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**IFAD**
**INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT**
**Executive Board – Eighty-Sixth Session**
Rome, 12-13 December 2005

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

## I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the three-month period ending 30 September 2005 and includes comparative figures for the year to date and earlier years. The report comprises the following six sections: investment policy; asset allocation; investment income; rate of return and performance comparison; currency composition; and risk measurement.

2. Information on the portfolio's second-quarter performance attribution, currency composition and risk measurement is provided in the annex. This information was not yet available at the dispatch of the report on the second quarter of 2005.

## II. INVESTMENT POLICY

3. During the third quarter of 2005, IFAD successfully completed negotiations for the World Bank to be appointed as the new financial adviser. Under the advisory contract (which started in September for an initial period of one year), the World Bank will provide IFAD with technical advice on (a) the benchmark against which to assess held-to-maturity investments performance and (b) the expected rate of return for different asset allocation scenarios.

## III. ASSET ALLOCATION

4. Table 1 shows the movements affecting the investment portfolio's major asset classes in the third quarter of 2005 and compares the portfolio's asset allocation with the policy allocation.

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

| | **Short-Term Liquidity Portfolio** | **Held-to-Maturity (HTM) Portfolio** | **Government Bonds Portfolio** | **Diversified Fixed-Interest Portfolio** | **Inflation-Indexed Bonds Portfolio** | **Overall Portfolio** |
|---|---|---|---|---|---|---|
| **Opening balance (30 June 2005)** [a] | **125 804** | **393 192** | **980 574** | **509 756** | **443 413** | **2 452 739** |
| Net investment income/(loss) | 828 | 3 109 | 882 | (2 143) | 2 401 | 5 077 |
| Transfers due to allocation[b] | 4 043 | (4 043) | - | - | - | - |
| Transfers due to expenses | (1 085) | 20 | 531 | 255 | 279 | - |
| Other net flows[c] | (33 460) | - | - | - | - | (33 460) |
| Movements on exchange | 311 | (778) | (5 508) | (19) | (7 144) | (13 138) |
| **Closing balance (30 September 2005)** | **96 441** | **391 500** | **976 479** | **507 849** | **438 949** | **2 411 218** |
| Actual portfolio allocation (%) | 4.0 | 16.2 | 40.5 | 21.1 | 18.2 | 100.0 |
| Reclassification of the held-to-maturity portfolio by asset class[d] | - | (391 500) | 139 530 | 251 970 | - | - |
| **Closing balance with the held-to-maturity portfolio reclassified** | **96 441** | **-** | **1 116 009** | **759 819** | **438 949** | **2 411 218** |
| Actual asset allocation with the held-to-maturity portfolio reclassified (%)[d] | 4.0 | - | 46.3 | 31.5 | 18.2 | 100.0 |
| Policy allocation (%) | 5.5 | - | 49.0 | 25.5 | 20.0 | 100.0 |
| **Difference in asset allocation (%)** | **(1.5)** | **-** | **(2.7)** | **6.0** | **(1.8)** | **-** |

[a] The opening balance at 30 June 2005 included dividend tax receivables of USD 24 000 equivalent pertaining to the former equities portfolio. These tax receivables are included here in the balance of the internally managed short-term liquidity portfolio.
[b] Transfers of coupon payments received from the held-to-maturity portfolio to the short-term liquidity portfolio.
[c] Disbursements for loans, grants and administrative expenses net of cash receipts and encashments of Member States' contributions.
[d] Assets of USD 391 500 000 equivalent in the HTM portfolio have been reclassified as part of the government bonds (USD 139 530 000 equivalent) and diversified fixed-interest (USD 251 970 000 equivalent) portfolios according to the investment guidelines of these two asset classes. This also means that the HTM portfolio's actual allocation of 16.2% has been reclassified to the government bonds portfolio (a reclassification of 5.8%) and the diversified fixed-interest portfolio (a reclassification of 10.4%).

