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REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR 2005

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the year ended 31 December 2005 and includes comparative figures for the year ended 31 December 2004 and earlier years. In addition, Annex X contains a report on the investment portfolio for the fourth quarter of 2005.

2. The report consists of the following eight sections: highlights; investment conditions; investment policy; asset allocation; investment income; rate of return and performance comparison; composition of the portfolio; and risk measurement.

II. HIGHLIGHTS

3. In 2005, the global economy continued to be confronted with rising oil prices; however, the impact on global growth and inflation was less than expected in most developed countries. During the first half of the year, fixed-interest markets performed relatively well especially in the Eurozone and Japan as economy still followed a slow-growth pace. During the second half of the year, the economy of the United States of America continued on a steady growth path, while European and Japanese economies showed signs of a pick-up leading fixed-interest markets to perform less positively. In the currency market, the United States dollar appreciated towards major currencies for most of the year, thereby reducing the value in USD terms of IFAD's investment portfolio.

4. In March 2005, as part of implementation of IFAD's asset liability management review of 2003, the remaining equities portion of IFAD's investment portfolio was liquidated in order to reduce the volatility of IFAD's investment returns. The proceeds were used to fund a held-to-maturity portfolio of high-grade fixed-income securities with a maximum maturity of five years.

5. In aggregate, net investment income on IFAD's investment portfolio amounted to USD 68 230 000 equivalent in 2005. This represented an overall net rate of return of 2.95% and an outperformance of 23 basis points against the aggregate benchmark.

6. The fixed-interest portion of the investment portfolio contributed USD 63 024 000 equivalent to the overall net investment income. The income from fixed-interest investments corresponded to an annual rate of return of 2.89%, which reflected an outperformance of 16 basis points against the aggregate fixed-interest benchmark.

7. The equities portion of the investment portfolio, over the two-month period from 1 January up to their liquidation on 1 March 2005, contributed USD 5 206 000 equivalent to the overall net investment income. The income from equities corresponded to a two-month rate of return of 1.92%, which was equivalent to an outperformance of 62 basis points against the aggregate equities benchmark.

8. The value of the investment portfolio in USD terms decreased from USD 2 559 975 000 equivalent at 31 December 2004 to USD 2 347 765 000 equivalent at the end of 2005. The decrease during the year was mainly due to negative movements from foreign exchange as the United States dollar appreciated strongly against other major currencies.

III. INVESTMENT CONDITIONS

9. This section reviews the economic and financial market background in 2005.

A. Economic Background

10. Annex I shows the development of four key economic indicators: real gross domestic product (GDP), consumer prices, unemployment rate and budget deficits and surpluses. The economic indicators are shown for the countries whose currencies make up the special drawing right (SDR) valuation basket: Eurozone countries, Japan, the United Kingdom of Great Britain and Northern Ireland, and the United States of America.

11. GDP growth rates generally decreased during 2005, with the exception of Japan. In the United States, growth was slightly decelerated by the rise in oil prices and by the increases in interest rates by the Federal Reserve Bank. Economic growth in the Eurozone was hampered by slow-recovering demand especially during the first half of 2005. In the United Kingdom, slow industrial production and weak consumer spending reduced growth rates. Only Japan's economy expanded, supported by strong domestic demand in the household and corporate sectors and steady export growth. Forecasts for 2006 are of increasing GDP growth rates with the exception of the United States. The economy of the United States is forecasted to suffer from lower consumer spending and a decline in housing demand. In contrast, GDP rates in the Eurozone are expected to increase due to a pick-up in domestic demand and to accelerating exports fuelled by a weaker currency. In the United Kingdom, projections for 2006 show a growth trend supported by recovery in the housing market and the retail sector.

