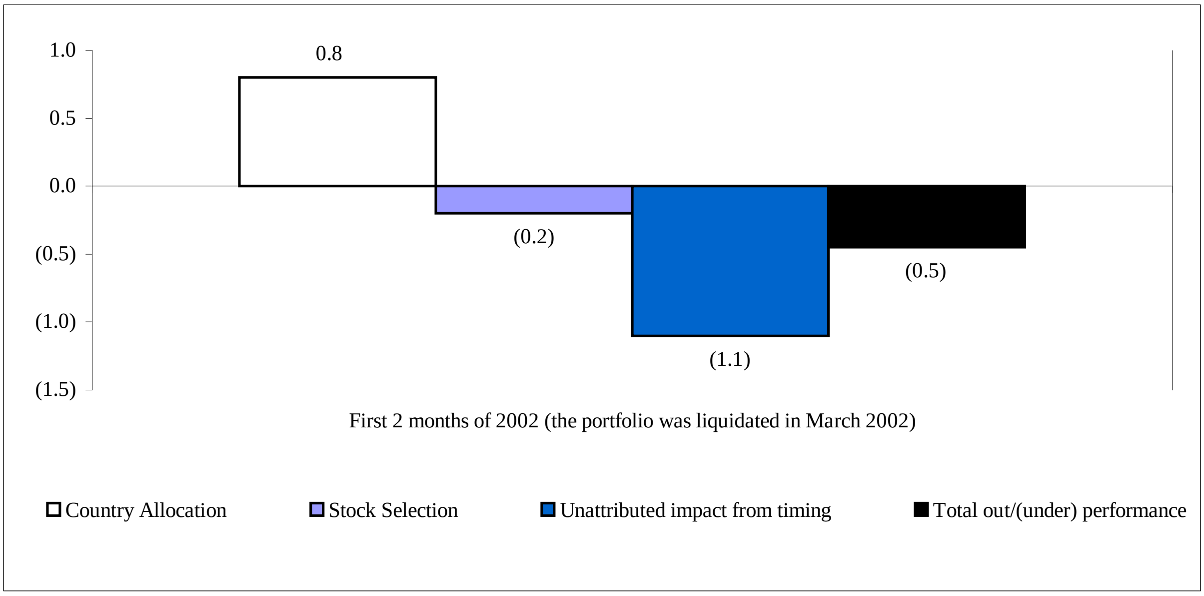


PERFORMANCE ATTRIBUTION FOR THE EQUITIES PORTFOLIO

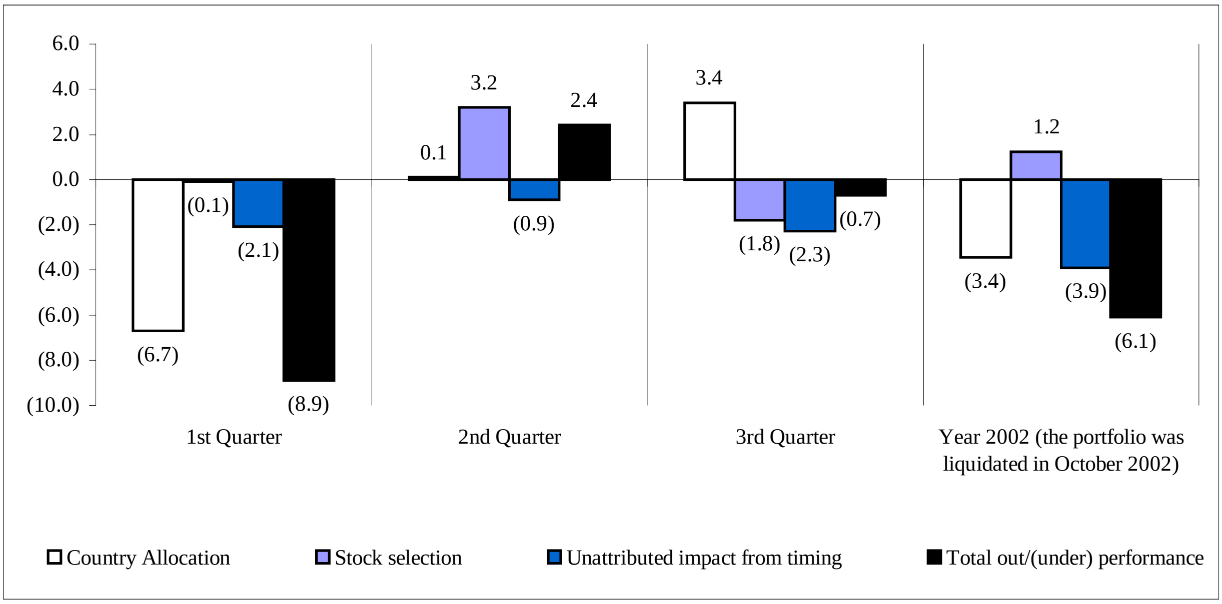
Japanese Equities



