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IFAD
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REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR THE THIRD QUARTER OF 2003

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the three-month period ended 30 September 2003 and includes comparative figures for year-to-date 2003 and earlier years.

2. This report is divided into six sections: investment policy, asset allocation, investment income, rate of return and performance comparison, currency composition, and risk measurement.

II. INVESTMENT POLICY

3. IFAD's current investment policy was adopted in December 2001 and was implemented for the most part during 2002. In June 2003, two investments were made in the asset class of inflation-indexed bonds, thus bringing holdings of inflation-indexed bonds to nearly 10% of the overall portfolio, as compared with the allocation of 18% indicated by the investment policy.

4. In the third quarter of 2003, it was decided to shorten the duration of the government bonds portfolio in order to reduce its exposure to potential losses in the event of rising interest rates. This decision was implemented by the end of September 2003. The timing of the duration change was opportune, considering that government bond markets started the fourth quarter of 2003 with negative performance.

5. A new financial adviser was selected in October 2003, and will be appointed following successful finalization of the contractual agreement.

III. ASSET ALLOCATION

6. Table 1 shows the cash and investment movements affecting the investment portfolio's major asset classes in the third quarter of 2003 and compares the portfolio's actual asset allocation with the policy allocation. There were no reallocations between the portfolio's asset classes in the third quarter, with the exception of the normal dividend repatriation from the equities portfolio to the internally managed portfolio. The latter portfolio, however, received a net inflow of USD 9 384 000 equivalent, representing Member States' contributions, less disbursements for loans, grants and administrative expenses. During the period there were also large positive movements on exchange, particularly in the government bonds and inflation-indexed bonds portfolios, as a result mainly of appreciation of the Japanese yen against the United States dollar.

7. The above-mentioned movements did not significantly alter the portfolio's allocation ratios. At 30 September 2003, the investment portfolio continued to show an excess allocation to the government bonds portfolio and, to a lesser extent, the internally managed portfolio. The excess allocations mainly reflected the fact that the asset class of inflation-indexed bonds was not yet fully funded. The allocation to equities remained closely in line with the policy allocation, while the diversified fixed-interest portfolio showed a moderate shortfall as at 30 September 2003.

**Table 1: Summary of Movements in Cash and Investment
Third Quarter of 2003**
(USD '000 equivalent)

	Internally Managed Portfolio	Government Bonds Portfolio	Diversified Fixed-Interest Portfolio	Inflation-Indexed Bonds Portfolio	Equities Portfolio	Overall Portfolio
Opening balance (30 June 2003)	**184 716**	**1 110 691**	**479 842**	**216 074**	**218 648**	**2 209 971**
Net investment income (losses)	990	(5 367)	(650)	2 531	3 846	1 350
Transfers due to allocation [a]	669	-	-	-	(669)	-
Transfers due to expenses	(1 560)	672	608	143	137	-
Other net flows [b]	9 384	-	-	-	-	9 384
Movements on exchange	2 063	19 517	(428)	12 098	1 079	34 329
Closing balance (30 September 2003)	**196 262**	**1 125 513**	**479 372**	**230 846**	**223 041**	**2 255 034**
Actual allocation (%)	8.7	49.9	21.3	10.2	9.9	100.0
Policy allocation (%)	5.0	44.0	23.0	18.0	10.0	100.0
Difference in allocation (%)	**3.7**	**5.9**	**(1.7)**	**(7.8)**	**(0.1)**	-

[a] Transfers from the equity portfolio reflect the repatriation of dividends.
[b] Member States' contributions, less disbursements for loans, grants and administrative expenses.

IV. INVESTMENT INCOME

8. Market conditions in the beginning of the third quarter of 2003 were characterized by a growing sentiment that an economic recovery was on the way. Equity markets therefore extended the previous quarter's gains, while fixed-interest investments performed negatively as a result of rising interest rates. Towards the end of the third quarter, investors again doubted the sustainability of the recovery, and fixed-interest investments regained some of their attraction and nearly managed to recover their losses from the beginning of the quarter.

9. Table 2 shows net investment income for the third quarter of 2003, year-to-date 2003 and earlier years for the investment portfolio's major asset classes. Aggregate net investment income in the third quarter of 2003 amounted to USD 1 350 000 equivalent, which, added to the net income of USD 74 496 000 equivalent in the first six months of 2003, resulted in a cumulative net income of

USD 75 846 000 equivalent for the first nine months of 2003 (compared with a net loss of USD 11 083 000 equivalent in the first nine months of 2002).