12. Inflation rose during 2005, with the exception of Japan, as a consequence of higher oil prices. Despite the increase in energy prices, United States consumer prices remained on the low scale as cheaper imports and stronger foreign competition hindered price increases. In the United Kingdom and the Eurozone, inflation rose quite significantly driving the consumer-price index above the European Central Bank target of 2.0%. Pressure on price increases is expected to decline in 2006 as energy prices are forecasted to stabilize. In Japan, deflation continued during 2005, while 2006 forecasts point to the end of a long deflationary period.

13. Unemployment rates fell in the United States, the Eurozone and Japan, while remaining stable in the United Kingdom. These trends are forecasted to continue in 2006.

14. In 2005, the budget deficit decreased slightly in the United States and grew slightly in Japan, while remaining unchanged in the Eurozone. The United Kingdom showed a broadly unchanged surplus in 2005. Forecasts for 2006 are of small variations around current levels.

15. Annex II shows the evolution of central bank interest rates for the countries whose currencies are included in the SDR valuation basket. The impact of these rates on short-term interest rates and bond markets is further described in paragraphs 18 and 19. The United States Federal Reserve Bank increased the federal funds rate eight times in 2005 from 2.25% to 4.25% in order to prevent inflation from accelerating. For the same reason, in December 2005, the European Central Bank raised its refinancing rate from 2.00% to 2.25% for the first time in five years. In the United Kingdom, the Bank of England lowered its base rate one time during the year from 4.75% to 4.50% to support a slow-growing economy. The Bank of Japan maintained its target rate at 0% during 2005.

16. Annex III illustrates month-end exchange rates for the United States dollar against the three other currencies included in the SDR valuation basket, i.e. the British pound sterling (GBP), the euro (EUR) and the Japanese yen (JPY). In 2005, the dollar appreciated against all three other currencies. This was due to a growing demand for the United States currency from foreign investors (especially from Asian central banks) to buy United States Treasury bonds. The impact of exchange rate movements in 2005 on the investment portfolio is reflected in Table 1 and paragraph 29.

B. Financial Markets Background

17. Annex IV shows the evolution in 2005 of short- and long-term interest rates for the countries whose currencies are included in the SDR valuation basket. In the United States, short-term rates increased in connection with the Federal Reserve Bank's eight rate increases, while those on 10-year bonds remained broadly stable, causing a further flattening of the yield curve. In the United Kingdom, short-term rates were higher than long-term rates during the whole year, inverting the yield curve. The decline of long-term yields in the United Kingdom was mostly caused by a large demand of long-term securities especially from pension funds and insurance companies. In the Eurozone, short-term rates increased slightly at the end of the year in conjunction with the European Central Bank's rate increase in December 2005. Long-term rates showed a slightly decreasing trend during the first part of the year in line with positive trends in fixed-interest markets, and later increased slightly as European fixed-interest markets suffered under fears of inflation increase. In Japan, both short- and long-term rates remained stable during the year.

18. Annex V shows government bond returns in 2005 for individual countries included in the customized JP Morgan global government bond index. The benchmark index includes both coupon and capital gains and losses, in line with market practice. The United Kingdom bond market was the best performer among the SDR countries as the outlook of weak economic growth and declining rates favoured fixed-income over equity investments.

19. Annex VI shows the performance in 2005 of fixed-interest and equities markets where IFAD's investment portfolio was invested during the year. The performance of the fixed-interest market is reflected in the representative benchmark indices used by IFAD for government bonds, diversified fixed-interest bonds and inflation-indexed bonds. Fixed-interest markets performed better than expected during the year, characterized by a large money supply worldwide, which benefited particularly the corporate sector. Inflation-linked bonds outperformed government bonds, with an accelerated trend during the fourth quarter when inflation reached higher levels under the pressure of higher energy prices.

20. Equities markets performed well in 2005 because of strong earnings delivery and solid buying flows. Especially in European markets, 2005 corporate earnings were stronger than expected at the beginning of the year.

