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

ADDENDUM

I. INTRODUCTION

1. As indicated in the report on the third quarter of 2004, the final audited information for that quarter became available from IFAD's custodian only after the report was dispatched. This addendum therefore presents the updated, actual information on the period's asset allocation, investment income, rate of return and performance comparison, together with additional information on performance attribution, sector allocation of the equities portfolio, currency composition and risk measurement.

II. INVESTMENT POLICY

2. There were no changes to the investment policy in the third quarter of 2004. The portfolio maintained the shorter duration that was implemented in the government bonds and inflation-indexed portfolios in the third quarter of 2003 and second quarter of 2004 respectively. The shorter duration will reduce the portfolio's exposure to losses in the event of rising interest rates.

III. ASSET ALLOCATION

3. Table 1 shows the movements affecting the investment portfolio's major asset classes in the third quarter of 2004 and compares the portfolio's asset allocation to the policy allocation. There were no reallocations among the portfolio's asset classes during the period, besides the normal dividend repatriation from the equities portfolio to the internally managed portfolio, whereby IFAD avoids reinvesting its dividend gains into equities. During the third quarter of 2004, there was, however, a net inflow of USD 57 316 000 equivalent to the internally managed portfolio, representing cash receipts and encashments of Member States' contributions, less disbursements for loans, grants and administrative expenses.

Table 1: Summary of Movements in Cash and Investments – Third Quarter of 2004
(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 2004)	**89 525**	**1 050 641**	**484 253**	**427 107**	**258 589**	**2 310 115**
Net investment income/(loss)	625	16 939	14 688	7 977	(4 734)	35 495
Transfers due to allocation[a]	1 043	-	-	-	(1 043)	-
Transfers due to expenses/other income	(996)	471	233	256	36	-
Other net flows[b]	57 316	-	-	-	-	57 316
Movements on exchange	2 360	9 178	(41)	(1 339)	1 082	11 240
Closing balance (30 September 2004)	**149 873**	**1 077 229**	**499 133**	**434 001**	**253 930**	**2 414 166**
Portfolio allocation (%)	6.2	44.6	20.7	18.0	10.5	100.0
Policy allocation (%)	5.0	44.0	23.0	18.0	10.0	100.0
Difference in allocation (%)	**1.2**	**0.6**	**(2.3)**	**-**	**0.5**	**-**

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

4. Changes in portfolio allocation ratios during the third quarter of 2004 also reflected positive movements in net investment income in the fixed-interest portfolio and negative net investment income movements in the equities portfolio. The overall, positive foreign exchange movement also had an impact, mainly in the government bonds portfolio, as the euro appreciated somewhat against the United States dollar.

5. As a result of the transfers and movements in the third quarter of 2004, an excess allocation was shown by the internally managed portfolio and, to a smaller extent, by the government bonds and equities portfolios. The excess allocations were offset by a shortfall in the allocations of the diversified fixed-interest portfolio.

IV. INVESTMENT INCOME

6. The third quarter of 2004 showed some evidence of a global slowdown in economic activity, and oil prices reached record high levels. In this environment, fixed-interest markets gained while equities markets generally declined.

7. Table 2 shows the net investment income for the third quarter of 2004, the first six months of 2004, year-to-date 2004 and actual net investment income for prior periods by the investment portfolio's major asset classes. Aggregate net investment income in the third quarter of 2004 amounted to USD 35 495 000 equivalent, which, added to the actual net investment income of USD 26 677 000 equivalent for the first six months of 2004, resulted in a cumulative net investment income of USD 62 172 000 equivalent for the first nine months of 2004 (while the first nine months of 2003 resulted in USD 75 846 000 equivalent).

Table 2: Net Investment Income by Asset Class –Third Quarter, First Six Months and Year-to-Date 2004 and Prior Periods[a]

(USD '000 equivalent)

Portfolio	Third Quarter 2004	First Six Months of 2004	Year-to-Date 2004	2003	2002	2001	2000	1999	1998	1997
Internally managed portfolio	625	1 149	1 774	4 086	4 098	2 050	3 654	3 114	4 834	18 633
Government bonds portfolio	16 939	9 397	26 336	36 735	85 541	41 471	74 625	(43 977)	195 506	154 228
Diversified fixed-interest portfolio	14 688	2 953	17 641	16 038	22 925	13 783	17 615	3 832	6 130	-
Inflation-indexed bonds portfolio	7 977	7 016	14 993	4 665	-	-	-	-	-	-
Equities portfolio	(4 734)	6 162	1 428	46 438	(86 378)	(100 286)	(143 744)	231 500	(18 571)	(8 921)
Overall portfolio	**35 495**	**26 677**	**62 172**	**107 962**	**26 186**	**(42 982)**	**(47 850)**	**194 469**	**187 899**	**163 940**

[a] Net investment income earned in prior years (1997 to 2001) reflects the previous investment policy.