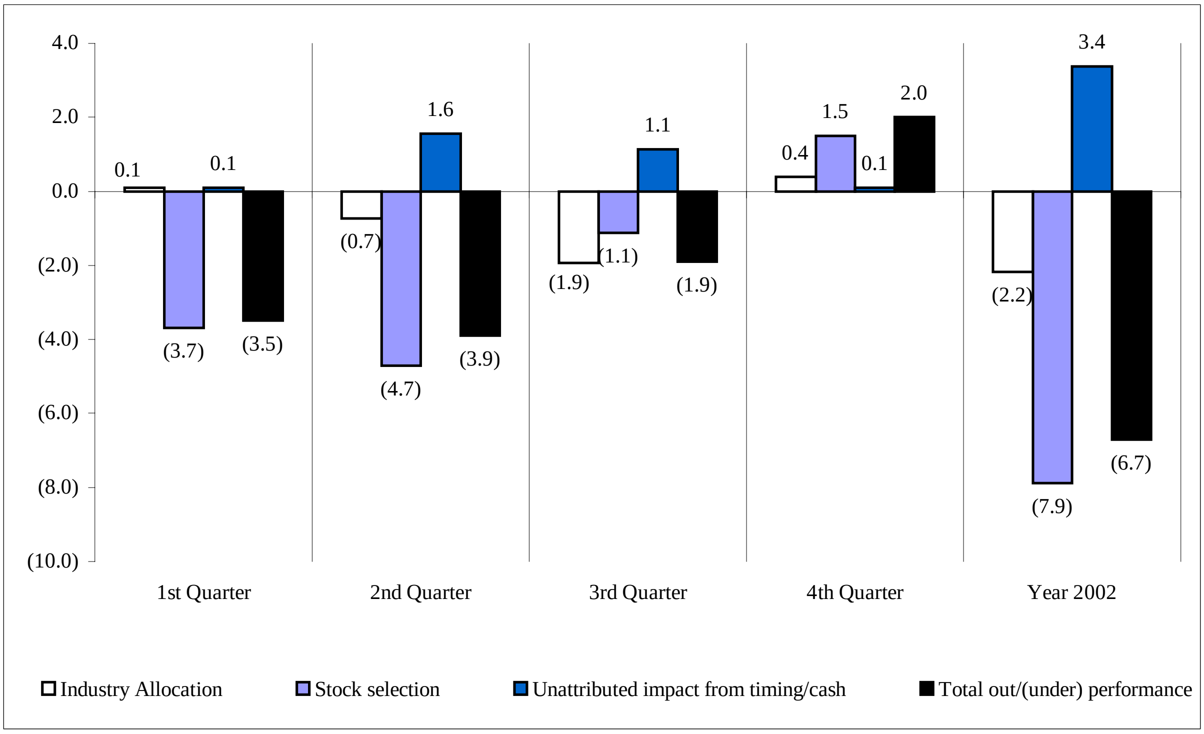
Asian and Australasian Equities



Emerging Markets Equities

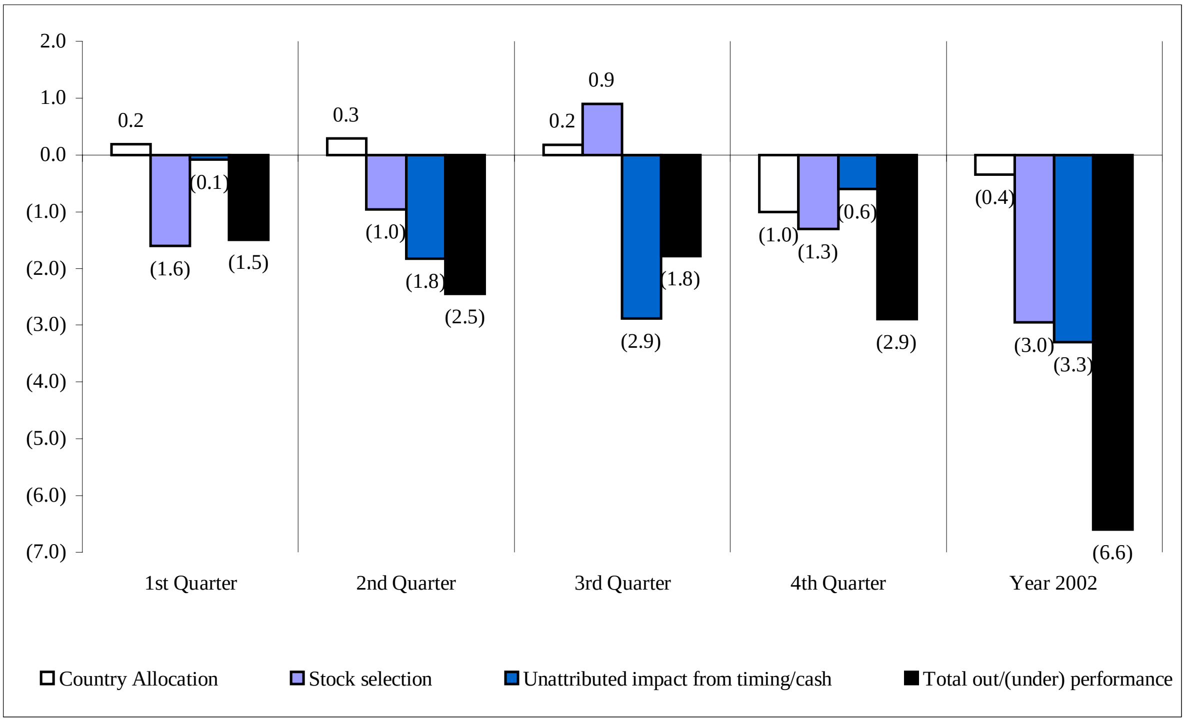


North American Equities