5. In this period, USD 4 043 000 equivalent was transferred from the held-to-maturity portfolio to the internally managed short-term liquidity portfolio. The transferred amount represented coupon payments, which are not reinvested in the held-to-maturity portfolio.

6. There were negative foreign exchange movements, mainly in the inflation-indexed and government bonds portfolios, as major currencies depreciated against the United States dollar.

7. During the third quarter of 2005, there was a net outflow of USD 33 460 000 equivalent from the short-term liquidity portfolio, representing disbursements for loans, grants and administrative expenses net of cash receipts and encashments of Member States' contributions. This net outflow increased the shortfall in the allocation of the short-term liquidity portfolio compared with its policy allocation. The investment portfolio is currently somewhat underweight in all asset classes except for diversified fixed-interest, which is overweight against its policy allocation.

8. The allocation to the diversified fixed-interest portfolio is augmented by a larger share of the held-to-maturity portfolio being held in diversified fixed-interest investments – and therefore classified as a diversified fixed-interest allocation. It is noted that the income and value of the held-to-maturity portion are not impacted by volatility in securities prices.

## IV. INVESTMENT INCOME

9. During the third quarter of 2005, fixed-interest markets generally suffered from inflationary pressures due to rising oil prices, which led to expectations that central banks may in the future accelerate their interest rate increases. Furthermore, fixed-interest markets were not favoured by the strong economic growth, especially of the United States of America. However, in this inflationary environment, inflation-indexed bonds performed more positively than other fixed-interest markets.

10. Table 2 shows the net investment income for the third quarter of 2005 and previous periods for the main component portfolios. Aggregate net investment income in the third quarter of 2005 amounted to USD 5 077 000 equivalent. Taking into account the gains of USD 41 204 000 equivalent during the second quarter of 2005 and USD 10 912 000 equivalent during the first quarter of 2005, the cumulative net investment income for 2005 amounted to USD 57 193 000 equivalent as at 30 September.

**Table 2: Net Investment Income by Main Portfolio – Third Quarter of 2005 and Prior Periods**

(USD ’000 equivalent)

| Portfolio | Third Quarter of 2005 | Second Quarter of 2005 | First Quarter of 2005 | Year-to-Date 2005 | 2004 | 2003 | 2002[b] |
|---|---|---|---|---|---|---|---|
| Short-term liquidity | 828 | 549 | 744 | 2 121 | 2 701 | 4 086 | 4 098 |
| Held-to-maturity | 3 109 | 2 968 | 901 | 6 978 | - | - | - |
| Government bonds | 882 | 17 523 | 3 443 | 21 848 | 38 675 | 36 735 | 85 541 |
| Diversified fixed-interest | (2 143) | 12 500 | (159) | 10 198 | 22 114 | 16 038 | 22 925 |
| Inflation-indexed bonds | 2 401 | 7 533 | 908 | 10 842 | 21 386 | 4 665 | - |
| Equities [a] | - | 131 | 5 075 | 5 206 | 23 786 | 46 438 | (86 378) |
| **Overall portfolio** | **5 077** | **41 204** | **10 912** | **57 193** | **108 662** | **107 962** | **26 186** |

[a] Although all remaining equities holdings were liquidated in the first quarter of 2005, some income and expenses were incurred in the second quarter of 2005.

[b] In 2002, the equities allocation was reduced to 10% pursuant to the investment policy decision taken in 2001.

11. Table 3 shows details on the net investment income for the third quarter of 2005 for the main portfolios. The diversified fixed-interest portfolio contributed somewhat negatively due to unrealized capital losses, but all other portfolios contributed positively to the quarter’s overall net investment income of USD 5 077 000 equivalent.