IV. INVESTMENT POLICY

21. In February 2005, as part of implementation of IFAD's asset liability management review of 2003, IFAD appointed a transition manager to liquidate the equities portfolio and a portion of the government bonds portfolio, and to invest the proceeds in the new held-to-maturity portfolio. Both the liquidation and the funding of the held-to-maturity portfolio were undertaken on 1 March 2005.

22. The total funding of the held-to-maturity portfolio amounted to USD 412 205 000 equivalent. The held-to-maturity portfolio, which is composed of high-quality bond instruments with a maximum maturity of five years, is managed internally and approximately USD 20 000 000 equivalent (5% of the total holdings) matures and is reinvested every quarter.

23. Following the liquidation of the equities portfolio and the funding of the held-to-maturity portfolio, the former equities policy allocation of 10% was proportionally redistributed across the remaining investment policy's asset classes.

24. In September 2005, IFAD appointed the World Bank as the new financial advisor. During an initial one-year period, the World Bank will provide IFAD with technical considerations on: (a) the benchmark to evaluate held-to-maturity investment performance, and (b) the expected rate of return for different asset allocation scenarios.

V. ASSET ALLOCATION

25. Table 1 shows the movements affecting the investment portfolio's major asset classes in 2005 and compares the portfolio's actual asset allocation with the policy allocation.

26. The held-to-maturity portfolio, amounting to approximately USD 400 000 000 equivalent, is part of IFAD's overall investment portfolio; however, it does not have a specific percentage allocation within the current investment policy. For the purpose of comparing the actual investment portfolio allocation with the investment policy allocation, the held-to-maturity portfolio is reclassified in line with the investment guidelines of the government bonds and diversified fixed-interest portfolios.

27. During the first quarter of 2005, USD 122 000 000 equivalent was liquidated from the government bonds portfolio. This amount, together with proceeds of USD 285 000 000 equivalent from the equities liquidation and additional cash from the short-term liquidity portfolio was used to fund the held-to-maturity portfolio. Furthermore, a total amount of USD 50 000 000 equivalent was transferred to the short-term liquidity portfolio to meet disbursement requirements. Additionally, there was a net outflow of USD 92 979 000 equivalent that represents a difference between disbursements for loans, grants and administrative expenses, and encashment of Member States' contributions.

28. Changes in the portfolio's allocation ratios in 2005 also reflected positive movements in investment income and large movements in exchange rates as other major currencies depreciated strongly against the United States dollar. Particularly the government bonds and the inflation-indexed bonds portfolios decreased in value as non-dollar investments made up about 75% and 90% respectively of their average holdings in 2005.

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

	Short-Term Liquidity	Held-to-Maturity	Government Bonds	Diversified Fixed-Interest	Inflation-Indexed Bonds	Equities [a]	Overall
Opening balance (31 December 2004)	**147 521**	**-**	**1 155 549**	**504 174**	**469 587**	**283 144**	**2 559 975**
Net investment income	4 316	10 108	25 013	13 501	10 086	5 206	68 230
Transfers due to allocation	57 574	401 427	(152 978)	(20 201)	-	(285 822)	-
Transfers due to expenses/other income	(3 944)	50	1 806	988	1 018	82	-
Other net flows[b]	(92 979)	-	-	-	-	-	(92 979)
Movements on exchange	(8 982)	(20 705)	(98 430)	(1)	(56 757)	(2 586)	(187 461)
Closing balance (31 December 2005)[c]	**103 530**	**390 880**	**930 960**	**498 461**	**423 934**	**-**	**2 347 765**
Actual portfolio allocation (%)	4.4	16.6	39.7	21.2	18.1	-	100.00
Reclassification of HTM portfolio by asset class[d]	-	(390 880)	144 704	246 176	-	-	-
Closing balance with HTM portfolio reclassified	**103 530**	**-**	**1 075 664**	**744 637**	**423 934**	**-**	**2 347 765**
Actual asset allocation with HTM portfolio reclassified (%)	4.4	-	45.8	31.7	18.1	-	100.0
Policy allocation (%)	5.5	-	49.0	25.5	20.0	-	100.0
Difference in asset allocation (%)	**(1.1)**	**-**	**(3.2)**	**6.2**	**(1.9)**	**-**	**-**