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

Portfolio	Third Quarter 2003	Six Months to 30 June 2003	Year-to-Date 2003	2002	2001	2000	1999	1998	1997
Internally managed portfolio	990	2 376	3 366	4 082	2 050	3 654	3 114	4 834	18 633
Government bonds portfolio	(5 367)	40 415	35 048	85 541	41 471	74 625	(43 977)	195 506	154 228
Diversified fixed-interest portfolio	(650)	15 517	14 867	22 925	13 783	17 615	3 832	6 130	-
Inflation-indexed bonds portfolio	2 531	6	2 537	-	-	-	-	-	-
Equities portfolio	3 846	16 182	20 028	(86 378)	(100 286)	(143 744)	231 500	(18 571)	(8 921)
Overall portfolio	**1 350**	**74 496**	**75 846**	**26 170**	**(42 982)**	**(47 850)**	**194 469**	**187 899**	**163 940**

10. Table 3 provides details on net investment income earned during the third quarter of 2003 broken down into the two main categories, i.e. fixed-interest and equity investments.

Table 3: Net Investment Income of the Overall Portfolio by Main Portfolio Category
Third Quarter of 2003
(USD ’000 equivalent)

	Fixed-Interest Portfolio	Equities Portfolio	Overall Portfolio
Interest from fixed-interest investments and bank accounts	17 319	1	17 320
Dividend income from equities	-	764	764
Realized capital gains (loss)	11 208	(1 946)	9 262
Unrealized capital gains (losses)	(30 115)	5 165	(24 950)
Subtotal: Gross investment income (loss)	**(1 588)**	**3 984**	**2 396**
Income from securities lending and commission recapture	137	40	177
Investment manager fees	(789)	(265)	(1 054)
Custody fees	(144)	(29)	(173)
Financial advisory and other investment management fees	(112)	(13)	(125)
Taxes	-	129	129
Other investment expenses	-	-	-
Net investment income (loss)	**(2 496)**	**3 846**	**1 350**

11. Table 4 shows net investment income for the sub-portfolios of the fixed-interest portfolio in the third quarter of 2003. In aggregate, the net loss from fixed-interest investments amounted to USD 2 496 000 equivalent. The government bonds portfolio – and, to a lesser extent, the diversified fixed-interest portfolio – contributed negatively to income, while the inflation-indexed bonds and internally managed portfolios contributed positively.

Table 4: Net Investment Income of the Fixed-Interest Portfolio by Sub-Portfolio
Third Quarter of 2003
(USD '000 equivalent)

	Internally Managed Portfolio	Government Bonds Portfolio	Diversified Fixed-Interest Portfolio	Inflation-Indexed Bonds Portfolio	Total Fixed-Interest Portfolio
Interest from fixed-interest investments and bank accounts	1 009	12 329	3 054	927	17 319
Dividend income from equities	-	-	-	-	-
Realized capital gains (loss)	-	12 607	(1 530)	131	11 208
Unrealized capital gains (losses)	-	(29 808)	(1 924)	1 617	(30 115)
Subtotal: Gross investment income (losses)	**1 009**	**(4 872)**	**(400)**	**2 675**	**(1 588)**
Income from securities lending and commission recapture	-	106	27	4	137
Investment manager fees	-	(476)	(205)	(108)	(789)
Custody fees	(19)	(56)	(42)	(27)	(144)
Financial advisory and other investment management fees	-	(69)	(30)	(13)	(112)
Taxes	-	-	-	-	-
Other investment expenses	-	-	-	-	-
Net investment income (losses)	**990**	**(5 367)**	**(650)**	**2 531**	**(2 496)**

12. Table 5 shows net investment income for the two sub-portfolios of the equities portfolio in the third quarter of 2003. In aggregate, the net income of this portfolio during the period amounted to USD 3 846 000 equivalent. Both the North American and, to a lesser extent, the European equities sub-portfolios contributed positively to income during the period.

Table 5: Net Investment Income of the Equities Portfolio by Sub-Portfolio
Third Quarter of 2003
(USD '000 equivalent)

	North American Equities	European Equities	Total Equities Portfolio
Interest from fixed-interest investments and bank accounts	1	-	1
Dividend income from equities	539	225	764
Realized capital gains (losses)	842	(2 788)	(1 946)
Unrealized capital gains	2 321	2 844	5 165
Subtotal: Gross investment income	**3 703**	**281**	**3 984**
Income from securities lending and commission recapture	8	32	40
Investment manager fees	(181)	(84)	(265)
Custody fees	(16)	(13)	(29)
Financial advisory and other investment management fees	(8)	(5)	(13)
Taxes	-	129	129
Other investment expenses	-	-	-
Net investment income	**3 506**	**340**	**3 846**

V. RATE OF RETURN AND PERFORMANCE COMPARISON

13. There was an overall positive return of 0.08% in the third quarter of 2003, net of investment expenses and movements on exchange. Cumulatively, the overall return for the first nine months of 2003 was 3.51% (non-annualized return).