**Table 3: Details of Net Investment Income – Third Quarter and Year-to-Date 2005**
(USD '000 equivalent)

| | Third Quarter of 2005 | | | | | | Year-to-Date 2005 |
|---|---|---|---|---|---|---|---|
| | **Short-Term Liquidity Portfolio** | **Held-to-Maturity Portfolio** | **Government Bonds Portfolio** | **Diversified Fixed-Interest Portfolio** | **Inflation-Indexed Bonds Portfolio** | **Overall Portfolio** | **Overall Portfolio** |
| Interest from fixed-interest investments and bank accounts | 809 | 3 621 | 9 563 | 4 734 | 2 577 | 21 304 | 63 184 |
| Dividend income from equities | - | - | - | - | - | - | 755 |
| Realized capital gains/(losses) | - | - | (879) | 743 | (822) | (958) | 41 293 |
| Unrealized capital gains/(losses) | - | - | (7 271) | (7 352) | 933 | (13 690) | (43 793) |
| Amortization[a] | | (492) | - | - | - | (492) | (1 186) |
| Income from securities lending and commission recapture | - | 18 | 81 | 63 | 14 | 176 | 602 |
| **Subtotal: gross investment income/(loss)** | **809** | **3 147** | **1 494** | **(1 812)** | **2 702** | **6 340** | **60 855** |
| Investment manager fees | - | - | (541) | (253) | (205) | (999) | (2 910) |
| Custody fees | (3)[b] | (13) | (8) | (32) | (59) | (115) | (391) |
| Financial advisory and other investment management fees | - | (25) | (63) | (33) | (29) | (150) | (415) |
| Taxes | 22 | - | - | - | - | 22 | 130 |
| Other investment expenses | - | - | - | (13) | (8) | (21) | (76) |
| **Net investment income/(loss)** | **828** | **3 109** | **882** | **(2 143)** | **2 401** | **5 077** | **57 193** |

[a] For held-to-maturity investments, as 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.

[b] Includes an adjustment of USD 8 000 equivalent due to earlier overestimated accrual for the equities portfolio, which was liquidated in March 2005.

## V. RATE OF RETURN AND PERFORMANCE COMPARISON

12. There was an overall return of 0.19% in the third quarter of 2005, net of investment expenses and excluding the impact of foreign exchange movements. Cumulatively, the overall return for the first nine months of 2005 was 2.50%, equalling an estimated annualized return of 3.33%. This estimate is currently lower than IFAD's target return of 3.50% per annum. The main reasons for the lower return estimate are the liquidation of equities investments and the funding of the held-to-maturity portfolio, which were both implemented in March 2005. Both contributed significantly to reducing the risk level of the portfolio – and therefore to reducing return fluctuations – but naturally also imply somewhat lower return expectations. In order to secure an appropriate expected return on the investment portfolio, while maintaining a prudent risk level, IFAD has been analysing the reasonableness of the current target rate of return on the investment portfolio and is considering different alternatives for improving the return. The World Bank, IFAD's new financial adviser, will also help IFAD explore alternative asset allocation scenarios to seek a better rate of return within similar risk parameters. This rate-of-return analysis will be undertaken during the first quarter of 2006.

13. 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-linked index for inflation-indexed bonds.

14. Table 4 compares the return on each major portfolio with its appropriate benchmark return. The overall portfolio outperformed its benchmark in the third quarter of 2005 by 7 basis points (for a year-to-date 2005 outperformance of 14 basis points), owing to the outperformance of the diversified fixed-interest and government bonds portfolios. This performance can be explained as follows:

(a) **Government bonds portfolio.** The portfolio returned 0.15%, outperforming by 27 basis points against its benchmark. The main contribution to the outperformance was the investment managers' shorter duration of bond securities (when compared with the benchmark), which – together with somewhat higher cash allocations – helped protect the portfolio from negatively performing bond markets as interest rates were rising. In addition, the investment managers' country allocation contributed positively through the to underweighting of United States and Japanese bonds, which performed very negatively in the quarter.

(b) **Diversified fixed-interest portfolio.** The portfolio returned a negative 0.28% but outperformed its benchmark by 32 basis points. The outperformance resulted mainly from **some** investment managers' overweighting of mortgage-backed and asset-backed securities, which outperformed other bond sectors during the quarter. This positive contribution was partially offset by a somewhat mistargeted securities selection.