[a] Movements occurred during the two-month period from 1 January up to liquidation on 1 March 2005.
[b] Member States' contributions, less disbursements for loans, grants and administrative expenses.
[c] The closing balance at 31 December 2005 includes dividend tax receivables of USD 24 000 equivalent pertaining to the equities portfolio. These tax receivables are included here in the balance of the internally managed short-term liquidity portfolio.
[d] The assets of the held-to-maturity portfolio have been reclassified as part of government bonds (USD 144 704 000 equivalent) and diversified fixed-interest (USD 246 176 000 equivalent) according to the investment guidelines of these two asset classes.

29. As at 31 December 2005, the investment portfolio showed an excess allocation in the diversified fixed-interest portfolio, offset by shortfalls in the remaining portfolios, especially in the government bonds portfolio. The excess allocation in the diversified fixed-interest portfolio mainly stemmed from its currency composition, as this portfolio is almost entirely invested in bonds denominated in United States dollars. Therefore, unlike the situation in the investment portfolio's other asset classes, its market value was not reduced by the movements on exchange. Furthermore, at 31 December 2005 almost 65% of the held-to-maturity portfolio was reclassified in the diversified fixed-interest asset class, thereby further increasing its allocation.

30. Annex VII provides further details on the movements in the two equities sub-portfolios.

VI. INVESTMENT INCOME

31. For the year 2005, aggregate net investment income amounted to USD 68 230 000 equivalent (compared with USD 108 662 000 in 2004). Both realized and unrealized security gains and losses are recognized in the period to which they relate and are included in investment income. Table 2 shows net investment income for 2005 and prior years for the investment portfolio's major asset classes.

Table 2: Net Investment Income by Asset Class – 2005 and Prior Years
(USD ’000 equivalent)

Portfolio	2005[c]	2004	2003	2002[b]	2001[a]
Short-term liquidity	4 316	2 701	4 086	4 098	2 050
Held-to-maturity	10 108	-	-	-	-
Government bonds	25 013	38 675	36 735	85 541	41 471
Diversified fixed-interest	13 501	22 114	16 038	22 925	13 783
Inflation-indexed bonds	10 086	21 386	4 665	-	-
Equities (until 1 March 2005)	5 206	23 786	46 438	(86 378)	(100 286)
Overall portfolio	**68 230**	**108 662**	**107 962**	**26 186**	**(42 982)**

[a] Net investment income earned in 2001 reflects the previous investment policy, which included up to 45% allocation to equities.
[b] In 2002, the equities allocation was reduced to 10%.
[c] In March 2005, the remaining equities portion was liquidated.

32. Table 3 provides details on net investment income earned in 2005 by the two portfolio categories (i.e. fixed-interest and equities), investments up until their liquidation, together with net investment income for the overall portfolio in 2001 to 2005. Both fixed-interest and equities investments contributed positively to the net investment income in 2005.

Table 3: Net Investment Income of the Overall Portfolio by Portfolio Category – 2005 and Prior Years
(USD ’000 equivalent)