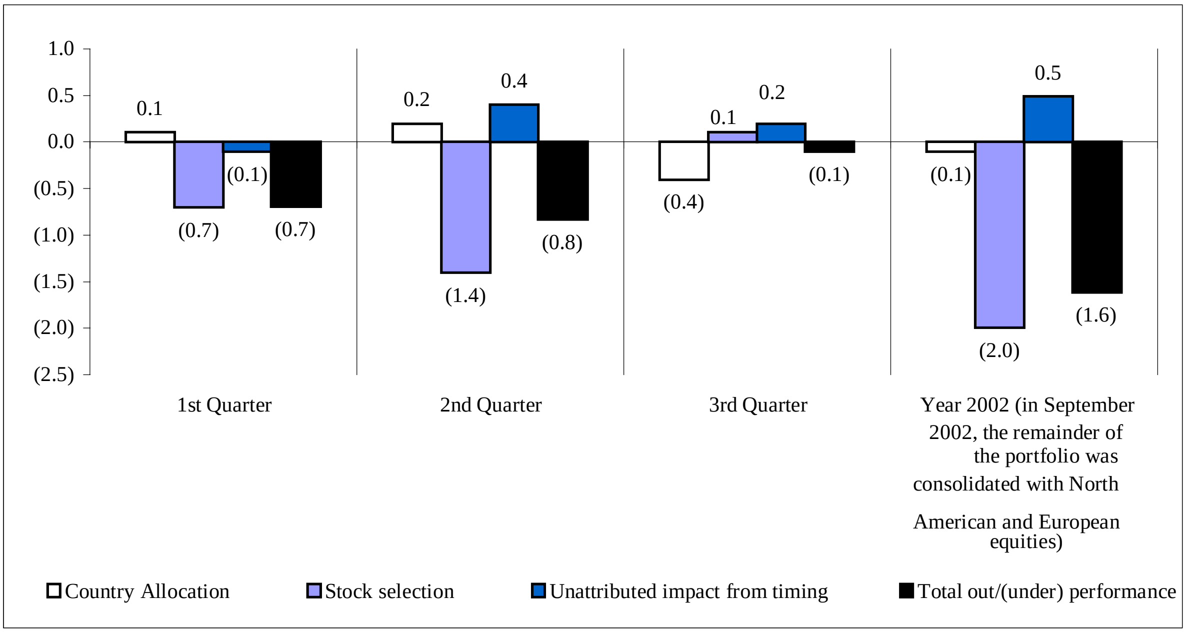


ANNEX XVIII

European Equities



Global Equities



ANNEX XIX

ANALYSIS OF CASH FLOWS

(USD ’000 equivalent)

