Distribution: Restricted | EB 2005/85/R.31 | 3 August 2005
Original: English | Agenda Item 17(c) | English

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IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Executive Board – Eighty-Fifth Session

Rome, 6-8 September 2005

REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR THE SECOND QUARTER OF 2005

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the three-month period ended 30 June 2005 and includes comparative figures for the year to date and earlier years. The report comprises the following four sections: investment policy; asset allocation; investment income; and rate of return and performance comparison. Additional information on the period's performance attribution, currency composition and risk measurement will become available after the dispatch of this document and will therefore be included as an annex to the report on the third quarter of 2005.

2. The present report contains an annex that provides figures for the entire first quarter of 2005, together with information on the first quarter's performance attribution, currency composition and risk measurement.

II. INVESTMENT POLICY

3. In June 2005, the first quarterly tranches of the held-to-maturity portfolio matured in the total amount of USD 19 195 000 equivalent and were reinvested with maturities of five years, as per the portfolio's investment guidelines. The annualized yields-to-maturity for the two securities purchased were 4.15% and 2.73% for United States dollar and euro securities, respectively.

4. IFAD is currently engaged in discussions with the World Bank as a potential provider of financial advisory services. These discussions are expected to be finalized within the coming months.

III. ASSET ALLOCATION

5. Table 1 shows the movements affecting the investment portfolio's major asset classes in the second quarter of 2005 and compares the portfolio's asset allocation to the policy allocation.

Table 1: Summary of Movements in Cash and Investments – Second Quarter of 2005
(USD '000 equivalent)

	Internally Managed		Externally Managed				
	Short-Term Liquidity Portfolio	**Held-to-Maturity Portfolio**	**Government Bonds Portfolio**	**Diversified Fixed-Interest Portfolio**	**Inflation-Indexed Bonds Portfolio**	**Equities Portfolio [a]**	**Overall Portfolio**
Opening balance (31 March 2005)	**103 315**	**411 009**	**1 006 712**	**504 258**	**454 762**	**311**	**2 480 367**
Net investment income	549	2 968	17 523	12 500	7 533	131	41 204
Transfers due to allocation	14 859	(6 995)	(381)	(7 201)	-	(282) [b]	-
Transfers due to expenses	(697)	5	406	173	248	(135)	-
Other net flows [c]	11 574	-	-	-	-	-	11 574
Movements on exchange	(3 820)	(13 795)	(43 686)	26	(19 130)	(1)	(80 406)
Closing balance (30 June 2005)	**125 780**	**393 192**	**980 574**	**509 756**	**443 413**	**24**	**2 452 739**
Actual portfolio allocation (%)	5.1	16.0	40.0	20.8	18.1	-	100.0
Distribution of portfolio by asset class [d]	-	(393 192)	135 426	257 766	-	-	-
Closing balance with portfolio redistributed	**125 780**	**-**	**1 116 000**	**767 522**	**443 413**	**24**	**2 452 739**
Actual asset allocation with portfolio redistributed (%)	5.1	-	45.5	31.3	18.1	-	100.0
Policy allocation (%)	5.5	-	49.0	25.5	20.0	-	100.0
Difference in asset allocation (%)	**(0.4)**	**-**	**(3.5)**	**5.8**	**(1.9)**	**-**	**-**

[a] The opening balance of USD 311 000 equivalent at 31 March 2005 reflected dividend and tax receivables plus residual cash. The remaining equities balance of USD 24 000 equivalent at 30 June 2005 reflected tax receivables on dividends.
[b] Transfers from the equity portfolio reflect the repatriation of dividends received during the second quarter of 2005.
[c] Cash receipts and encashments of Member States' contributions less disbursements for loans, grants and administrative expenses.
[d] The assets of the held-to-maturity portfolio have been distributed between the asset classes of government bonds (USD 135 426 000 equivalent) and diversified fixed-interest (USD 257 766 000 equivalent) according to the investment guidelines of these two asset classes.

6. In this period, USD 6 995 000 equivalent was transferred from the internally managed held-to-maturity portfolio to the internally managed short-term liquidity portfolio. The transferred amount represented received coupons and residual cash in the held-to-maturity portfolio, which was funded in March 2005. Furthermore, the diversified fixed-interest portfolio was redistributed from two to three investment managers to increase diversification across managers. Following the redistribution, a balance of USD 7 201 000 equivalent was transferred from the diversified fixed-interest portfolio to the short-term liquidity portfolio in order to better meet disbursement requirements.