8. Table 3 provides details on the aggregate net investment income in the third quarter of 2004 by the two main portfolio categories, i.e. fixed-interest and equities investments. The period's gains stemmed from the fixed-interest portfolio but were partially offset by losses in the equities portfolio.

Table 3: Net Investment Income of the Overall Portfolio by Main Portfolio Category – Third Quarter of 2004

(USD '000 equivalent)

	Total Fixed-Interest Portfolio	**Total Equities Portfolio**	**Overall Portfolio**
Interest from fixed-interest investments and bank accounts	18 711	14	18 725
Dividend income from equities	-	1 199	1 199
Realized capital gains/(losses)	7 715	(178)	7 537
Unrealized capital gains/(losses)	14 782	(5 733)	9 049
Income from securities lending and commission recapture	160	25	185
Subtotal: gross investment income/(loss)	**41 368**	**(4 673)**	**36 695**
Investment manager fees	(854)	(272)	(1 126)
Custody fees	(122)	(27)	(149)
Financial advisory and other investment management fees	(163)	(22)	(185)
Taxes	-	260	260
Net investment income/(loss)	**40 229**	**(4 734)**	**35 495**

9. Table 4 shows the net investment income in the third quarter from the fixed-interest portfolio's four sub-portfolios. In aggregate, net investment income from fixed-interest investment amounted to USD 40 229 000 equivalent. All sub-portfolios of the fixed-interest portfolio contributed positively, particularly the government bonds and the diversified fixed-interest sub-portfolios.

Table 4: Net Investment Income of the Fixed-Interest Portfolio by Sub-Portfolio – Third Quarter of 2004

(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	644	11 779	3 553	2 735	18 711
Dividend income from equities	-	-	-	-	-
Realized capital gains/(losses)	-	(1 330)	7 181	1 864	7 715
Unrealized capital (losses)	-	6 961	4 187	3 634	14 782
Income from securities lending and commission recapture	-	86	57	17	160
Subtotal: gross investment income/(loss)	**644**	**17 496**	**14 978**	**8 250**	**41 368**
Investment manager fees	-	(431)	(219)	(204)	(854)
Custody fees	(19)	(38)	(30)	(35)	(122)
Financial advisory and other investment management fees	-	(88)	(41)	(34)	(163)
Taxes	-	-	-	-	-
Net investment income/(loss)	**625**	**16 939**	**14 688**	**7 977**	**40 229**

10. Table 5 shows the net investment loss in the third quarter of 2004 from the two sub-portfolios of the equities portfolio. In aggregate, net investment loss from equities amounted to USD 4 734 000 equivalent. The loss stemmed entirely from the North American equities sub-portfolio while the European equities sub-portfolio contributed a slight gain.

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

	North American Equities	**European Equities**	**Total Equities Portfolio**
Interest from fixed-interest investments and bank accounts	8	6	14
Dividend income from equities	819	380	1 199
Realized capital gains/(losses)	(715)	537	(178)
Unrealized capital gains/(losses)	(5 025)	(708)	(5 733)
Income from securities lending and commission recapture	16	9	25
Subtotal: gross investment income/(loss)	**(4 897)**	**224**	**(4 673)**
Investment manager fees	(198)	(74)	(272)
Custody fees	(19)	(8)	(27)
Financial advisory and other investment management fees	(13)	(9)	(22)
Taxes	-	260	260
Net investment income/(loss)	**(5 127)**	**393**	**(4 734)**

V. RATE OF RETURN AND PERFORMANCE COMPARISON

11. There was an overall return of 1.51% in the third quarter of 2004, net of investment expenses and movements on exchange. Cumulatively, the overall return for the first nine months of 2004 was 2.73% (estimated annualized return of 3.64%).

12. 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 indexes 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.

13. Table 6 compares the return on each major sub-portfolio with the appropriate benchmark return. The overall portfolio only slightly underperformed the benchmark in the third quarter of 2004.