	2002	2001[1]
Balance at 1 January	**1 917 089**	**2 068 191**
Net investment income	**26 170**	**(42 982)**
Other inflows:		
Loan income received	42 282	42 109
Loan principal repayments	126 823	128 036
Encashment of promissory notes	206 948	158 121
Contributions received in cash	19 105	40 248
Total other inflows	**395 158**	**368 514**
Outflows:		
Loan disbursements	(267 295)	(299 584)
Grant disbursements	(21 793)	(23 000)
PDFF disbursements	(18 407)	(9 666)
Transfer to ASMCS[2] restricted funds	(8 891)	(5 274)
Transfer of funds to Debt Initiative for HIPCs[3]	(14 000)	(4 000)
Payment of administrative expenses	(36 036)	(53 352)
Miscellaneous	(16 430)	5 949
Total outflows	**(382 852)**	**(388 927)**
Effects of movements in exchange rates	**138 428**	**(87 707)**
Balance at 31 December	**2 093 993**	**1 917 089**

[1] Restated per Appendix C of the Financial Statements for year 2002.
[2] After-service medical coverage scheme.
[3] Heavily Indebted Poor Countries.

ANNEX XX

ANALYSIS OF THE FIXED-INTEREST PORTFOLIO BY TYPE OF MANDATE AND BY INSTRUMENT AT 31 DECEMBER 2002

(USD ’000 equivalent)

Instruments	Internally Managed Portfolio	Global Government Bonds Portfolio	Inflation Indexed Bonds Portfolio[1]	Diversified Fixed-Interest Portfolio	Total Fixed-Interest Portfolio 31.12.2002
Cash	258 530	20 760	-	42 753	322 043
Time deposits	148 398	47 048	-	184 300	379 746
Global government bonds	-	935 984	-	68 676	1 004 660
Emerging markets bonds	-	-	-	-	-
Mortgage-backed securities	-	-	-	315 606	315 606
Asset-backed securities	-	-	-	56 466	56 466
Corporate bonds	-	-	-	32 132	32 132
Equities	-	-	-	-	-
Futures	-	12	-	939	951
Options	-	-	-	(226)	(226)
Open trades	(180)	146	-	(238 535)	(238 569)
Accrued interest income	648	18 428	-	2 107	21 183
Dividends receivable	-	-	-	-	-
Non-convertible currencies	741	-	-	-	741
Total	**408 137**	**1 022 378**	**-**	**464 218**	**1 894 733**
Actual allocation (%)	19.5	48.8	-	22.2	90.5
Policy allocation (%)[1/]	5.0	44.0	18.0	23.0	90.0
Difference in allocation (%)	**14.5**	**4.8**	**(18.0)**	**(0.8)**	**0.5**

[1] The policy allocates 18% to inflation-indexed bonds. The asset class was unfunded as of 31 December 2002.

ANNEX XXI

COMPOSITION OF THE INVESTMENT PORTFOLIO BY MATURITY OF INVESTMENTS
(USD ’000 equivalent)

Period	31 December 2002		31 December 2001	
	Amount	**%**	**Amount**	**%**
Due in one year or less	508 462	24.3	167 980	8.8
Due after one year through five years	450 615	21.5	259 510	13.5
Due from five to ten years	373 420	17.8	416 315	21.7
Due after ten years	566 313	27.0	317 357	16.6
No fixed maturity (equities)	195 183	9.3	755 927	39.4
Total	**2 093 993**	**100.0**	**1 917 089**	**100.0**

ANNEX XXII

DIVERSIFICATION OF THE INVESTMENT PORTFOLIO BY MEMBER COUNTRIES

(USD '000 equivalent)

31 December 2002

	Cash	Time deposits	Fixed-Income Securities	Equities	Other Assets	Total	%
Latin America and Caribbean	28	-	-		-	28	0.0
North Africa, Near East	-	50 000	-	-	-	50 000	2.4
Sub-Saharan Africa	13	-	-	-	-	13	0.0
East and South Asia	700	-	-	-	-	700	0.0
Subtotal Developing Countries	741	50 000	-	-	-	50 741	2.4
Developed countries	322 158	332 959	1 349 583	195 183	(215 911)	1 983 972	94.8
International development institutions	-	-	59 281	-	-	59 281	2.8
Total	**322 899**	**382 959**	**1 408 864**	**195 183**	**(215 911)**	**2 093 993**	**100.0**