7. During the second quarter of 2005, there was a net inflow of USD 11 574 000 equivalent to the short-term liquidity portfolio, representing cash receipts and encashments of Member States' contributions less disbursements for loans, grants and administrative expenses.

8. Negative foreign exchange movements reduced the amounts of the held-to-maturity, government bonds and inflation-indexed portfolios. The negative foreign exchange movements resulted from depreciation of the major currencies, particularly the euro, against the United States dollar. (The portfolio's currency composition is a result of IFAD's need to maintain its overall assets in the currencies of the SDR-valuation basket. For further reference, see section VI on currency composition in the annex.)

9. The above movements increased the shortfall in the government bonds and inflation-indexed portfolios compared with the policy allocation. This shortfall was offset by somewhat increased allocations in the short-term liquidity portfolio, owing to its net inflows, and in the diversified fixed-interest portfolio. The diversified fixed-interest portfolio is almost entirely invested in United States dollar-denominated securities and therefore its value was not impacted by the negative foreign exchange movements.

10. The allocation to the diversified fixed-interest portfolio is also augmented by a larger share of the held-to-maturity portfolio being held in diversified fixed-interest investments. It is noted, however, that the income and value of the held-to-maturity portion are not impacted by volatility in securities prices.

IV. INVESTMENT INCOME

11. During the second quarter of 2005 the economy continued on a slow growth path, especially in the euro zone and Japan. Furthermore, the downgraded credit quality of a number of major corporates led to more risk-adversity among investors. This resulted in a flight-to-quality towards more stable sources of investment income. In this environment, high-quality fixed-income securities represented a safe haven and thus their prices also gained strongly in this period.

12. Table 2 shows the net investment income for the second quarter of 2005 and previous periods for the main portfolios within the overall investment portfolio. Aggregate net investment income in the second quarter of 2005 amounted to USD 41 204 000 equivalent. When also considering the gain of USD 10 912 000 equivalent during the first quarter of 2005, the cumulative net investment income amounted to USD 52 116 000 equivalent at 30 June 2005.

Table 2: Net Investment Income by Main Portfolios – Second Quarter of 2005 and Prior Periods

(USD '000 equivalent)

Portfolio	Second Quarter of 2005	First Quarter of 2005[a]	Year-to-Date 2005	2004	2003	2002[b]
Short-term liquidity portfolio	549	744	1 293	2 701	4 086	4 098
Held-to-maturity portfolio	2 968	901	3 869	-	-	-
Government bonds portfolio	17 523	3 443	20 966	38 675	36 735	85 541
Diversified fixed-interest portfolio	12 500	(159)	12 341	22 114	16 038	22 925
Inflation-indexed bonds portfolio	7 533	908	8 441	21 386	4 665	-
Equities portfolio	131	5 075	5 206	23 786	46 438	(86 378)
Overall portfolio	**41 204**	**10 912**	**52 116**	**108 662**	**107 962**	**26 186**

[a] The remaining equities holdings were liquidated in the first quarter of 2005.
[b] In 2002, the equities allocation was reduced to 10% as per the investment policy decision in 2001.

13. Table 3 provides details on the aggregate net investment income in the second quarter of 2005 and on year-to-date 2005.

Table 3: Net Investment Income of the Overall Portfolio by Main Portfolio Category – Second Quarter and Year-to-Date 2005

(USD ’000 equivalent)

	Second Quarter of 2005			Year-to-Date 2005
	Total Fixed-Interest Portfolio	**Total Equities Portfolio**[a]	**Overall Portfolio**	**Overall Portfolio**
Interest from fixed-interest investments and bank accounts	22 637	-	22 637	41 880
Dividend income from equities	-	2	2	755
Realized capital gains/(losses)	(1 217)	-	(1 217)	42 251
Unrealized capital gains/(losses)	21 032	-	21 032	(30 103)
Amortization	(515)	-	(515)	(694)
Income from securities lending and commission recapture	215	-	215	426
Subtotal: gross investment income	**42 152**	**2**	**42 154**	**54 515**
Investment manager fees	(849)	-	(849)	(1 911)
Custody fees	(140)	(3)	(143)	(276)
Financial advisory and other investment management fees	(69)	-	(69)	(265)
Taxes	-	132	132	108
Other investment expenses	(21)	-	(21)	(55)
Net investment income	**41 073**	**131**	**41 204**	**52 116**

[a] These amounts reflect income and expenses occurring after the liquidation of the equities holdings in March 2005.