	2005[c]						
	Total Fixed-Interest Portfolio	Total Equities Portfolio	Overall Portfolio	2004 Overall Portfolio	2003 Overall Portfolio	2002[b] Overall Portfolio	2001[a] Overall Portfolio
Interest from fixed-interest investments and bank accounts	84 596	16	84 612	76 768	69 938	61 541	59 241
Dividend income from equities	-	755	755	6 204	4 709	7 652	13 614
Realized capital gains/ (losses)	(7 228)	4 542	(2 686)	20 271	42 179	(89 120)	(74 793)
Unrealized capital gains/ (losses)	(10 171)	-	(10 171)	11 258	(3 779)	53 541	(31 400)
Amortization	(1 619)	-	(1 619)	-	-	-	-
Income from securities lending and commission recapture	780	22	802	738	430	436	841
Subtotal: gross investment income/(loss)	**66 358**	**5 335**	**71 693**	**115 239**	**113 477**	**34 050**	**(32 497)**
Investment manager fees	(3 635)	(195)	(3 830)	(5 087)	(4 276)	(4 866)	(7 037)
Custody fees	(467)	(19)	(486)	(485)	(680)	(1 621)	(2 103)
Financial advisory and other investment management fees	(581)	(23)	(604)	(921)	(475)	(791)	(688)
Taxes	1 440	108	1 548	(84)	(84)	(365)	(606)
Other investment expenses	(91)	-	(91)	-	-	(221)	(51)
Net investment income/(loss)	**63 024**	**5 206**	**68 230**	**108 662**	**107 962**	**26 186**	**(42 982)**

[a] Net investment income earned in 2001 reflects the previous investment policy, which included up to 45% allocation to equities.
[b] In 2002, the equities allocation was reduced to 10%.
[c] In March 2005, the remaining equities portion was liquidated.

33. Table 4 shows net investment income in 2005 from the fixed-interest portfolio's five sub-portfolios, namely the short-term liquidity, the held-to-maturity, the government bonds, the diversified fixed-interest and the inflation-indexed bonds portfolios. In aggregate, net investment income from fixed-interest investments in 2005 amounted to USD 63 024 000 equivalent. All fixed-interest sub-portfolios contributed positively to income with the government bonds portfolio showing the largest contribution.

Table 4: Net Investment Income on the Fixed-Interest Portfolio by Sub-Portfolio – 2005
(USD '000 equivalent)

	Short-term Liquidity	**Held-to-Maturity**	**Government Bonds**	**Diversified Fixed-Interest**	**Inflation-Indexed Bonds**	**Total Fixed-Interest**
Interest from fixed-interest investments and bank accounts	2 917	11 777	38 504	18 891	12 507	84 596
Dividend income from equities	-	-	-	-	-	-
Realized capital gains/(losses)	-	-	(6 578)	(916)	266	(7 228)
Unrealized capital losses	-	-	(5 105)	(3 428)	(1 638)	(10 171)
Amortization[a]	-	(1 619)	-	-	-	(1 619)
Income from securities lending and commission recapture	-	47	352	285	96	780
Subtotal: gross investment income	**2 917**	**10 205**	**27 173**	**14 832**	**11 231**	**66 358**
Investment manager fees	-	-	(1 775)	(1 023)	(837)	(3 635)
Custody fees	(41)	(40)	(112)	(116)	(158)	(467)
Financial advisory and other investment management fees	-	(57)	(271)	(134)	(119)	(581)
Taxes	1 440[b]	-	-	-	-	1 440
Other investment expenses	-	-	(2)	(58)	(31)	(91)
Net investment income	**4 316**	**10 108**	**25 013**	**13 501**	**10 086**	**63 024**

[a] A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments as per the International Financial Reporting Standards.
[b] From the total amount of USD 1 440 000 equivalent, an amount of USD 1 418 000 equivalent represents outstanding Italian taxes received from the Italian tax authority in November 2005 as IFAD is not liable for withholding tax on income given its tax-exempt status. The remaining amount of USD 22 000 equivalent reflects tax receivables of the first three quarters of 2005.

34. Net investment income in 2005 from the two sub-portfolios of the equities portfolio over the two-month period from 1 January up to their liquidation on 1 March 2005 is shown in Table 5. In aggregate, net investment income from equities amounted to USD 5 206 000 equivalent. Particularly the European equities sub-portfolio contributed strongly to income in the first two months of 2005.