(c) **Inflation-indexed bonds portfolio.** The portfolio returned 0.61%, underperforming by 17 basis points against its benchmark. As in the previous quarter, the main reason for the **underperformance** was the managers' country allocation, especially nominal Japanese government bonds, which performed very negatively in the quarter. This negative impact was partially offset by a positively contributing securities selection, especially among United States inflation-indexed bonds.

**Table 4: Performance Compared with Benchmarks – Third Quarter and Year-to-Date 2005**
(Percentage in local currency terms)

| Portfolio | Third Quarter of 2005 | | | Year-to-Date 2005 | | |
|---|---|---|---|---|---|---|
| | Rate of Return (%) | | Out/(Under) Performance | Rate of Return (%) | | Out/(Under) Performance |
| | Portfolio | Benchmark | | Portfolio | Benchmark | |
| Internally managed short-term liquidity[a] | 0.79 | 0.79 | 0.00 | 2.42 | 2.42 | 0.00 |
| Internally managed held-to-maturity[a] | 0.78 | 0.78 | 0.00 | 1.74 | 1.74 | 0.00 |
| Government bonds | 0.15 | (0.12) | 0.27 | 2.60 | 2.09 | 0.51 |
| Diversified fixed-interest | (0.28) | (0.60) | 0.32 | 2.21 | 1.91 | 0.30 |
| Inflation-indexed bonds | 0.61 | 0.78 | (0.17) | 2.72 | 3.67 | (0.95) |
| **Total fixed-interest portfolio** | **0.26** | **0.19** | **0.07** | **2.41** | **2.33** | **0.08** |
| North American equities | - | - | - | 0.45 | (0.69) | 1.14 |
| European equities | - | - | - | 4.08 | 4.21 | (0.13) |
| **Total equities portfolio** | **-** | **-** | **-** | **1.92** | **1.30** | **0.62** |
| **Overall portfolio gross rate of return** | **0.26** | **0.19** | **0.07** | **2.61** | **2.47** | **0.14** |
| **Less expenses** | **(0.07)** | **(0.07)** | **0.00** | **(0.11)** | **(0.11)** | **0.00** |
| **Overall portfolio net rate of return** | **0.19** | **0.12** | **0.07** | **2.50** | **2.36** | **0.14** |

[a] No specific benchmark assigned.

## VI. CURRENCY COMPOSITION

15. 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.

16. 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.

17. 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 30 September 2005, are shown in Table 5.

**Table 5: Units and Weights Applicable to the SDR Valuation Basket**

| | 1 January 2001 | | 30 September 2005 | |
|---|---|---|---|---|
| **Currency** | **Units** | **Percentage Weight** | **Units** | **Percentage Weight** |
| United States dollar (USD) | 0.577 | 44.3 | 0.577 | 39.8 |
| Euro (EUR) | 0.426 | 30.4 | 0.426 | 35.4 |
| Japanese yen (JPY) | 21.000 | 14.0 | 21.000 | 12.8 |
| Pound sterling (GBP) | 0.0984 | 11.3 | 0.0984 | 12.0 |
| **Total** | | **100.0** | | **100.0** |

18. As at 30 September 2005, assets in the form of investment portfolio, promissory notes and amounts receivable from contributors under the Fourth, Fifth and Sixth Replenishments, net of provisions, amounted to USD 2 780 417 000 equivalent, as indicated in Table 6 (compared with USD 2 862 654 000 equivalent at 30 June 2005).

