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**IFAD**  
**INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT**  
**Executive Board – Eighty-First Session**  
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**REPORT ON IFAD'S INVESTMENT PORTFOLIO**  
**FOR THE FIRST QUARTER OF 2004**

## **I. INTRODUCTION**

1. The following report on IFAD's investment portfolio covers the three-month period ending 31 March 2004 and consists of four sections: investment policy, asset allocation, investment income, and rate of return and performance comparison. Information on the period's performance attribution, currency composition and risk measurement will become available by the end of April 2004 and will therefore be included as an annex to the report on the second quarter of 2004.

## **II. INVESTMENT POLICY**

2. In March 2004, two external investment managers were selected for the management of the remaining, unfunded portion of inflation-indexed bonds. The two managers will be funded following successful finalization of the contractual agreements. The funding will bring the portfolio's asset allocation to inflation-indexed bonds in line with the 18% allocation in investment policy.

3. Also in March 2004, a decision was taken to shorten the duration of the inflation-indexed bonds portfolio from approximately eight to six years in order to reduce its exposure to potential losses in the event of rising interest rates. The decision will be implemented following the revision of the portfolio's investment guidelines.

## **III. ASSET ALLOCATION**

4. Table 1 shows the movements affecting the investment portfolio's major asset classes in the first quarter of 2004 and compares the portfolio's actual asset allocation to the policy allocation. There were no reallocations among the portfolio's asset classes during the period, besides the normal dividend repatriations from the equities portfolio to the internally managed portfolio, whereby IFAD avoids reinvesting its dividend gains into equities. From the internally managed portfolio, however, there was a net outflow of USD 20 153 000 equivalent, representing disbursements for loans, grants and administrative expenses, less cash receipts and encashments of Member States' contributions.

**Table 1: Summary of Movements in Cash and Investments – First Quarter 2004**  
(USD '000 equivalent)

|   | <b>Internally<br/>Managed<br/>Portfolio</b> | <b>Government<br/>Bonds<br/>Portfolio</b> | <b>Diversified<br/>Fixed-<br/>Interest<br/>Portfolio</b> | <b>Inflation-<br/>Indexed<br/>Bonds<br/>Portfolio</b> | <b>Equities<br/>Portfolio</b> | <b>Overall<br/>Portfolio</b> |
|---|---|---|--|---|-------------------------------|------------------------------|
| <b>Opening balance<br/>(31 December 2003)</b> | <b>185 326</b>                              | <b>1 190 833</b>                          | <b>480 873</b>   | <b>243 803</b>  | <b>256 086</b>                | <b>2 356 921</b>             |
| Net investment income                         | 621   | 20 197                                    | 11 912   | 6 534   | 1 831                         | 41 095                       |
| Transfers due to<br>allocation <sup>a</sup>   | 829   | -   | -  | -   | (829)                         | -                            |
| Transfers due to<br>expenses/other income     | (1 278)                                     | 568                                       | 244  | 162   | 304                           | -                            |
| Other net flows <sup>b</sup>                  | (20 153)                                    | -   | -  | -   | -                             | (20 153)                     |
| Movements on exchange                         | (1 572)                                     | (5 193)                                   | (33)   | 6 666   | (750)                         | (882)                        |
| <b>Closing balance<br/>(31 March 2004)</b>    | <b>163 773</b>                              | <b>1 206 405</b>                          | <b>492 996</b>   | <b>257 165</b>  | <b>256 642</b>                | <b>2 376 981</b>             |
| Actual allocation (%)                         | 6.9   | 50.8                                      | 20.7   | 10.8  | 10.8                          | 100.0                        |
| Policy allocation (%)                         | 5.0   | 44.0                                      | 23.0   | 18.0  | 10.0                          | 100.0                        |
| <b>Difference in allocation<br/>(%)</b>       | <b>1.9</b>                                  | <b>6.8</b>                                | <b>(2.3)</b>   | <b>(7.2)</b>  | <b>0.8</b>                    | <b>-</b>                     |

<sup>a</sup> Transfers from the equity portfolio reflect the repatriation of dividends.

<sup>b</sup> Disbursements for loans, grants and administrative expenses, less cash receipts and encashments of Member States' contributions.

5. Changes in portfolio allocation ratios during the first quarter of 2004 also reflected positive movements in net investment income, particularly in the government bonds portfolio. Foreign exchange movements, on the other hand, had less impact this quarter.

6. As a result of these movements in the first quarter of 2004, the internally managed portfolio showed a somewhat reduced excess allocation, while the government bonds portfolio showed a slightly increased excess allocation. The excess allocations mainly reflected the fact that the asset class of inflation-indexed bonds was not yet fully funded. However, as stated in section II, two external investment managers were selected in March 2004 for the management of the remaining, unfunded portion of inflation-indexed bonds. The amount needed for the funding will be transferred from the government bonds portfolio as well as the internally managed portfolio. Furthermore, at 31 March 2004, the diversified fixed-interest portfolio continued to show some shortfall while the equity portfolio showed a slight excess allocation.