Table 5: Net Investment Income of the Equities Portfolio by Sub-portfolio – 2005 [a]
(USD ’000 equivalent)

	North American Equities	European Equities	Total Equities
Interest from fixed-interest investments and bank accounts	13	3	16
Dividend income from equities	388	367	755
Realized capital gains	457	4 085	4 542
Income from securities lending and commission recapture	9	13	22
Subtotal: gross investment income	**867**	**4 468**	**5 335**
Investment manager fees	(139)	(56)	(195)
Custody fees	(13)	(6)	(19)
Financial advisory and other investment management fees	(14)	(9)	(23)
Taxes	-	108	108
Other investment expenses	-	-	-
Net investment income	**701**	**4 505**	**5 206**

[a] Income earned during the two-month period from 1 January up to liquidation on 1 March 2005.

35. Annex VIII shows annual gross income from 2001 to 2005 for the categories of the investment portfolio (i.e. fixed-interest and equities investments), and indicates the amounts of income earned through capital gains, interest income, dividends and income from securities lending and commission recapture. Most of the income in 2005 stemmed from interest income.

VII. RATE OF RETURN AND PERFORMANCE COMPARISON

Overall Rate of Return

36. There was an overall positive return of 2.95% in 2005 (compared with a positive 4.54% in 2004), net of investment expenses excluding the impact of foreign exchange movements. Both fixed-interest and equities investments contributed positively to the overall return in 2005.

Portfolio Performance Compared with Benchmark

37. 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 indices used are the JP Morgan customized global government bonds index for government bonds, Lehman Brothers United States aggregate index for diversified fixed-interest bonds, Barclays customized inflation-linked index for the inflation-indexed

bonds portfolio, Standard & Poor's 500 index for North American equities and Morgan Stanley Capital International (MSCI) index for European equities.

38. Table 6 compares the return on each major sub-portfolio with the appropriate benchmark return. The overall portfolio showed an outperformance of 23 basis points in 2005 (compared with an outperformance of 12 basis points in 2004). Both fixed-interest investments and equities investments contributed to the outperformance.

Table 6: Performance Compared with Benchmarks – 2005
(percentage in local currency terms)

Portfolio	Rate of Return (%)		Out/(Under) Performance
	Portfolio	**Benchmark**	
Short-term liquidity portfolio	3.78	3.78	0.00
Held-to-maturity portfolio	2.53	2.53	0.00
Government bonds portfolio	3.00	2.27	0.73
Diversified fixed-interest portfolio	2.96	2.55	0.41
Inflation-indexed bonds portfolio	2.64	3.75	(1.11)
Total fixed-interest portfolio	**2.89**	**2.73**	**0.16**
North American equities portfolio	0.45	(0.69)	1.14
European equities portfolio	4.08	4.21	(0.13)
Total equities portfolio [a]	**1.92**	**1.30**	**0.62**
Overall portfolio gross rate of return	**3.10**	**2.87**	**0.23**
Less expenses	**(0.15)**	**(0.15)**	**0.00**
Overall portfolio net rate of return	**2.95**	**2.72**	**0.23**

[a] Rate of return over the two-month period from 1 January up to liquidation on 1 March 2005.

39. As indicated in Table 6, the total fixed-interest portfolio returned 2.89% in 2005, which reflected an outperformance of 16 basis points compared to the aggregate fixed-interest benchmark. The externally managed sub-portfolios of the fixed-interest portfolio performed as follows:

(a) **Government bonds portfolio.** The portfolio returned 3.00%, which reflected an outperformance of 73 basis points against its benchmark. The outperformance was due to both a favourable securities' duration and asset allocation as the investment portfolio kept an overweight exposure in European government bond markets while underweighting its market position in Japan and the United States.

(b) **Diversified fixed-interest portfolio.** The portfolio returned 2.96%, which reflected an outperformance of 41 basis points against its benchmark. The outperformance was mainly due to a favourable securities selection including securities' duration and credit quality in the credit and asset-backed sectors. Also a somewhat overweight asset allocation in these sectors compared to the benchmark further contributed to the outperformance.