14. 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 indices used are the J.P. Morgan customized global government bonds index for government bonds, Lehman Brothers United States aggregate index for diversified fixed-interest bonds, Barclay customized inflation-indexed index for the inflation-indexed bonds portfolio, Standard & Poor's 500 index for North American equities and Morgan Stanley capitalization index for European equities.

15. Table 6 compares the return on each major sub-portfolio with the appropriate benchmark return. The overall portfolio showed an outperformance of 16 basis points in the third quarter of 2003, as fixed-interest investments outperformed while equities showed a moderate underperformance relative to the benchmark.

Table 6: Performance Compared with Benchmarks
(in local currency terms)

	Third Quarter 2003			Year-to-Date 2003		
	Rate of Return %		Out/(Under)	Rate of Return %		Out/(Under)
Portfolio	**Portfolio**	**Benchmark**	**Performance**	**Portfolio**	**Benchmark**	**Performance**
Internally managed portfolio	0.52	0.52	-	1.14	1.14	-
Government bonds portfolio	(0.45)	(0.59)	0.14	3.28	2.78	0.50
Diversified fixed-interest portfolio	(0.09)	(0.19)	0.10	3.33	2.72	0.61
Inflation-indexed bonds portfolio	1.17	0.42	0.75	1.17	0.42	0.75
Total fixed-interest portfolio	**(0.07)**	**(0.29)**	**0.22**	**2.95**	**2.40**	**0.55**
North American equities portfolio	2.74	2.21	0.53	16.05	13.21	2.84
European equities portfolio	0.61	1.98	(1.37)	2.10	4.73	(2.63)
Total equities portfolio	**1.98**	**2.16**	**(0.18)**	**10.97**	**10.38**	**0.59**
Overall portfolio gross rate of return	**0.12**	**(0.04)**	**0.16**	**3.67**	**3.15**	**0.52**
Less expenses	**(0.04)**	**(0.04)**	**-**	**(0.16)**	**(0.16)**	**-**
Overall portfolio net rate of return	**0.08**	**(0.08)**	**0.16**	**3.51**	**2.99**	**0.52**

16. The total fixed-interest portfolio returned a negative 0.07% in the third quarter of 2003, but earned an outperformance of 22 basis points compared to its aggregate benchmark. The various sub-portfolios of the fixed-interest portfolio performed as follows:

- **Government bonds portfolio:** the portfolio outperformed by 14 basis points, mainly as investment managers' underweighting of the negatively performing Japanese bond market remained a positive factor.

- **Diversified fixed-interest portfolio:** the portfolio outperformed by 10 basis points as security selection continued to add value, and asset-backed securities compensated for their negative impact in the previous quarter.

- **Inflation-indexed bonds portfolio:** the portfolio outperformed by 75 basis points. The portfolio was funded at the end of June 2003, and the outperformance was generated in July as the portfolio benefited from slowly entering the market at a time of negative market returns.

17. The total equities portfolio returned a positive 1.98% in the third quarter of 2003, but underperformed its aggregate benchmark by 18 basis points. The two equity sub-portfolios contributed as follows:

- **North American equities portfolio:** the portfolio outperformed by 53 basis points, mainly due to its steady gains from stock selection.

- **European equities portfolio:** the portfolio extended the previous quarter's underperformance by 137 basis points, as its stock selection remained negative across several sectors. The portfolio's adherence to its investment style, which focuses on quality growth stocks in mostly large capitalization stocks, did not pay off, although the portfolio performed in line with overall market development during the last two months of the quarter.

VI. CURRENCY COMPOSITION

18. 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.

19. The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be part of the basket and which percentage weight should apply to each currency at the date of the reweighting.

20. 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 applicable units, together with their weights as at 1 January 2001 and 30 September 2003, are shown in Table 7.