#### IV. INVESTMENT INCOME

7. In the first quarter of 2004, fixed-interest investments performed well. Last year's equities rally, on the other hand, seemed to take a pause in the first quarter of 2004 and equity investments contributed only slightly positively during the quarter.

8. Table 2 shows net investment income for the first quarter of 2004 and earlier years for the investment portfolio's major asset classes. Aggregate net investment income in the first quarter of 2004 amounted to USD 41 095 000 (first quarter 2003 – USD 8 294 000 equivalent).

**Table 2: Net Investment Income by Asset Class – First Quarter 2004 and Prior Years<sup>a</sup>**  
(USD '000 equivalent)

| Portfolio                            | First Quarter 2004 | 2003           | 2002          | 2001            | 2000            | 1999           | 1998           | 1997           |
|--------------------------------------|--------------------|----------------|---------------|-----------------|-----------------|----------------|----------------|----------------|
| Internally managed portfolio         | 621                | 4 086          | 4 098         | 2 050           | 3 654           | 3 114          | 4 834          | 18 633         |
| Government bonds portfolio           | 20 197             | 36 735         | 85 541        | 41 471          | 74 625          | (43 977)       | 195 506        | 154 228        |
| Diversified fixed-interest portfolio | 11 912             | 16 038         | 22 925        | 13 783          | 17 615          | 3 832          | 6 130          | -              |
| Inflation-indexed bonds portfolio    | 6 534              | 4 665          | -             | -               | -               | -              | -              | -              |
| Equities portfolio                   | 1 831              | 46 438         | (86 378)      | (100 286)       | (143 744)       | 231 500        | (18 571)       | (8 921)        |
| <b>Overall portfolio</b>             | <b>41 095</b>      | <b>107 962</b> | <b>26 186</b> | <b>(42 982)</b> | <b>(47 850)</b> | <b>194 469</b> | <b>187 899</b> | <b>163 940</b> |

<sup>a</sup> Net investment income earned in prior years (1997 to 2001) reflects the previous investment policy.

9. Table 3 provides details on net investment income earned in the first quarter of 2004 by the two main portfolio categories, i.e. fixed-interest and equity investments. Most of the period's net investment income stemmed from the fixed-interest portfolio.

**Table 3: Net Investment Income of the Overall Portfolio by Main Portfolio Category – First Quarter 2004**  
(USD '000 equivalent)

|  | Total Fixed-Interest Portfolio | Total Equities Portfolio | Overall Portfolio |
|--|--------------------------------|--------------------------|-------------------|
| Interest from fixed-interest investments and bank accounts | 17 808                         | 4                        | 17 812            |
| Dividend income from equities                              | -                              | 1 079                    | 1 079             |
| Realized capital gains                                     | 9 525                          | 4 100                    | 13 625            |
| Unrealized capital gains/(losses)                          | 12 919                         | (3 048)                  | 9 871             |
| Income from securities lending and commission recapture    | 129                            | 40                       | 169               |
| <b>Subtotal: gross investment income</b>                   | <b>40 381</b>                  | <b>2 175</b>             | <b>42 556</b>     |
| Investment manager fees                                    | (886)                          | (304)                    | (1 190)           |
| Custody fees   | (110)                          | (24)                     | (134)             |
| Financial advisory and other investment management fees    | (121)                          | (16)                     | (136)             |
| Taxes  | -                              | -                        | -                 |
| <b>Net investment income</b>                               | <b>39 264</b>                  | <b>1 831</b>             | <b>41 095</b>     |

10. Table 4 shows the net investment income in the first quarter of 2004 from the fixed-interest portfolio's four sub-portfolios. In aggregate, net investment income from fixed-interest investments amounted to USD 39 264 000 equivalent and all four sub-portfolios contributed positively.

**Table 4: Net Investment Income of the Fixed-Interest Portfolio by Sub-Portfolio –  
First Quarter of 2004**  
(USD '000 equivalent)

|  | <b>Internally<br/>Managed<br/>Portfolio</b> | <b>Government<br/>Bonds<br/>Portfolio</b> | <b>Diversified<br/>Fixed-<br/>Interest<br/>Portfolio</b> | <b>Inflation-<br/>Indexed<br/>Bonds<br/>Portfolio</b> | <b>Total Fixed-<br/>Interest<br/>Portfolio</b> |
|--|---|---|--|---|--|
| Interest from fixed-interest investments and bank accounts | 635   | 12 608                                    | 3 288  | 1 277   | 17 808   |
| Dividend income from equities                              | -   | -   | -  | -   | -  |
| Realized capital gains                                     | -   | 587                                       | 6 445  | 2 493   | 9 525  |
| Unrealized capital gains                                   | -   | 7 570                                     | 2 423  | 2 926   | 12 919   |
| Income from securities lending and commission recapture    | -   | 94  | 30   | 5   | 129  |
| <b>Subtotal: gross investment income</b>                   | <b>635</b>                                  | <b>20 859</b>                             | <b>12 186</b>  | <b>6 701</b>  | <b>40 381</b>                                  |
| Investment manager fees                                    |   | (553)                                     | (212)  | (121)   | (886)  |
| Custody fees   | (14)  | (34)                                      | (31)   | (31)  | (110)  |
| Financial advisory and other investment management fees    | -   | (75)                                      | (31)   | (15)  | (121)  |
| Taxes  | -   | -   | -  | -   | -  |
| <b>Net investment income</b>                               | <b>621</b>                                  | <b>20 197</b>                             | <b>11 912</b>  | <b>6 534</b>  | <b>39 264</b>                                  |

