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IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
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REPORT ON IFAD'S INVESTMENT PORTFOLIO
FOR THE THIRD QUARTER OF 2004

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the three-month period ending 30 September 2004 and consists of four sections: investment policy; asset allocation; investment income; and rate of return and performance comparison. The report is partially based on estimates as IFAD's custodian will only make available the final, audited information relating to September 2004 after the dispatch of the current document. Updated, actual information on the third quarter of 2004 and additional information on the period's performance attribution, sector allocation of the equities portfolio, currency composition and risk measurement will be published on IFAD's restricted website as an addendum to this document as soon as it becomes available.

2. Furthermore, the annex contains additional information on the investment portfolio's performance attribution, currency composition and risk measurement for the second quarter of 2004. This information became available by the end of July 2004, i.e. after the submission of the report on the second quarter of 2004 to the Executive Board's Eighty-Second Session.

II. INVESTMENT POLICY

3. 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

4. Table 1 shows the estimated 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, an estimated net inflow of USD 65 804 000 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 – Estimated 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
Estimated net investment income/(loss)	724	16 570	13 830	9 136	(5 727)	34 533
Estimated transfers due to allocation ^a	457	-	-	-	(457)	-
Estimated transfers due to expenses/other income	(1 063)	621	286	252	(96)	-
Estimated other net flows ^b	65 804	-	-	-	-	65 804
Estimated movements on exchange	(545)	9 663	(19)	(2 398)	1 121	7 822
Estimated closing balance (30 September 2004)	154 902	1 077 495	498 350	434 097	253 430	2 418 274
Estimated portfolio allocation (%)	6.4	44.5	20.6	18.0	10.5	100.0
Policy allocation (%)	5.0	44.0	23.0	18.0	10.0	100.0
Estimated difference in allocation (%)	1.4	0.5	(2.4)	-	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.

5. Estimated 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 (EUR) currency appreciated somewhat against the United States dollar (USD).

6. As a result of the estimated 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

7. 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.

8. Table 2 shows the estimated net investment income for the third quarter of 2004 and year-to-date 2004 and actual net investment income for prior periods by the investment portfolio's major asset classes. Estimated, aggregate net investment income in the third quarter of 2004 amounted to USD 34 533 000 equivalent, which, added to the actual net investment income of USD 26 677 000 equivalent for the first six months of 2004, resulted in an estimated, cumulative net investment income of USD 61 210 000 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 – Estimated Third Quarter and Year-to-Date 2004 and Actual Prior Periods^a
(USD '000 equivalent)

Portfolio	Estimated Third Quarter 2004	First Six Months of 2004	Estimated Year-to-Date 2004	2003	2002	2001	2000	1999	1998	1997
Internally managed portfolio	724	1 149	1 873	4 086	4 098	2 050	3 654	3 114	4 834	18 633
Government bonds portfolio	16 570	9 397	25 967	36 735	85 541	41 471	74 625	(43 977)	195 506	154 228
Diversified fixed-interest portfolio	13 830	2 953	16 783	16 038	22 925	13 783	17 615	3 832	6 130	-
Inflation-indexed bonds portfolio	9 136	7 016	16 152	4 665	-	-	-	-	-	-
Equities portfolio	(5 727)	6 162	435	46 438	(86 378)	(100 286)	(143 744)	231 500	(18 571)	(8 921)
Overall portfolio	34 533	26 677	61 210	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.

9. Table 3 provides details on the estimated, 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. Detailed information by the sub-portfolio of fixed-interest and equities investments will be made available when the final, audited information on September 2004 has been received.

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

	Total Fixed- Interest Portfolio	Total Equities Portfolio	Overall Portfolio
Interest from fixed-interest investments and bank accounts	12 539	9	12 548
Dividend income from equities	2	879	881
Realized capital gains/(losses)	6 614	110	6 724
Unrealized capital gains/(losses)	22 130	(6 821)	15 309
Income from securities lending and commission recapture	134	-	134
Subtotal: Estimated gross investment income/(loss)	41 419	(5 823)	35 596
Investment manager fees	(985)	(130)	(1 115)
Custody fees	(122)	(16)	(138)
Financial advisory and other investment management fees	(52)	(7)	(59)
Taxes	-	249	249
Estimated net investment income/(loss)	40 260	(5 727)	34 533

V. RATE OF RETURN AND PERFORMANCE COMPARISON

10. There was an estimated, overall return of 1.49% in the third quarter of 2004, net of investment expenses and movements on exchange. Cumulatively, the estimated overall return for the first nine months of 2004 was 2.70% (non-annualized return).