Table 6: Performance Compared with Benchmarks – Third Quarter and Year-to-Date 2004

(percentage in local currency terms)

Portfolio	Third Quarter 2004			Year-to-Date 2004		
	Rate of Return (%)		Out/(Under)-performance	Rate of Return (%)		Out/(Under)-Performance
	Portfolio	Benchmark		Portfolio	Benchmark	
Internally managed	0.64	0.64	0.00	1.50	1.50	0.00
Government bonds	1.62	1.68	(0.06)	2.60	2.55	0.05
Diversified fixed-interest	3.07	2.89	0.18	3.82	3.16	0.66
Inflation-indexed bonds	1.89	2.25	(0.36)	4.69	5.00	(0.31)
Total fixed-interest portfolio	**1.97**	**1.99**	**(0.02)**	**3.10**	**2.96**	**0.14**
North American equities	(3.10)	(2.31)	(0.79)	(0.57)	0.24	(0.81)
European equities	0.21	(0.35)	0.56	3.25	2.53	0.72
Total equities portfolio	**(1.83)**	**(1.56)**	**(0.27)**	**0.90**	**1.14**	**(0.24)**
Overall portfolio gross rate of return	**1.54**	**1.59**	**(0.05)**	**2.86**	**2.75**	**0.11**
Less expenses	**(0.03)**	**(0.03)**	**0.00**	**(0.13)**	**(0.13)**	**0.00**
Overall portfolio net rate of return	**1.51**	**1.56**	**(0.05)**	**2.73**	**2.62**	**0.11**

14. The total fixed-interest portfolio returned a positive 1.97% in the third quarter of 2004 and slightly underperformed its aggregate benchmark by 2 basis points. The underperformance resulted principally from the inflation-indexed portfolio and, to a small extent, the government bonds portfolio. The inflation-indexed portfolio underperformed mainly due to its shorter duration compared to benchmark. However, the shorter duration contributed to reducing the volatility of the investment portfolio. The underperformance of inflation-indexed bonds and government bonds was largely offset by the diversified fixed-interest portfolio, which outperformed its benchmark mainly due to its underweighting of mortgages as well as duration positioning.

15. The total equities portfolio returned a negative 1.83% in the third quarter of 2004 and underperformed its benchmark by 27 basis points. This underperformance can be traced to the negative stock selection of the North American equities portfolio. Meanwhile, the European equities portfolio contributed significantly to reducing the overall equities underperformance by outperforming its benchmark largely due to positive stock selection.

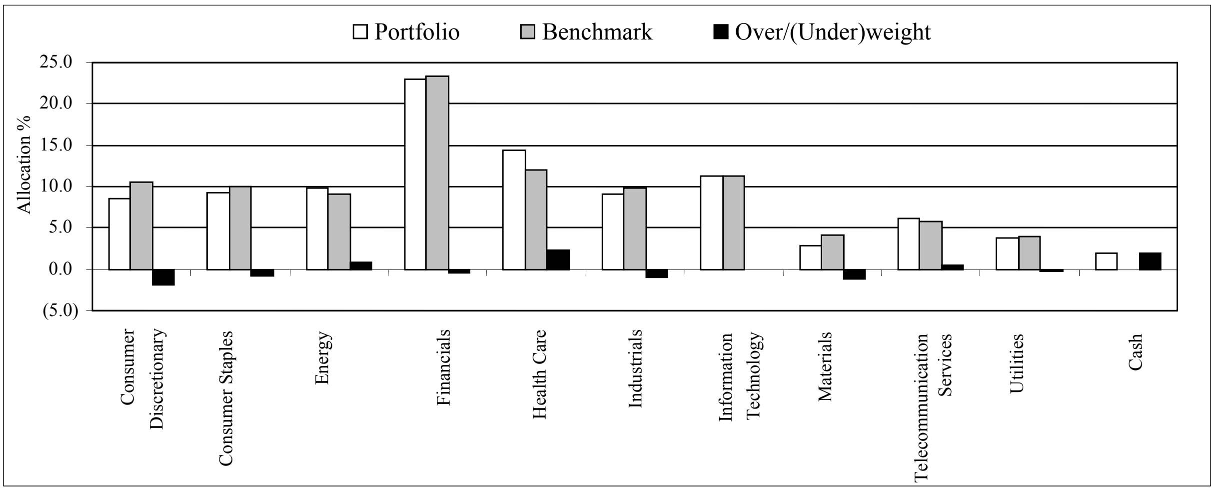
VI. SECTOR ALLOCATION OF THE EQUITIES PORTFOLIO

16. The figure below shows the sector allocation by industry of the total equities portfolio at 30 September 2004 and also compares this allocation with the sector allocation of the aggregate benchmark. The sectors refer to sector classifications applied by the portfolio's two benchmark indexes, i.e. Standard & Poor's 500 for North American equities and Morgan Stanley capitalization index for European equities.