14. Table 4 shows the net investment income in the second quarter of 2005 from the five fixed-interest portfolios. In aggregate, net investment income from fixed-interest investments amounted to USD 41 073 000 equivalent. All fixed-interest portfolios contributed positively to the net investment income.

Table 4: Net Investment Income of the Fixed-Interest Portfolio – Second Quarter of 2005
(USD '000 equivalent)

	Internally Managed		Externally Managed			
	Short-Term Liquidity Portfolio	**Held-to-Maturity Portfolio**	**Government Bonds Portfolio**	**Diversified Fixed-Interest Portfolio**	**Inflation-Indexed Bonds Portfolio**	**Total Fixed-Interest Portfolio**
Interest from fixed-interest investments and bank accounts	560	3 488	9 183	4 550	4 856	22 637
Dividend income from equities	-	-	-	-	-	-
Realized capital gains/(losses)	-	-	(3 465)	2 199	49	(1 217)
Unrealized capital gains	-	-	12 211	5 936	2 885	21 032
Amortization[a]		(515)	-	-	-	(515)
Income from securities lending and commission recapture	-	10	86	94	25	215
Subtotal: gross investment income	**560**	**2 983**	**18 015**	**12 779**	**7 815**	**42 152**
Investment manager fees	-	-	(410)	(227)	(212)	(849)
Custody fees	(11)	(15)	(47)	(22)	(45)	(140)
Financial advisory and other investment management fees	-	-	(35)	(18)	(16)	(69)
Taxes	-	-	-	-	-	-
Other investment expenses	-	-	-	(12)	(9)	(21)
Net investment income	**549**	**2 968**	**17 523**	**12 500**	**7 533**	**41 073**

[a] For held-to-maturity investments, as per the International Financial Reporting Standards (IFRS), a period's amortization amount is a portion of the difference between the paid purchase price and the final redemption value. Spread over the holding period, amortization is the accounting treatment of bonds bought at a discount or with a premium.

V. RATE OF RETURN AND PERFORMANCE COMPARISON

15. There was an overall return of 1.77 % in the second quarter of 2005, net of investment expenses and movements on exchange. Cumulatively, the overall return for the first six months of 2005 was 2.30% (estimated annualized return 4.60 %).

16. 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 and Barclay customized inflation-indexed index for the inflation-indexed bonds.

17. Table 5 compares the return on each major portfolio with its appropriate benchmark return. The overall portfolio underperformed its benchmark in the second quarter of 2005 by 23 basis points, mainly due to the inflation-indexed bonds portfolio. It is however noted that, recently, inflation-indexed bond markets have been less favoured by the lowered inflation expectations. To a lesser extent, the diversified fixed-interest and government bond portfolios also showed an underperformance. Further performance attribution against benchmarks will be included in an annex to the report on the third quarter of 2005.

18. Although the investment portfolio showed an underperformance against benchmark in the second quarter of 2005, on a year-to-date basis the investment portfolio has outperformed its aggregate benchmark by seven basis points.

Table 5: Performance Compared with Benchmarks – Second Quarter of 2005

(Percentage in local currency terms)

	Second Quarter of 2005			Year-to-Date 2005		
	Rate of Return %		Out/(Under)	Rate of Return %		Out/(Under)
Portfolio	**Portfolio**	**Benchmark**	**Performance**	**Portfolio**	**Benchmark**	**Performance**
Internally managed short-term liquidity portfolio[a]	0.84	0.84	0.00	1.61	1.61	0.00
Internally managed held-to-maturity portfolio[a]	0.73	0.73	0.00	0.95	0.95	0.00
Government bonds portfolio	1.93	1.98	(0.05)	2.45	2.21	0.24
Diversified fixed-interest portfolio	2.48	2.86	(0.38)	2.50	2.53	(0.03)
Inflation-indexed bonds portfolio	1.81	2.89	(1.08)	2.10	2.87	(0.77)
Total fixed-interest portfolio	**1.78**	**2.01**	**(0.23)**	**2.15**	**2.14**	**0.01**
North American equities portfolio	-	-	-	0.45	(0.69)	1.14
European equities portfolio	-	-	-	4.08	4.21	(0.13)
Total equities portfolio	-	-	-	**1.92**	**1.30**	**0.62**
Overall portfolio gross rate of return	**1.78**	**2.01**	**(0.23)**	**2.35**	**2.28**	**0.07**
Less expenses	**(0.01)**	**(0.01)**	**0.00**	**(0.05)**	**(0.05)**	**0.00**
Overall portfolio net rate of return	**1.77**	**2.00**	**(0.23)**	**2.30**	**2.23**	**0.07**

[a] No specific benchmark assigned.