31 December 2001

	Cash	Time deposits	Fixed-Income Securities	Equities	Other Assets	Total	%
Developing countries	2 949	15 372	21 422	131 245	-	170 988	8.9
Developed countries	69 117	116 922	936 378	624 682	(38 039)	1 709 060	89.1
International development institutions	-	-	37 041	-	-	37 041	1.9
Total	**72 066**	**132 294**	**994 841**	**755 927**	**(38 039)**	**1 917 089**	**100.0**

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

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the three-month period ending 31 December 2002 and includes comparative figures for the year to date and earlier years. The report comprises the following sections: implementation of the new investment policy, asset allocation, investment income, and rate of return and performance comparison.

II. IMPLEMENTATION OF THE NEW INVESTMENT POLICY

2. In October 2002, equity markets experienced a new rally 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 reduced IFAD's equities portfolio to two remaining mandates for North American and European equities respectively, and completed the transition from 45% to approximately 10% in equity holdings as required by the new investment policy.

3. On the basis of an international tender and an internal process of evaluation, a new global custodian was selected in November 2002, and preparatory work was begun to implement the transition on 1 April 2003.

III. ASSET ALLOCATION

4. Table 1 shows the movements affecting the investment portfolio's major asset classes in the fourth quarter of 2002 and compares the portfolio's actual asset allocation to the policy allocation as of 31 December 2002. In the fourth quarter, an amount of USD 95 169 000 equivalent was transferred from the equities portfolio to the internally managed portfolio, as a result of the equity liquidations mentioned in the previous section. There were also large positive exchange movements in the fourth quarter, especially in the government bonds portfolio, due to the appreciation of most currencies against the United States dollar. Additionally, there was a net outflow of USD 33 005 000 equivalent from the overall portfolio, since disbursements for loans, grants and administrative expenses exceeded the cash received from Member States in the fourth quarter.

Table 1: Summary of Movements in Cash and Investments
(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 September 2002)	**336 687**	**975 941**	**-**	**458 985**	**274 472**	**2 046 085**
Gross investment income	1 297	15 710	-	5 435	16 201	38 643
Income from securities lending and commission recapture	-	26	-	-	34	60
Fees, charges and taxes	(33)	(702)	-	(330)	(385)	(1 450)
Net investment income	**1 264**	**15 034**	**-**	**5 105**	**15 850**	**37 253**
Transfers due to allocation[2]	95 169	-	-	-	(95 169)	-
Transfers due to expenses	(1 203)	672	-	203	328	-
Transfers between portfolios	**93 966**	**672**	**-**	**203**	**(94 841)**	**-**
Other net flows[3]	(33 005)	-	-	-	-	(33 005)
Movements on exchange	9 225	30 731	-	(75)	3 779	43 660
Closing balance (31 December 2002)	**408 137**	**1 022 378**	**-**	**464 218**	**199 260**	**2 093 993**
Actual allocation (%)	19.5	48.8	-	22.2	9.5	100.0
Policy allocation (%)	5.0	44.0	18.0	23.0	10.0	100.0
Difference in allocation (%)	**14.5**	**4.8**	**(18.0)**	**(0.8)**	**(0.5)**	**-**

[1] The policy allocates 18% to inflation-indexed bonds. The asset class was unfunded as of 31 December 2002.
[2] These transfers refer to cash receipts from sales of equities and to repatriation of dividends earned on equity investments.
[3] These net flows consist of cash received from Member States, less disbursements for loans, grants and administrative expenses.

IV. INVESTMENT INCOME

5. Table 2 shows net investment income for the fourth quarter 2002 and previous periods for the major asset classes. Aggregate net investment income in the fourth quarter 2002 amounted to a gain of USD 37 253 000 equivalent, which, added to the loss of USD 11 083 000 equivalent in the first nine months of 2002, amounts to a gain of USD 26 170 000 equivalent in 2002.