17. As illustrated in the figure, the three major sectors of the total equities portfolio and its aggregate benchmark were financials, health care and information technology, which together constituted approximately half of both the portfolio and its aggregate benchmark. Other major sectors were energy, consumer staples, industrials and consumer discretionary. At 30 September 2004, the overall equities

portfolio did not show significant over- or underweights relative to the aggregate benchmark; the largest sector deviations were the overweights in the health care sector (+2.3%) and cash (+2.0%), which were offset by underweights mainly in consumer discretionary (-1.9%) and materials (-1.2%).

Figure: Sector Allocation of the Total Equities Portfolio at 30 September 2004



18. Table 7 shows the sector allocation of the two sub-portfolios, i.e. North American and European equities, and also compares these with the sector allocations of their respective benchmarks.

Table 7: Sector Allocation of the Equities Portfolio by Sub-Portfolio at 30 September 2004
(percentage)

Industry Sector	North American Equities			European Equities			Total Equities Portfolio		
	Portfolio	Benchmark	Over/(Under)-weight	Portfolio	Benchmark	Over/(Under)-weight	Portfolio	Benchmark	Over/(Under) -weight
Consumer discretionary	8.2	10.7	(2.5)	9.3	10.2	(1.0)	8.6	10.5	(1.9)
Consumer staples	9.1	10.7	(1.6)	9.3	9.0	0.3	9.2	10.0	(0.8)
Energy	6.7	7.3	(0.6)	14.8	11.9	2.9	9.9	9.1	0.8
Financials	21.1	20.9	0.2	25.6	27.2	(1.6)	22.9	23.4	(0.5)
Health care	14.8	13.2	1.6	13.5	10.2	3.3	14.3	12.0	2.3
Industrials	10.3	11.4	(1.1)	7.1	7.6	(0.4)	9.0	9.9	(0.9)
Information technology	16.4	15.9	0.5	3.4	4.2	(0.8)	11.3	11.3	0.0
Materials	3.1	3.1	0.0	2.7	5.8	(3.1)	2.9	4.1	(1.2)
Telecommunication services	4.1	3.7	0.4	9.5	8.9	0.6	6.2	5.8	0.4
Utilities	3.8	3.1	0.7	3.7	5.2	(1.5)	3.7	3.9	(0.2)
Cash	2.4	0.0	2.4	1.3	0.0	1.3	2.0	0.0	2.0
Total	**100.0**	**100.0**	**–**	**100.0**	**100.0**	**–**	**100.0**	**100.0**	**–**

19. The North American equities portfolio remained largely sector-neutral at 30 September 2004. The main overweights were in cash (+2.4%) and health care (+1.6%), while the main underweights were in consumer discretionary (-2.5%) and consumer staples (-1.6%).

20. The European equities portfolio showed a level of sector deviations at 30 September 2004 similar to the previous quarter-end. The main overweights were in health care (+3.3%) and energy (+2.9%), which were offset by underweights mainly in materials (-3.1%), financials (-1.6%) and utilities (-1.5%).

VII. CURRENCY COMPOSITION

21. 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.

22. 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 what percentage weight should apply to each currency at the date of reweighting of the basket.

23. New units for each of the four currencies constituting 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 at 1 January 2001 and 30 September 2004, are shown in Table 8.

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

	1 January 2001		30 September 2004	
Currency	**Units**	**Percentage Weight**	**Units**	**Percentage Weight**
United States dollar (USD)	0.577	44.3	0.577	39.1
Euro (EUR)	0.426	30.4	0.426	35.9
Japanese yen (JPY)	21.000	14.0	21.000	12.9
Pound sterling (GBP)	0.0984	11.3	0.0984	12.1
Total		**100.0**		**100.0**

24. As at 30 September 2004, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth, Fifth and Sixth Replenishments amounted to USD 2 944 804 000 equivalent, as indicated in Table 9 (compared with USD 2 855 650 000 equivalent at 30 June 2004).