ADDITIONAL INFORMATION ON IFAD'S INVESTMENT PORTFOLIO FOR THE FIRST QUARTER OF 2005

I. INTRODUCTION

1. The present annex covers the three-month period ending 31 March 2005, thereby updating the data on the first two months of the year presented to the Executive Board in April 2005. The annex comprises the following updated sections: investment policy; asset allocation; investment income; rate of return and performance comparison; currency composition and risk measurement.

II. INVESTMENT POLICY: LIQUIDATION OF EQUITIES AND FUNDING OF A HELD-TO-MATURITY PORTFOLIO

2. The asset liability management (ALM) review presented to the Executive Board in December 2003 contained, among other items, an action point to reduce the market risk in the investment portfolio by holding a portion of investments until maturity. Following additional ALM analyses, a decision was taken in 2004[1] to fund the new held-to-maturity portfolio by liquidating the remaining equities portfolio and a portion of the government bonds portfolio in the first quarter of 2005.

3. In February 2005, IFAD appointed a transition manager to liquidate the equities portfolio and a portion of the government bonds portfolio and invest the proceeds in the new held-to-maturity portfolio. The liquidation of equities and government bonds and the funding of the held-to-maturity portfolio were undertaken on 1 March 2005.

4. The attachment to this annex shows both the cumulative proceeds from equities portfolios sold on 1 March 2005 as well as prior liquidations. The total cumulative equities proceeds amounted to USD 835.2 million for equities sold in 2001-2002 and on 1 March 2005. This compares with an initial amount of USD 897.1 million invested in equities. The difference between the initial funding amount and the proceeds occurred as a result of investment losses and negative movements on foreign exchange. The cumulative gross investment loss amounted to USD 24.9 million, thereby equalling a cumulative loss of -2.8% on the initial funding amount. The amount of cumulative equities losses has been positively impacted by strong gains on equities investments in 2003, 2004 and the first two months of 2005. Cumulative foreign exchange movements amounted to a negative amount of USD 37.0 million. The foreign exchange movements arose from non-United States dollar equities investments deriving from IFAD's need to maintain its overall assets, including its former equities portfolio, in the currencies of the SDR valuation basket. The need for currency alignment is due to IFAD's loan commitments being denominated in SDR.

5. An amount of USD 122 597 000 equivalent was liquidated from the government bonds portfolio during the first quarter of 2005. This amount, together with proceeds of USD 285 540 000 equivalent from the equities liquidation in March 2005 and additional cash from the short-term liquidity portfolio, was used to fund the held-to-maturity portfolio. The total funding of the held-to-maturity portfolio amounted to USD 412 205 000 equivalent. The held-to-maturity portfolio contains high-quality bond instruments with a maximum maturity of five years, with approximately USD 20 000 000 equivalent maturing and being reinvested every quarter.

[1] See the Report on IFAD's Investment Portfolio for 2004 (document EB 2004/84/R.32).

6. The held-to-maturity portfolio will be managed internally in terms of reinvesting the quarterly maturing amounts. The portfolio will be accounted for at amortized cost, in accordance with international financial reporting standards, and will therefore not be impacted by future fluctuations in market prices.

7. Following the liquidation of the equities portfolio and the funding of the held-to-maturity portfolio on 1 March 2005, the former equities allocation (10%) has been proportionately redistributed among the investment policy's remaining asset classes. The redistributed policy allocation will be reviewed in line with prior suggestions to review the policy allocation about every three years, and the Executive Board will be informed in due course.

III. ASSET ALLOCATION

8. Table 1 shows the movements affecting the investment portfolio's major asset classes in the first quarter of 2005 and compares the portfolio's asset allocation to the policy allocation. Changes in portfolio allocations during the first quarter of 2005 reflected the transfer of the aforementioned liquidation proceeds from the equities and government bonds portfolios for the purpose of funding the new held-to-maturity portfolio. There was also a net outflow of USD 35 476 000 equivalent from the internally managed short-term liquidity portfolio, representing net disbursements for loans, grants and administrative expenses.