11. 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 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 500 index for North American equities and Morgan Stanley capitalization index for European equities.

12. Table 4 compares the return on each major sub-portfolio with the appropriate benchmark return. It is estimated that the overall portfolio performed broadly in line with the benchmark in the third quarter of 2004.

**Table 4: Performance Compared with Benchmarks –
Estimated Third Quarter and Year-to-Date 2004**
(percentage in local currency terms)

Portfolio	Estimated Third Quarter 2004			Estimated Year-to-Date 2004		
	Rate of Return %		Out/(Under) Performance	Rate of Return %		Out/(Under) Performance
	Portfolio	Benchmark		Portfolio	Benchmark	
Internally managed portfolio	0.56	0.56	0.00	1.41	1.41	0.00
Government bonds portfolio	1.63	1.68	(0.05)	2.61	2.55	0.06
Diversified fixed-interest portfolio	2.91	2.89	0.02	3.65	3.16	0.49
Inflation-indexed bonds portfolio	2.18	2.24	(0.06)	4.99	4.99	0.00
Total fixed-interest portfolio	1.99	1.97	0.02	3.12	2.94	0.18
North American equities portfolio	(3.87)	(2.31)	(1.56)	(1.37)	0.24	(1.61)
European equities portfolio	0.39	(0.35)	0.74	3.44	2.53	0.91
Total equities portfolio	(2.24)	(1.56)	(0.68)	0.48	1.14	(0.66)
Overall portfolio gross rate of return	1.52	1.59	(0.07)	2.84	2.75	0.09
Less expenses	(0.04)	(0.04)	0.00	(0.13)	(0.13)	0.00
Overall portfolio net rate of return	1.49	1.55	(0.06)	2.70	2.61	0.09

13. The total fixed-interest portfolio returned an estimated, positive 1.99% in the third quarter of 2004, while it is estimated that the total equities portfolio returned a negative 2.24%. As soon as it becomes available, information on the actual performance and its attribution for the third quarter of 2004 will be published on the IFAD restricted website together with other additional information for the third quarter of 2004.

**ADDITIONAL INFORMATION ON IFAD'S INVESTMENT PORTFOLIO FOR
THE SECOND QUARTER OF 2004**

I. INTRODUCTION

1. The present annex provides the following additional information on IFAD's investment portfolio for the second quarter of 2004: performance attribution; currency composition; and risk measurement. The additional information became available after the report on the second quarter of 2004 had been submitted to the Executive Board's Eighty-Second Session.

II. PERFORMANCE ATTRIBUTION

2. As already presented in the report on the second quarter of 2004, there was an overall negative return of 0.54%, net of investment expenses and movements on exchange.

3. 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 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 500 index for North American equities and Morgan Stanley capitalization index for European equities.

4. Table 1 compares the return on each major sub-portfolio with the appropriate benchmark return. The overall portfolio showed an outperformance of 25 basis points in the second quarter of 2004, as both fixed-interest and equities investments showed an outperformance relative to their benchmarks.

Table 1: Performance Compared with Benchmarks – Second Quarter 2004
(percentage in local currency terms)

Portfolio	Second Quarter 2004		
	Rate of Return %		Out/(Under) Performance
	Portfolio	Benchmark	
Internally managed portfolio	0.49	0.49	0.00
Government bonds portfolio	(0.77)	(0.96)	0.19
Diversified fixed-interest portfolio	(1.76)	(2.15)	0.39
Inflation-indexed bonds portfolio	0.00	(0.35)	0.35
Total fixed-interest portfolio	(0.80)	(1.02)	0.22
North American equities portfolio	1.42	1.31	0.11
European equities portfolio	2.72	1.81	0.91
Total equities portfolio	1.93	1.52	0.41
Overall portfolio gross rate of return	(0.50)	(0.75)	0.25
Less expenses	(0.04)	(0.04)	0.00
Overall portfolio net rate of return	(0.54)	(0.79)	0.25

5. The total fixed-interest portfolio returned a negative 0.80% in the second quarter of 2004 but outperformed its aggregate benchmark by 22 basis points. The outperformance stemmed from all three externally managed sub-portfolios of the fixed-interest portfolio. Compared with the benchmark, the government bonds portfolio benefited from the investment managers' decision to maintain a shorter duration compared with the benchmark as well as their lower exposure to the period's underperforming

United States bond market. Also the inflation-indexed portfolio benefited from the managers' shorter duration compared to benchmark. The diversified fixed-interest portfolio, on the other hand, benefited more from its security selection, and particularly in asset-backed securities and United States Treasury bonds.