Table 9: Currency Composition of Assets at 30 September 2004
(USD '000 equivalent)

Currency Group	Cash and Investments[a]	Promissory Notes[a]	Amounts Receivable from Contributors	Total
USD	1 011 505	60 172	101 520	1 173 197
EUR	698 251	105 658	44 130	848 039
JPY	349 262	16 586	16 586	382 434
GBP	294 113	12 484	59 965	366 562
Other	60 242	40 829	73 501	174 572
Total	**2 413 373**	**235 729**	**295 702**	**2 944 804**

[a] Includes assets in freely convertible currencies. The excluded assets in non-convertible currencies amounted to USD 794 000 equivalent for cash and investments and USD 1 399 000 equivalent for promissory notes.

25. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 174 572 000 equivalent at 30 September 2004 (compared with USD 207 364 000 equivalent at 30 June 2004). These are allocated to currency groups as indicated in Table 10.

Table 10: Allocation of Assets to Currency Groups at 30 September 2004
(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	Total Currencies per Group
USD	1 173 197	-	48 988	1 222 185
EUR	848 039	125 584	-	973 623
JPY	382 434	-	-	382 434
GBP	366 562	-	-	366 562
Total	**2 770 232**	**125 584**	**48 988**	**2 944 804**

26. The alignment of assets by currency group against the SDR valuation basket at 30 September 2004 is shown in Table 11. The balance of the General Reserve at 30 September 2004 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 51 600 000 respectively.

Table 11: Alignment of Assets by Currency Group with the Currency Composition of the SDR Valuation Basket at 30 September 2004
(USD ’000 equivalent)

Currency Group	Asset Amount	Less: Commitment Denominated in USD	Net Asset Amount	Net Asset Amount at 30 September 2004 as a Percentage	Compare SDR Weights as a Percentage at 30 September 2004
USD	1 222 185	(146 600)	1 075 585	38.4	39.1
EUR	973 623	–	973 623	34.8	35.9
JPY	382 434	–	382 434	13.7	12.9
GBP	366 562	–	366 562	13.1	12.1
Total	**2 944 804**	**(146 600)**	**2 798 204**	**100.0**	**100.0**

27. At 30 September 2004, there were only small currency group deviations between IFAD’s net assets and the SDR valuation basket. The currency group holdings of United States dollar and euro showed some small shortfalls, which were offset by small excess holdings of Japanese yen and pound sterling.

VIII. RISK MEASUREMENT

28. 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 2004, the standard deviation of IFAD’s investment portfolio was 1.8%, which implied a lower risk compared with the 2.0% standard deviation of the investment policy (as against 2.2% for the investment portfolio and 2.3% for the investment policy at 30 June 2004).

29. Value-at-Risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount the portfolio could lose over a three-month time horizon, with a 95% confidence level. Table 12 shows the VaR of IFAD's investment portfolio and policy. At 30 September 2004, the investment portfolio continued to show a VaR percentage (1.5%) slightly below the investment policy (1.7%), hence indicating a somewhat smaller risk in the investment portfolio. The portfolio's lower risk was partially explained by its somewhat higher cash allocation compared with the policy at 30 September 2004 as a result of larger encashment receipts from Member States' contributions during the third quarter of 2004. In addition, all externally managed asset classes within the investment portfolio showed a similar or lower VaR than the investment policy. This indicated that, in all asset classes, IFAD's external investment managers were taking similar or less risk than implied by their respective benchmark indexes. Furthermore, both the investment portfolio and the investment policy showed slightly lower VaR percentages vis-à-vis the previous quarter-end. This was due to the slightly lower volatility recently exhibited by the financial markets.

Table 12: Value-at-Risk

(forecast horizon three months, confidence level 95%)

Date	Investment Portfolio[a]		Investment Policy[b]	
	VaR (%)	**Amount (USD '000)**	**VaR (%)**	**Amount (USD '000)**
30 September 2004	1.5	36 900	1.7	40 700
30 June 2004	1.8	41 600	1.9	43 900
31 March 2004	1.7	40 400	2.0	48 200
31 December 2003	1.7	40 800	2.0	46 700
30 September 2003	1.7	39 000	2.0	46 200
30 June 2003[c]	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	2.9	54 700	2.4	45 700
31 December 2001	5.5	105 100	6.2	119 100

[a] The current investment policy was implemented in 2002, with the exception of the asset class of inflation-indexed bonds. Changes in VaR during 2002 reflect the gradual implementation of the current investment policy.

[b] The current investment policy is reflected in the policy's VaR as at 31 March 2002, while 31 December 2001 still reflected the VaR of the previous investment policy.

[c] IFAD's transition to its new global custodian took place on 1 April 2003. Variations in VaR between 31 March 2003 and 30 June 2003 therefore reflect some differences in VaR methodologies used by the two different custodians providing risk measurement services on these dates.