Table 1: Summary of Movements in Cash and Investments – First Quarter of 2005
(USD '000 equivalent)

	Internally Managed		Externally Managed				
	Short-Term Liquidity Portfolio	**Held-to-Maturity Portfolio**	**Government Bonds Portfolio**	**Diversified Fixed-Interest Portfolio**	**Inflation-Indexed Bonds Portfolio**	**Equities Portfolio**	**Overall Portfolio**
Opening balance (31 December 2004)	**147 521**	**-**	**1 155 549**	**504 174**	**469 587**	**283 144**	**2 559 975**
Net investment income/(loss)	744	901	3 443	(159)	908	5 075	10 912
Transfers due to allocation	(4 068)	412 205	(122 597)	-	-	(285 540)	-
Transfers due to expenses	(1 168)	3	461	240	247	217	-
Other net flows [a]	(35 476)	-	-	-	-	-	(35 476)
Movements on exchange	(4 238)	(2 100)	(30 144)	3	(15 980)	(2 585)	(55 044)
Closing balance by portfolio (31 March 2005)	**103 315**	**411 009**	**1 006 712**	**504 258**	**454 762**	**311**	**2 480 367**
Actual portfolio allocation (%)	4.2	16.6	40.6	20.3	18.3	-	100.0
Distribution of HTM portfolio by asset class [b]	-	(411 009)	146 867	264 142	-	-	-
Closing balance with HTM portfolio redistributed (%)	**103 315**	**-**	**1 153 579**	**768 400**	**454 762**	**311**	**2 480 367**
Actual asset allocation with HTM portfolio redistributed (%)	4.2	-	46.5	31.0	18.3	-	100.0
Policy allocation (%)	5.5	-	49.0	25.5	20.0	-	100.0
Difference in asset allocation (%)	**(1.3)**	**-**	**(2.5)**	**5.5**	**(1.7)**	**-**	**-**

[a] Member States' contributions, less disbursements for loans, grants and administrative expenses.
[b] The assets of the held-to-maturity portfolio have been distributed between the asset classes of government bonds (USD 146 867 000 equivalent) and diversified fixed-interest (USD 264 142 000 equivalent) according to their investment guidelines.

9. During the period under review there were negative foreign exchange movements, mainly in the government bonds and inflation-indexed portfolios, as major currencies depreciated against the

United States dollar. Furthermore, the allocation to the diversified fixed-interest portfolio was augmented by a larger share of the held-to-maturity portfolio being invested in diversified fixed-interest investments. It is noted, however, that the income and value of the held-to-maturity portion are not impacted by volatility in securities prices.

IV. INVESTMENT INCOME

10. In the first quarter for 2005, fixed-interest investments performed positively, especially in the euro zone and Japan, due to signs of weaker economic growth and low inflation. The United States bond markets, however, performed negatively due to growing inflation concerns; they also suffered from the prospect of faster interest-rate increases by the Federal Reserve. Equity market conditions remained favourable prior to the liquidation of the equities portfolio on 1 March 2005.

11. Table 2 shows net investment income for the first quarter of 2005 and earlier years in the main portfolios of the overall investment portfolio. Aggregate net investment income in the first quarter of 2005 amounted to USD 10 912 000 equivalent.

Table 2: Net Investment Income by Main Portfolios – First Quarter of 2005 and Prior Periods
(USD ’000 equivalent)

Portfolio	First Quarter of 2005[a]	2004	2003	2002[b]
Short-term liquidity portfolio	744	2 701	4 086	4 098
Held-to-maturity portfolio	901	-		
Government bonds portfolio	3 443	38 675	36 735	85 541
Diversified fixed-interest portfolio	(159)	22 114	16 038	22 925
Inflation-indexed bonds portfolio	908	21 386	4 665	–
Equities portfolio	5 075	23 786	46 438	(86 378)
Overall portfolio	**10 912**	**108 662**	**107 962**	**26 186**

[a] The remaining equities holdings were liquidated in the first quarter of 2005.
[b] In 2002 the equities allocation was reduced to 10% as per the investment policy decision in 2001.

12. Table 3 provides details on net investment income earned in the first quarter of 2005 by the two main portfolio categories, i.e. fixed-interest and equities investments. Both categories contributed strongly, and the contribution of the equities portfolio was also strong prior to its liquidation on 1 March 2005.