**Table 6: Currency Composition of Assets at 30 September 2005**
(USD ’000 equivalent)

| Currency Group | Cash and Investments[a] | Promissory Notes[a] | Amounts Receivable from Contributors | Total |
|---|---|---|---|---|
| USD | 1 043 563 | 72 422 | 49 761 | 1 165 746 |
| EUR | 754 752 | 75 468 | 25 041 | 855 261 |
| JPY | 339 058 | 24 193 | - | 363 251 |
| GBP | 233 908 | - | 58 624 | 292 532 |
| Other | 39 221 | 16 651 | 47 755 | 103 627 |
| **Total** | **2 410 502** | **188 734** | **181 181** | **2 780 417** |

[a] Includes assets in freely-convertible currencies. The excluded assets in non-convertible currencies amounted to USD 716 000 equivalent for cash and investments and USD 1 399 000 equivalent for promissory notes.

19. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 103 627 000 equivalent as at 30 September 2005 (compared with USD 131 207 000 equivalent at 30 June 2005). These assets were allocated to currency groups as indicated in Table 7.

**Table 7: Allocation of Assets to Currency Groups at 30 September 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 |
|---|---|---|---|---|
| USD | 1 165 746 | - | 36 419 | 1 202 165 |
| EUR | 855 261 | 67 208 | - | 922 469 |
| JPY | 363 251 | - | - | 363 251 |
| GBP | 292 532 | - | - | 292 532 |
| **Total** | **2 676 790** | **67 208** | **36 419** | **2 780 417** |

20. The alignment of assets by currency group against the SDR valuation basket as at 30 September 2005 is shown in Table 8. The balance of the General Reserve at 30 September 2005 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 74 753 000, respectively.

**Table 8: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 30 September 2005**
(USD ’000 equivalent)

| Currency Group | Asset Amount | Less Commitments Denominated in USD | Net Asset Amount | Net Asset Amount as a Percentage at 30 September 2005 | SDR Weight as a Percentage at 30 September 2005 |
|---|---|---|---|---|---|
| USD | 1 202 165 | (169 753) | 1 032 412 | 39.6 | 39.8 |
| EUR | 922 469 | - | 922 469 | 35.3 | 35.4 |
| JPY | 363 251 | - | 363 251 | 13.9 | 12.8 |
| GBP | 292 532 | - | 292 532 | 11.2 | 12.0 |
| **Total** | **2 780 417** | **(169 753)** | **2 610 664** | **100.0** | **100.0** |

21. As at 30 September 2005, there was a small excess of Japanese yen, which was offset by a small shortfall of pound sterling as well as currency group holdings in euros and United States dollars.

## VII. RISK MEASUREMENT

22. The investment portfolio, with the exception of cash and held-to-maturity investments, is subject to fluctuations in returns due to economic and market conditions. One of the most common risk measures is volatility, which is measured in terms of standard deviation of returns. 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 30 September 2005 was 1.4 %, compared with 1.2% at 30 June 2005.

23. 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 9, at 30 September 2005 the VaR of the investment portfolio was 1.1% (equivalent to USD 26 500 000), which was lower than the investment policy’s VaR of 1.5% (equivalent to USD 36 200 000). This means that overall the investment portfolio was less risk-exposed than the investment policy.

24. The main reason for the portfolio's lower risk compared with the policy was the external investment managers’ decisions to generally keep a somewhat shorter duration (compared with benchmarks) of bond securities in order to better protect the portfolio against rising interest rates.

25. Compared with the previous quarter-end, both portfolio and policy VaR (and also the portfolio’s standard deviation per paragraph 22) increased slightly due to somewhat more volatile fixed-interest markets.

**Table 9: Value-at-Risk**
(Forecast horizon of three months, confidence level of 95%)

| Date | Investment Portfolio | | Investment Policy | |
|---|---|---|---|---|
| | VaR (%) | Amount (USD '000) | VaR (%) | Amount (USD '000) |
| 30 September 2005 | 1.1 | 26 500 | 1.5 | 36 200 |
| 30 June 2005 | 1.0 | 24 500 | 1.4 | 34 300 |
| 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 |

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

### I. INTRODUCTION

1. This annex contains additional information on the second quarter of 2005 with regard to performance attribution (rate of return and performance comparison), currency composition and risk measurement.

### II. RATE OF RETURN AND PERFORMANCE COMPARISON

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

3. 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-linked index for the inflation-indexed bonds.