6. The total equities portfolio returned a positive 1.93% in the second quarter of 2004 and outperformed its benchmark by 41 basis points. The outperformance was particularly due to the European equities portfolio while the North American equities portfolio outperformed the benchmark only to a smaller extent. The equity performance information available for the second quarter of 2004 did not clearly attribute the period's outperformance to either sector allocation or stock selection

III. CURRENCY COMPOSITION

7. 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 USD are matched by assets denominated in the same currency.

8. 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 of the basket.

9. 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 of 1 January 2001 and 30 June 2004, are shown in Table 2.

Table 2: Units and Weights Applicable to the SDR Valuation Basket

Currency	1 January 2001		30 June 2004	
	Units	Percentage Weight	Units	Percentage Weight
USD	0.577	44.3	0.577	39.4
EUR	0.426	30.4	0.426	35.3
JPY	21.000	14.0	21.000	13.1
GBP	0.0984	11.3	0.0984	12.2
Total		100.0		100.0

GBP: Great Britain pound

JPY: Japanese yen

10. As at 30 June 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 2 855 650 000 equivalent, as indicated in Table 3 (compared with USD 2 943 083 000 equivalent at 31 March 2004).

Table 3: Currency Composition of Assets at 30 June 2004
(USD '000 equivalent)

Currency Group	Cash and Investments ^a	Promissory Notes ^a	Amounts Receivable from Contributors	Total
USD	981 418	73 084	101 520	1 156 022
EUR	631 967	121 041	47 683	800 691
JPY	342 333	-	-	342 333
GBP	270 651	11 965	66 624	349 240
Other	82 952	55 165	69 247	207 364
Total	2 309 321	261 255	285 074	2 855 650

^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.

11. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 207 364 000 equivalent at 30 June 2004 (compared with USD 230 873 000 equivalent at 31 March 2004). These are allocated to currency groups as indicated in Table 4.

Table 4: Allocation of Assets to Currency Groups at 30 June 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	1 156 022	-	57 911	1 213 933
EUR	800 691	149 453	-	950 144
JPY	342 333	-	-	342 333
GBP	349 240	-	-	349 240
Total	2 648 286	149 453	57 911	2 855 650

12. The alignment of assets by currency group against the SDR valuation basket at 30 June 2004 is shown in Table 5. The balance of the General Reserve at 30 June 2004 and the commitment for grants denominated in USD on the same date amounted to USD 95 000 000 and USD 53 900 000 respectively.

Table 5: Alignment of Assets by Currency Group with the Currency Composition of the SDR Valuation Basket at 30 June 2004
(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 June 2004	Compare SDR Weights as a Percentage at 30 June 2004
USD	1 213 933	(148 900)	1 065 033	39.4	39.4
EUR	950 144	-	950 144	35.1	35.3
JPY	342 333	-	342 333	12.6	13.1
GBP	349 240	-	349 240	12.9	12.2
Total	2 855 650	(148 900)	2 706 750	100.0	100.0

13. At 30 June 2004, there were only small currency group deviations between IFAD's net assets and the SDR valuation basket.

IV. RISK MEASUREMENT

14. 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 June 2004, the standard deviation of IFAD's investment portfolio was 2.2%, which implied a lower risk compared with the 2.3% standard deviation of the investment policy (as against 2.0% for the investment portfolio and 2.4% for the investment policy at 31 March 2004).

15. 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 6 shows the VaR of IFAD's investment portfolio and policy. At 30 June 2004, the investment portfolio continued to show a VaR percentage (1.8%) slightly below the investment policy (1.9%), hence indicating a somewhat smaller risk in the investment portfolio. The investment portfolio showed a slightly higher VaR percentage compared with that at previous quarter-end, which was mainly due to the remaining inflation-indexed portion being partially funded from the internally managed portfolio's holdings of cash and time-deposits. Short-term liquidity holdings are normally considered risk-free and therefore IFAD's investment portfolio had a somewhat lower risk prior to the transfer of funds to the new inflation-indexed bonds.

Table 6: 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 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 of 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.