Table 3: Net Investment Income of the Overall Portfolio by Main Portfolio Category – First Quarter of 2005
(USD '000 equivalent)

	Total Fixed-Interest Portfolio	Total Equities Portfolio	Overall Portfolio
Interest from fixed-interest investments and bank accounts	19 227	16	19 243
Dividend income from equities	-	753	753
Realized capital gains	1 151	42 317	43 468
Unrealized capital losses	(13 360)	(37 775)	(51 135)
Amortization	(179)	-	(179)
Income from securities lending and commission recapture	189	22	211
Subtotal: gross investment income	**7 028**	**5 333**	**12 361**
Investment manager fees	(867)	(195)	(1 062)
Custody fees	(117)	(16)	(133)
Financial advisory and other investment management fees	(173)	(23)	(196)
Taxes	-	(24)	(24)
Other investment expenses	(34)	-	(34)
Net investment income	**5 837**	**5 075**	**10 912**

13. Table 4 shows the net investment income in the first quarter of 2005 from the five fixed-interest portfolios, which in aggregate amounted to USD 5 837 000 equivalent. The diversified fixed-interest portfolio contributed somewhat negatively, but all other fixed-interest portfolios contributed positively.

Table 4: Net Investment Income of the Fixed-Interest Portfolio – First Quarter of 2005
(USD '000 equivalent)

	Internally Managed		Externally Managed			
	Short-Term Liquidity Portfolio	Held-to-Maturity Portfolio	Government Bonds Portfolio	Diversified Fixed-Interest Portfolio	Inflation-Indexed Bonds Portfolio	Total Fixed-Interest Portfolio
Interest from fixed-interest investments and bank accounts	761	1 083	10 475	4 298	2 610	19 227
Dividend income from equities	-	-	-	-	-	-
Realized capital gains/(losses)	-	-	(716)	273	1 594	1 151
Unrealized capital losses	-	-	(5 853)	(4 465)	(3 042)	(13 360)
Amortization [a]		(179)	-	-	-	(179)
Income from securities lending and commission recapture	-	2	105	55	27	189
Subtotal: gross investment income	**761**	**906**	**4 011**	**161**	**1 189**	**7 028**
Investment manager fees	-	-	(439)	(218)	(210)	(867)
Custody fees	(17)	(5)	(33)	(36)	(26)	(117)
Financial advisory and other investment management fees	-	-	(94)	(41)	(38)	(173)
Taxes	-	-	-	-	-	-
Net investment income / (loss)	**744**	**901**	**3 443**	**(159)**	**908**	**5 837**

[a] For held-to-maturity investments, per the international financial reporting standards, a period's amortization amount is a portion of the difference between the paid purchase price and the final redemption value. Spread over the holding period, amortization is the accounting treatment of bonds bought at a discount or with a premium

14. Net investment income in the first quarter of 2005 from the two equities portfolios is shown in Table 5. In aggregate, net investment income from equities amounted to USD 5 075 000 equivalent. The European equities portfolio contributed strongly; the North American equities portfolio contributed less to income.

Table 5: Net Investment Income of the Equities Portfolio – First Quarter of 2005
(USD ’000 equivalent)

	North American Equities	European Equities	Total Equities Portfolio
Interest from fixed-interest investments and bank accounts	13	3	16
Dividend income from equities	388	365	753
Realized capital gains	29 844	12 473	42 317
Unrealized capital losses	(29 387)	(8 388)	(37 775)
Income from securities lending and commission recapture	9	13	22
Subtotal: gross investment income	**867**	**4 466**	**5 333**
Investment manager fees	(139)	(56)	(195)
Custody fees	(11)	(5)	(16)
Financial advisory and other investment management fees	(14)	(9)	(23)
Taxes	-	(24)	(24)
Other investment expenses	-	-	-
Net investment income	**703**	**4 372**	**5 075**

V. RATE OF RETURN AND PERFORMANCE COMPARISON

15. There was an overall positive return of 0.51% in the first quarter of 2005, net of investment expenses and movements on exchange.

16. 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 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-linked index for the inflation-indexed bonds portfolio, Standard & Poor’s 500 index for North American equities and the Morgan Stanley capital international index for European equities.

17. Table 6 compares the return on each major portfolio with its appropriate benchmark return. The overall portfolio showed an outperformance of 29 basis points in the first quarter of 2005, as both the fixed-interest and the equities portfolios clearly outperformed their aggregate benchmarks.