11. Net investment income in the first quarter of 2004 from the two sub-portfolios of the equities portfolio is shown in Table 5. In aggregate, net investment income from equities amounted to USD 1 831 000 equivalent. Both the North American and the European equities sub-portfolios contributed somewhat positively.

**Table 5: Net Investment Income of the Equities Portfolio by Sub-Portfolio – First Quarter of 2004**  
(USD '000 equivalent)

|  | <b>North<br/>American<br/>Equities</b> | <b>European<br/>Equities</b> | <b>Total<br/>Equities<br/>Portfolio</b> |
|--|--|------------------------------|---|
| Interest from fixed-interest investments and bank accounts | 3                                      | 1                            | 4                                       |
| Dividend income from equities                              | 557                                    | 522                          | 1 079                                   |
| Realized capital gains/(losses)                            | 4 422                                  | (322)                        | 4 100                                   |
| Unrealized capital gains                                   | (3 156)                                | 108                          | (3 048)                                 |
| Income from securities lending and commission recapture    | 15                                     | 25                           | 40                                      |
| <b>Subtotal: gross investment income</b>                   | <b>1 841</b>                           | <b>334</b>                   | <b>2 175</b>                            |
| Investment manager fees                                    | (204)                                  | (100)                        | (304)                                   |
| Custody fees   | (18)                                   | (6)                          | (24)                                    |
| Financial advisory and other investment management fees    | (10)                                   | (6)                          | (16)                                    |
| Taxes  | -                                      | -                            | -                                       |
| <b>Net investment income</b>                               | <b>1 609</b>                           | <b>222</b>                   | <b>1 831</b>                            |

## V. RATE OF RETURN AND PERFORMANCE COMPARISON

12. There was an overall positive return of 1.75% in the first quarter of 2004, net of investment expenses and movements on exchange.

13. The performance 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 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 500 index for North American equities and Morgan Stanley capitalization index for European equities.

14. Table 6 compares the return on each major sub-portfolio with the appropriate benchmark return. The overall portfolio showed a small underperformance of ten basis points in the first quarter of 2004, as both fixed-interest and equities investments showed some underperformance relative to their benchmarks.

**Table 6: Performance Compared with Benchmarks – First Quarter 2004**  
(percentage in local currency terms)

| Portfolio                                     | First Quarter 2004 |               |                         |
|---|--------------------|---------------|-------------------------|
|   | Rate of Return %   |               | Out/(Under) Performance |
|   | Portfolio          | Benchmark     |                         |
| Internally managed portfolio                  | 0.36               | 0.36          | 0.00                    |
| Government bonds portfolio                    | 1.74               | 1.83          | (0.09)                  |
| Diversified fixed-interest portfolio          | 2.53               | 2.46          | 0.07                    |
| Inflation-indexed bonds portfolio             | 2.75               | 3.05          | (0.30)                  |
| <b>Total fixed-interest portfolio</b>         | <b>1.92</b>        | <b>2.00</b>   | <b>(0.08)</b>           |
| North American equities portfolio             | 1.16               | 1.29          | (0.13)                  |
| European equities portfolio                   | 0.31               | 1.06          | (0.75)                  |
| <b>Total equities portfolio</b>               | <b>0.83</b>        | <b>1.20</b>   | <b>(0.37)</b>           |
| <b>Overall portfolio gross rate of return</b> | <b>1.81</b>        | <b>1.91</b>   | <b>(0.10)</b>           |
| <b>Less expenses</b>                          | <b>(0.05)</b>      | <b>(0.05)</b> | <b>0.00</b>             |
| <b>Overall portfolio net rate of return</b>   | <b>1.75</b>        | <b>1.85</b>   | <b>(0.10)</b>           |

15. The total fixed-interest portfolio returned a positive 1.92% in the first quarter of 2004 but underperformed its aggregate benchmark slightly by eight basis points. The slight underperformance was due to the government bonds and inflation-indexed bonds portfolios, and was partially offset by a small outperformance in the diversified fixed-interest portfolio.

16. The total equities portfolio returned a positive 0.83% in the first quarter of 2004 but underperformed its benchmark by 37 basis points. The underperformance was largely due to the European equities portfolio.

17. Information on the first quarter's performance attribution will become available by the end of April 2004 and will therefore be included as an annex to the report on the second quarter of 2004.