4. Table 1 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, attributable mainly to the inflation-indexed bonds portfolio. To a lesser extent, the diversified fixed-interest and government bond portfolios also showed underperformance. This performance can be explained as follows:

(a) **Government bonds portfolio.** The portfolio returned 1.93%, underperforming by 5 basis points against its benchmark. The main reason for the underperformance was a somewhat negatively contributing country allocation, which was partially offset by the positive contribution from investment managers' decisions on the duration of bond securities.

(b) **Diversified fixed-interest portfolio.** The portfolio returned 2.48%, underperforming by 38 basis points against its benchmark. The underperformance was mainly due to the investment managers' conservatively short duration of bond securities (compared with the benchmark), which did not allow the portfolio to fully benefit from the quarter's rallying bond markets. Furthermore, a small overweight in the less strongly performing mortgage-backed and asset-backed securities subportfolios also contributed to the underperformance.

(c) **Inflation-indexed bonds portfolio.** The portfolio returned 1.81%, underperforming by 108 basis points against its benchmark. One reason for the underperformance was the managers' somewhat negatively contributing country allocation through the underweighting of some well-performing countries like the United Kingdom of Great Britain and Northern Ireland and the United States of America. Also in this case, the conservatively short duration of bond securities (compared with the benchmark) did not allow the portfolio to fully benefit from the rallying bond markets during the quarter.

**Table 1: Performance Compared with Benchmarks –
Second Quarter of 2005**

(Percentage in local currency terms)

| | Second Quarter of 2005 | | | Year-to-Date 2005 | | |
|---|---|---|---|---|---|---|
| | Rate of Return (%) | | | Rate of Return (%) | | |
| **Portfolio** | **Portfolio** | **Benchmark** | **Out/(Under) Performance** | **Portfolio** | **Benchmark** | **Out/(Under) Performance** |
| Internally managed short-term liquidity[a] | 0.84 | 0.84 | 0.00 | 1.61 | 1.61 | 0.00 |
| Internally managed held-to-maturity[a] | 0.73 | 0.73 | 0.00 | 0.95 | 0.95 | 0.00 |
| Government bonds | 1.93 | 1.98 | (0.05) | 2.45 | 2.21 | 0.24 |
| Diversified fixed-interest | 2.48 | 2.86 | (0.38) | 2.50 | 2.53 | (0.03) |
| Inflation-indexed bonds | 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 | - | - | - | 0.45 | (0.69) | 1.14 |
| European equities | - | - | - | 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.

5. Although the investment portfolio showed underperformance against the benchmark in the second quarter of 2005, on a year-to-date basis the investment portfolio outperformed its aggregate benchmark by 7 basis points.

## III. CURRENCY COMPOSITION

6. 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.

7. 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.

8. 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 30 June 2005, are shown in Table 2.

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

| | 1 January 2001 | | 30 June 2005 | |
|---|---|---|---|---|
| **Currency** | **Units** | **Percentage Weight** | **Units** | **Percentage Weight** |
| United States dollar (USD) | 0.577 | 44.3 | 0.577 | 39.6 |
| Euro (EUR) | 0.426 | 30.4 | 0.426 | 35.3 |
| Japanese yen (JPY) | 21.000 | 14.0 | 21.000 | 13.0 |
| Pound sterling (GBP) | 0.0984 | 11.3 | 0.0984 | 12.1 |
| **Total** | | **100.0** | | **100.0** |

9. As at 30 June 2005, assets in the form of investment portfolio, promissory notes and amounts receivable from contributors under the Fourth, Fifth and Sixth Replenishments, net of provisions, amounted to USD 2 862 654 000 equivalent, as indicated in Table 3 (compared with USD 2 972 811 000 equivalent at 31 March 2005).