Table 2: Net Investment Income by Asset Class
(USD ’000 equivalent)

Portfolio	4th Quarter 2002	3rd Quarter 2002	2nd Quarter 2002	1st Quarter 2002	2002	2001	2000	1999	1998	1997
Internally managed portfolio	1 264	967	1 383	468	4 082	2 050	3 654	3 114	4 834	18 633
Government bonds portfolio	15 034	48 285	26 715	(4 493)	85 541	41 471	74 625	(43 977)	195 506	154 228
Diversified fixed-interest	5 105	13 744	3 116	960	22 925	13 783	17 615	3 832	6 130	-
Equities portfolio	15 850	(64 971)	(50 286)	13 029	(86 378)	(100 286)	(143 744)	231 500	(18 571)	(8 921)
Overall Portfolio	**37 253**	**(1 975)**	**(19 072)**	**9 964**	**26 170**	**(42 982)**	**(47 850)**	**194 469**	**187 899**	**163 940**

6. Fixed-interest investments continued to perform well also in the fourth quarter, prolonging the sharp rally experienced in government bonds in the previous quarter. Fixed-interest gains reflected to some extent central bank interest rate cuts in the United States and Europe.

7. Equities investments experienced a new downturn in December, but overall the fourth quarter was positive for equities. News on corporate governance issues and corporate earnings were somewhat negative, but there was also some positive sentiment for a pick-up in the new year.

8. Table 3 shows the details of the net investment income earned during the fourth quarter and year 2002.

Table 3: Investment Income – Fourth Quarter and Year 2002
(USD ’000 equivalent)

	Fourth Quarter 2002			**Year 2002 Overall Portfolio**
	Fixed-Interest Portfolio	**Equity Portfolio**	**Overall Portfolio**	
Interest from fixed-interest investments and bank accounts	16 388	54	16 442	61 525
Dividend income from equities	-	821	821	7 652
Realized capital gains/(losses)	7 824	(16 605)	(8 781)	(89 120)
Unrealized capital gains/(losses)	(1 770)	31 931	30 161	53 541
Subtotal: Gross investment income	**22 442**	**16 201**	**38 643**	**33 598**
Income from securities lending and commission recapture	26	34	60	436
Investment manager fees	(578)	(204)	(782)	(4 866)
Custody fees	(211)	(108)	(319)	(1 621)
Financial advisory and other investment Management fees	(145)	(27)	(172)	(791)
Taxes	1	(49)	(48)	(365)
Other investment expenses	(132)	3	(129)	(221)
Net investment income	**21 403**	**15 850**	**37 253**	**26 170**

9. As shown in Table 4, in aggregate the net income from fixed-interest investments in the fourth quarter of 2002 amounted to USD 21 403 000 equivalent. All sections of the fixed-interest portfolio contributed positively to income.

Table 4: Investment Income on the Fixed-Interest Portfolio – Fourth 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	1 297	11 994	3 097	16 388
Dividend income from equities	-	-	-	-
Realized capital gains/(losses)	-	3 682	4 142	7 824
Unrealized capital gains/(losses)	-	34	(1 804)	(1 770)
Subtotal: Gross investment income	**1 297**	**15 710**	**5 435**	**22 442**
Income from securities lending and commission recapture	-	26	-	26
Investment manager fees	-	(488)	(90)	(578)
Custody fees	(33)	(111)	(67)	(211)
Financial advisory and other investment management fees	-	(99)	(46)	(145)
Taxes	-	1	-	1
Other investment expenses	-	(5)	(127)	(132)
Net investment income	**1 264**	**15 034**	**5 105**	**21 403**

10. In aggregate, the net income from equities investments in the fourth quarter of 2002 amounted to USD 15 850 000 equivalent, as shown in Table 5. All sections of the equities portfolio contributed positively in terms of gross income.

Table 5: Investment Income on the Equities Portfolio – Fourth Quarter 2002
(USD '000 equivalent)

	Japanese Equities[1]	**Asian and Australasian Equities[1]**	**Emerging Markets Equities[2]**	**Currency Overlay[2]**	**North American Equities**	**European Equities**	**Global Equities[3]**	**Total Equities Portfolio**
Interest from fixed-interest investments and bank accounts	-	-	16	37	-	1	-	54
Dividend income from equities	-	-	99	-	500	222	-	821
Realized capital losses	-	-	(9 059)	-	(2 891)	(4 655)	-	(16 605)
Unrealized capital gains	-	-	10 759	-	13 235	7 937	-	31 931
Subtotal: Gross investment income	**-**	**-**	**1 815**	**37**	**10 844**	**3 505**	**-**	**16 201**
Income from securities lending and commission recapture	2	19	24	-	(9)	3	(5)	34
Investment manager fees	8	-	(51)	-	(101)	(53)	(7)	(204)
Custody fees	-	(2)	(24)	(9)	(45)	(34)	6	(108)
Financial advisory and other investment management fees	-	-	(6)	(1)	(11)	(9)	-	(27)
Taxes	-	-	(9)	-	-	(40)	-	(49)
Other investment expenses	-	-	-	-	-	3	-	3
Net investment income	**10**	**17**	**1 749**	**27**	**10 678**	**3 375**	**(6)**	**15 850**