Table 7: Units and Weights Applicable to the SDR Valuation Basket

	1 January 2001		30 September 2003	
Currency	**Units**	**Percentage Weight**	**Units**	**Percentage Weight**
USD	0.5770	44.3	0.5770	40.5
EUR	0.4260	30.4	0.4260	34.8
JPY	21.000	14.0	21.000	13.2
GBP	0.0984	11.3	0.0984	11.5
Total		**100.0**		**100.0**

21. As at 30 September 2003, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth, Fifth and Sixth Replenishments amounted to USD 2 662 193 000 equivalent (compared with USD 2 392 210 000 equivalent at 31 December 2002), as indicated in Table 8.

Table 8: Currency Composition of Assets at 30 September 2003
(USD '000 equivalent)

Currency Group	Cash and Investments	Promissory Notes	Amounts Receivable from Contributors	Total
USD	950 347	53 471	40 721	1 044 539
EUR	609 014	54 113	36 933	700 060
JPY	329 152	14 683	-	343 835
GBP	257 604	16 708	30 787	305 099
Other	108 917	73 178	86 565	268 660
Total	**2 255 034**	**212 153**	**195 006**	**2 662 193**

22. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 268 660 000 equivalent at 30 September 2003 (compared with USD 169 996 000 equivalent at 31 December 2002). These are allocated to currency groups as indicated in Table 9.

Table 9: Allocation of Assets to Currency Groups at 30 September 2003
(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	1 044 539	-	96 417	2 170	1 143 126
EUR	700 060	170 073	-	-	870 133
JPY	343 835	-	-	-	343 835
GBP	305 099	-	-	-	305 099
Total	**2 393 533**	**170 073**	**96 417**	**2 170**	**2 662 193**

23. The alignment of assets by currency group against the SDR valuation basket at 30 September 2003 is shown in Table 10. The balance of the General Reserve at 30 September 2003 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 49 022 000 respectively.

Table 10: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 30 September 2003
(USD '000 equivalent)

Currency Group	Amount per Currency Group	Less: Commitment Denominated in USD	Net Assets per Currency Group	Net Assets as a Percentage at 30 Sept 2003	Comparative SDR Weight as a Percentage at 30 Sept 2003
USD	1 143 126	(144 022)	999 104	39.7	40.5
EUR	870 133	-	870 133	34.6	34.8
JPY	343 835	-	343 835	13.6	13.2
GBP	305 099	-	305 099	12.1	11.5
Total	**2 662 193**	**(144 022)**	**2 518 171**	**100.0**	**100.0**

24. As at 30 September 2003, there were only small shortfalls in currency group holdings of United States dollar and euro. The shortfalls were offset by small excess holdings of Japanese yen and British pound sterling. The existing currency deviations between IFAD's net assets and the currency weights of the SDR valuation basket were mainly the result of investment managers' unhedged currency positions in the government bonds portfolio.

VII. RISK MEASUREMENT

25. 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 deviation of returns from their mean. At 30 September 2003, the standard deviation of IFAD's actual portfolio was 2.1%, compared with 2.5% for the investment policy (as against 2.5% for the portfolio and 2.8% for the policy at 30 June 2003), hence indicating a volatility reduction for both the portfolio and the policy.

26. 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 11 shows the VaR of IFAD's actual portfolio and its investment policy. At 30 September 2003, both the portfolio and the policy showed a lower VaR than at 30 June 2003, which indicates a risk reduction for both the portfolio and the policy. The major reason for this reduction was IFAD's decision to shorten the duration of its government bonds in the third quarter of 2003. This diminished the interest rate sensitivity of both the portfolio and the policy, and thus also lessened the possibility of losses.

Table 11: Value at Risk
(Forecast horizon of three months – confidence level of 95%)

Date	Portfolio		Policy[a]	
	VaR %	Amount (USD '000)	VaR %	Amount (USD '000)
30 September 2003	1.7	39 000	2.0	46 200
30 June 2003 [b]	2.1	46 100	2.3	51 500
31 March 2003	1.7	36 200	2.4	50 800
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 [a]	2.9	54 700	2.4	45 700
31 December 2001	5.5	105 100	6.2	119 100

[a] The new investment policy is reflected in the policy VaR as of 31 March 2002.
[b] The VaR figures at 30 June 2003 reflect the use of a new risk measurement tool due to IFAD's change of global custodian.

27. As also shown in Table 11 above, at 30 September 2003 the portfolio VaR remained below the policy VaR, indicating that the portfolio had a lower risk than the policy. The portfolio's lower risk is partially explained by its somewhat higher cash allocation compared with the policy. In addition, within the portfolio, both fixed-income and equities sectors showed a lower VaR than the policy, indicating that on average fixed-interest as well as equity investment managers were taking less risk than implied by their respective benchmark indices.