**Table 3: Currency Composition of Assets at 30 June 2005**
(USD ’000 equivalent)

| Currency Group | Cash and Investments[a] | Promissory Notes[a] | Amounts Receivable from Contributors | Total |
|---|---|---|---|---|
| USD | 1 062 704 | 80 571 | 53 461 | 1 196 736 |
| EUR | 770 335 | 75 781 | 25 145 | 871 261 |
| JPY | 341 378 | 8 248 | 16 497 | 366 123 |
| GBP | 232 016 | 5 913 | 59 398 | 297 327 |
| Other | 45 590 | 38 471 | 47 146 | 131 207 |
| **Total** | **2 452 023** | **208 984** | **201 647** | **2 862 654** |

[a] Includes assets in freely-convertible currencies. The excluded assets in non-convertible currencies amounted to USD 716 000 equivalent for cash and investments and USD 1 399 000 equivalent for promissory notes.

10. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 131 207 000 equivalent as at 30 June 2005 (compared with USD 151 397 000 equivalent at 31 March 2005). These assets were allocated to currency groups as indicated in Table 4.

**Table 4: Allocation of Assets to Currency Groups at 30 June 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 |
|---|---|---|---|---|
| USD | 1 196 736 | - | 40 933 | 1 237 669 |
| EUR | 871 261 | 90 274 | - | 961 535 |
| JPY | 366 123 | - | - | 366 123 |
| GBP | 297 327 | - | - | 297 327 |
| **Total** | **2 731 447** | **90 274** | **40 933** | **2 862 654** |

11. The alignment of assets by currency group against the SDR valuation basket as at 30 June 2005 is shown in Table 5. The balance of the General Reserve at 30 June 2005 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 61 264 000, respectively.

**Table 5: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 30 June 2005**
(USD ’000 equivalent)

| Currency Group | Asset Amount | Less Commitments Denominated in USD | Net Asset Amount | Net Asset Amount as a Percentage at 30 June 2005 | SDR Weight as a Percentage at 30 June 2005 |
|---|---|---|---|---|---|
| USD | 1 237 669 | (156 264) | 1 081 405 | 40.0 | 39.6 |
| EUR | 961 535 | - | 961 535 | 35.5 | 35.3 |
| JPY | 366 123 | - | 366 123 | 13.5 | 13.0 |
| GBP | 297 327 | - | 297 327 | 11.0 | 12.1 |
| **Total** | **2 862 654** | **(156 264)** | **2 706 390** | **100.0** | **100.0** |

12. As at 30 June 2005, there was a modest shortfall in the pound sterling, which was offset by a small excess of Japanese yen and the currency group holdings in euros and United States dollars.

## IV. RISK MEASUREMENT

13. The investment portfolio, with the exception of cash and held-to-maturity investments, is subject to fluctuations in returns due to economic and market conditions. One of the most common risk measures is volatility, which is measured in terms of standard deviation of returns. A higher standard deviation indicates higher return fluctuations in the portfolio and therefore a higher risk. The standard deviation of IFAD’s investment portfolio at 31 March 2005 was 1.5%. As at 30 June 2005, the investment portfolio’s standard deviation decreased to 1.2%.

14. 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 6, at 30 June 2005 the VaR of the investment portfolio was 1.0% (equivalent to USD 24 500 000), which was lower than the investment policy’s VaR of 1.4% (equivalent to USD 34 300 000). This means that on overall the investment portfolio was less risk-exposed than the investment policy.

15. Compared with the previous quarter-end, both portfolio and policy VaR decreased somewhat due to less volatile fixed-interest markets. The portfolio VaR also decreased due to a drop in the diversified fixed-interest portfolio’s VaR as this portfolio’s investment managers shortened the duration of bond securities.

**Table 6: Value-at-Risk**
(Forecast horizon of three months, confidence level of 95%)

| Date | Investment Portfolio | | Investment Policy | |
|---|---|---|---|---|
| | **VaR (%)** | **Amount (USD '000)** | **VaR (%)** | **Amount (USD '000)** |
| 30 June 2005 | 1.0 | 24 500 | 1.4 | 34 300 |
| 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 |