[1] The portfolio was liquidated in March 2002. Income and expenses for fourth quarter 2002 refer to transactions that could not be effected in March 2002.
[2] The portfolio was liquidated in October 2002.
[3] Part of the portfolio was liquidated in March 2002, and the remainder was consolidated with North American and European equities in September 2002. Income and expenses for fourth quarter 2002 refer to transactions that could not be effected in September 2002.

IV. RATE OF RETURN AND PERFORMANCE COMPARISON

11. There was an overall return of 1.86% in the fourth quarter of 2002, net of investment expenses and movements on exchange.

12. The performance of the various mandates of the investment portfolio is measured against pre-assigned independent benchmarks, indicating the return that would be expected through passive management of defined sectors of the market. The indices used as of 31 December 2002 were the J.P. Morgan Global Government Bond Index for government bonds, Lehman Brothers United States Aggregate Index for diversified fixed-interest bonds, S&P 500 for North American equities and the Morgan Stanley Capitalization Index for European equities.

13. Table 6 compares the return of each major section of the portfolio with the appropriate benchmark rate of return. The overall portfolio showed an outperformance of 18 basis points in the fourth quarter of 2002.

Table 6: Performance Compared with Benchmarks – Fourth Quarter and Year 2002
(USD '000 equivalent)

	Fourth Quarter 2002			Year 2002		
	Rate of Return %		Out/(Under)	Rate of Return %		Out/(Under)
Portfolio	**Portfolio**	**Benchmark**	**Performance**	**Portfolio**	**Benchmark**	**Performance**
Internally managed portfolio	0.38	0.38	-	1.33	1.33	-
Government bonds portfolio	1.61	1.23	0.38	9.98	9.34	0.64
Diversified fixed-interest portfolio	1.18	1.11	0.07	6.46	9.23	(2.77)
Total fixed-interest	**1.22**	**1.00**	**0.22**	**7.22**	**7.22**	**0.00**
Japanese equities	-	-	-	7.32	6.42	0.90
Asian and Australasian equities (excluding Japanese)	-	-	-	7.54	7.99	(0.45)
Emerging markets equities	2.87	3.31	(0.44)	(14.11)	(7.98)	(6.13)
North American equities	9.84	7.89	1.95	(25.22)	(18.53)	(6.69)
European equities	2.69	5.59	(2.90)	(32.92)	(26.30)	(6.62)
Global equities	-	-	-	(27.30)	(26.02)	(1.28)
Total equities	**5.01**	**5.13**	**(0.12)**	**(21.56)**	**(17.66)**	**(3.90)**
Overall portfolio gross rate of return	**1.93**	**1.75**	**0.18**	**1.64**	**2.89**	**(1.25)**
Less expenses	**(0.07)**	**(0.07)**	**-**	**(0.38)**	**(0.38)**	**-**
Overall portfolio net rate of return	**1.86**	**1.68**	**0.18**	**1.26**	**2.51**	**(1.25)**

14. The total fixed-interest portfolio returned 1.22% in the fourth quarter of 2002, outperforming its benchmark by 22 basis points. The outperformance was due to the government bonds portfolio, which outperformed by 38 basis points as a result of investment managers' bond selection and the duration of bonds. The diversified fixed-interest portfolio also slightly outperformed its benchmark.

15. The total equities portfolio returned 5.01% in the fourth quarter 2002, in particular due to the high returns in the North American equities portfolio. In aggregate, the equities portfolio underperformed its benchmark by 12 basis points, due to a notable underperformance in the European equities portfolio and, to a smaller extent, in the emerging markets equities portfolio prior to its liquidation in October 2002. The European equities mandate underperformed largely due to its conservative stock selection that had contributed positively during most of the year, but was unfavourable in the fourth quarter when especially technology and telecommunications stocks rebounded. The underperformance of the European equities mandate was largely offset by the outperformance of the North American equities mandate, which benefited strongly from its stock selection in a wide range of sectors.