Table 6: Performance Compared with Benchmarks – First Quarter of 2005
(Percentage in local currency terms)

	First Quarter of 2005		
	Rate of Return %		Out/(Under)
Portfolio	Portfolio	Benchmark	Performance
Internally managed short-term liquidity portfolio [a]	0.76	0.76	0.00
Internally managed held-to-maturity portfolio [a]	0.22	0.22	0.00
Government bonds portfolio	0.52	0.23	0.29
Diversified fixed-interest portfolio	0.02	(0.32)	0.34
Inflation-indexed bonds portfolio	0.29	(0.02)	0.31
Total fixed-interest portfolio	**0.37**	**0.12**	**0.25**
North American equities portfolio	0.45	(0.69)	1.14
European equities portfolio	4.08	4.21	(0.13)
Total equities portfolio	**1.92**	**1.30**	**0.62**
Overall portfolio gross rate of return	**0.55**	**0.26**	**0.29**
Less expenses	**(0.04)**	**(0.04)**	**0.00**
Overall portfolio net rate of return	**0.51**	**0.22**	**0.29**

[a] No specific benchmark assigned.

18. The total fixed-interest portfolio made a positive return of 0.37% in the first quarter of 2005, thereby outperforming its benchmark by 25 basis points. The outperformance resulted from all the three externally managed portfolios.

(a) **Government bonds portfolio.** The portfolio returned 0.52%, which included an out-performance of 29 basis points against its benchmark, thanks to the investment managers' decision to keep a short duration in the United States in light of rising interest rates. In the euro zone, the duration was kept even shorter, which slightly reduced the positive return. The underweight exposure to Japan, which was the lowest-yielding market, provided opportunities for managers to be overweight in Denmark and Sweden, which were the best-performing markets.

(b) **Diversified fixed-interest portfolio.** The portfolio returned 0.02%, which included an outperformance of 34 basis points against its benchmark. The tactically underweighted duration exposure in the United States for most of the period contributed positively to the outperformance and confirmed the managers' conservative approach with regard to rising interest rates. The underweight exposure in mortgages also had a positive impact in this period. Investments for diversification purposes in inflation-indexed bonds and non-United States bonds also enhanced returns.

(c) **Inflation-indexed bonds portfolio.** The portfolio returned 0.29%, which included an outperformance of 31 basis points against benchmark. The managers' strategy was to underweight United States and United Kingdom bonds due to rising yields in these markets. Also, the exposure to the period's outperforming Swedish inflation-indexed bonds contributed positively.

19. The total equities portfolio returned a positive 1.92% in the first quarter of 2005 and outperformed its aggregated benchmark by 62 basis points. Performance attribution is not available for equities due to their only-partial investment period, i.e. until 1 March 2005.

VI. CURRENCY COMPOSITION

20. The majority of IFAD's commitments are expressed in 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.

21. 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.

22. 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 March 2005, are shown in Table 7.

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

	1 January 2001		31 March 2005	
Currency	**Units**	**Percentage Weight**	**Units**	**Percentage Weight**
USD	0.577	44.3	0.577	38.1
EUR	0.426	30.4	0.426	36.6
JPY	21.000	14.0	21.000	13.0
GBP	0.0984	11.3	0.0984	12.3
Total		**100.0**		**100.0**

23. As of 31 March 2005, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth, Fifth and Sixth Replenishments, net of provisions, amounted to USD 2 972 883 000 equivalent as indicated in Table 8 (compared with USD 3 085 939 000 equivalent as at 31 December 2004).

Table 8: Currency Composition of Assets at 31 March 2005
(USD '000 equivalent)

Currency Group	Cash and Investments[a]	Promissory Notes[a]	Amounts Receivable from Contributors	Total
USD	1 036 759	94 742	56 308	1 187 809
EUR	781 849	121 311	27 502	930 662
JPY	352 211	8 545	17 091	377 847
GBP	256 318	6 233	62 617	325 168
Other	52 512	41 848	57 037	151 397
Total	**2 479 649**	**272 679**	**220 555**	**2 972 883**

[a] Includes assets in freely-convertible currencies. The excluded assets in non-convertible currencies amounted to USD 718 000 equivalent for cash and investments and USD 1 399 000 equivalent for promissory notes.

24. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 151 397 000 equivalent as at 31 March 2005 (compared with USD 177 975 000 equivalent as at 31 December 2004). These assets are allocated to currency groups as indicated in Table 9.

Table 9: Allocation of Assets to Currency Groups at 31 March 2005
(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	1 187 809	-	47 299	1 235 108
EUR	930 662	104 098	-	1 034 760
JPY	377 847	-	-	377 847
GBP	325 168	-	-	325 168
Total	**2 821 486**	**104 098**	**47 299**	**2 972 883**

25. The alignment of assets by currency group against the SDR valuation basket as at 31 March 2005 is shown in Table 10. The balance of the General Reserve as of 31 March 2005 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 63 224 000, respectively.

Table 10: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 31 March 2005
(USD ’000 equivalent)

Currency Group	Asset Amount	Less Commitments Denominated in USD	Net Asset Amount	Net Asset Amount as a Percentage at 31 March 2005	Compare SDR Weights as a Percentage at 31 March 2005
USD	1 235 108	(158 224)	1 076 884	38.2	38.1
EUR	1 034 760	-	1 034 760	36.8	36.6
JPY	377 847	-	377 847	13.4	13.0
GBP	325 168	-	325 168	11.6	12.3
Total	**2 972 883**	**(158 224)**	**2 814 659**	**100.0**	**100.0**

26. As at 31 March 2005, there was a small shortfall in the British pound sterling, which was offset by some slight excesses of Japanese yen and the currency group holdings of euro and United States dollars.

VII. RISK MEASUREMENT

27. The investment portfolio is subject to fluctuations in returns due to economic and market conditions. Equities investments have historically shown higher return fluctuations, hence implying a higher risk compared with other securities. The liquidation of equities holdings on 1 March 2005 therefore significantly decreased the investment portfolio’s market risk. The implementation of the held-to-maturity portfolio on the same day, which also entailed a partial government bonds liquidation, further reduced the investment portfolio’s market risk. This is due to accounting rules allowing a designated held-to-maturity

investment to be accounted for at amortized cost, and therefore a held-to-maturity investment is not impacted by fluctuations in market prices.

28. One of the most common risk measures is volatility, which is measured in terms of standard deviation of returns from their mean. A higher standard deviation indicates higher return fluctuations in the portfolio and therefore a higher risk. The standard deviation of IFAD's investment portfolio as at 31 December 2004 was 1.8 %. As a consequence of the equities liquidation and the held-to-maturity implementation, the investment portfolio's standard deviation decreased to 1.5 % as at 31 March 2005.

29. Value-at-Risk (VaR) is the risk measure that IFAD uses to estimate the maximum amount the investment portfolio could lose over a three-month time horizon, with a 95% confidence level. As indicated in Table 11, as of 31 December 2004, the VaR for the investment portfolio was 1.5% and 1.7% for the investment policy. After the equities liquidation and the held-to-maturity implementation, the portfolio's VaR decreased to 1.2% at 31 March 2005 and the policy's VaR decreased to 1.6%. This indicates that the investment portfolio had a lower risk than the investment policy. The reason for the portfolio's relatively lower VaR was mainly the externally managed asset classes, which all showed lower VaR compared with their respective benchmarks. This in turn indicates that, overall, the external investment managers were taking lower risks compared with their assigned benchmark indices.

Table 11: Value-at-Risk (VaR)
(Forecast horizon three-months, confidence level 95%)

	Investment Portfolio		**Investment Policy**	
Date	**VaR %**	**Amount USD '000**	**VaR %**	**Amount USD '000**
31 March 2005	1.2	29 900	1.6	38 700
31 December 2004	1.5	38 400	1.7	43 500
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

Attachment

CUMULATIVE PROCEEDS FROM EQUITIES SALES
(USD million equivalent)

	Initial Funding	Cumulative Gross Income/(Loss)	Cumulative Exchange Adjustments	Total Proceeds including Repatriated Dividends [c]	Repatriated Dividends [c]	Total Proceeds excluding Repatriated Dividends
Subtotal: Equities sold August 2001-October 2002 [a]	**533.4**	**61.0**	**(59.7)**	**534.7**	**na**	**534.7**
European equities portfolio[b]	133.1	(27.9)	20.0	125.2	(8.4)	116.8
North American equities portfolio[b]	230.6	(58.0)	2.7	175.3	(6.6)	168.7
Subtotal: Equities sold in March 2005	**363.7**	**(85.9)**	**22.7**	**300.5**	**(15.0)**	**285.5**
Total	**897.1**	**(24.9)**	**(37.0)**	**835.2**	**(15.0)**	**820.2**

[a] Cumulative proceeds from equities sales in 2001 and 2002, as per the addendum to the Report on IFAD's Investment Portfolio in 2002 (document EB 2003/78/R.5/Add.1).

[b] The European and North American equities portfolios include initial funding amounts and movements of a number of portfolios that were consolidated in September 2002. At 31 December 2002, cumulative gross losses on the remaining equities portfolio amounted to USD 163.9 million equivalent and cumulative positive foreign exchange movements amounted to USD 4.0 million equivalent.

[c] From 1 January 2002, dividends were repatriated to the internally managed portfolio in order to avoid reinvesting into equities.