(c) **Inflation-indexed bonds portfolio.** The portfolio returned 2.64%, which reflected an underperformance of 111 basis points against its benchmark. The performance was undermined by a somewhat unfavourable country allocation as the portfolio underweighted well-performing countries such as Eurozone countries and the United Kingdom. The underperformance was partially recovered by a favourable securities selection and duration management, particularly among European bonds.

(d) The total equities portfolio returned 1.92% over the two-month period from 1 January up to their liquidation on 1 March 2005. This represented an outperformance of 62 basis points compared with the aggregate equities benchmark. Performance attribution is not available for equities due to their very short investment period.

40. Table 7 shows the duration of the externally managed portfolios and benchmarks at 31 December 2005 and compared to previous year-end.

Table 7: Duration of Fixed-Interest Portfolios and Benchmarks

	31 December 2005 (Years)		31 December 2004 (Years)	
	Portfolio	Benchmark	Portfolio	Benchmark
Government bonds	1.9	2.6	2.8	2.9
Diversified fixed-interest	4.2	4.0	4.3	3.9
Inflation-indexed bonds	2.2	5.4	4.3	5.6

VIII. COMPOSITION OF THE PORTFOLIO

Composition of the Portfolio by Instrument

41. An analysis of the overall portfolio composition by the type of instrument is shown in Table 8. An analysis of the fixed-interest portfolio by its five sub-portfolios is found in Annex IX.

Table 8: Composition of the Portfolio by Type of Instrument at 31 December 2005
(USD ’000 equivalent)

	Overall Portfolio at Year-End 2005	Overall Portfolio at Year-End 2004
Cash[a]	235 211	151 160
Time deposits and other obligations of banks[b]	101 092	207 111
Global government bonds	1 636 754	1 694 347
Mortgage-backed securities	339 398	258 892
Asset-backed securities	56 322	96 436
Corporate bonds	133 782	37 933
Equities	-	278 475
Unrealized market value gain/(loss) on forward contracts	2 303	(898)
Unrealized gain/(loss) on futures	306	(1 224)
Options	14	(59)
Subtotal: cash and investments	**2 505 182**	**2 722 173**
Receivables for investments sold	87 437	40 176
Payables for investments purchased	(244 854)	(202 374)
Total	**2 347 765**	**2 559 975**

[a] Includes cash in non-convertible currencies amounting to USD 69 000 equivalent (compared with USD 332 000 in 2004).
[b] Includes time deposits in non-convertible currencies amounting to USD 655 000 equivalent (compared with USD 386 000 in 2004).

Composition of the Portfolio by Currency

42. The majority of IFAD’s commitments are expressed in special drawing rights. 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.

43. 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.

44. 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 December 2005, are shown in Table 9.

Table 9: Units and Weights Applicable to the SDR Valuation Basket

	1 January 2001		31 December 2005	
Currency	Units	Percentage Weight	Units	Percentage Weight
USD	0.577	44.3	0.577	40.5
EUR	0.426	30.4	0.426	35.2
JPY	21.00	14.0	21.000	12.5
GBP	0.0984	11.3	0.0984	11.8
Total		**100.0**		**100.0**

USD: United States dollar; EUR: euro; JPY: Japanese yen; GBP: British pound sterling

45. As at 31 December 2005, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth, Fifth and Sixth Replenishments amounted to USD 2 688 417 000 equivalent, as indicated in Table 10 (compared with USD 3 085 939 000 equivalent at 31 December 2004).

Table 10: Currency Composition of Assets at 31 December 2005
(USD ’000 equivalent)

Currency Group	Cash and Investments[a]	Promissory Notes[a]	Amounts Receivable from Contributors	Total
USD	1 046 503	68 599	40 828	1 155 930
EUR	717 601	83 270	15 369	816 240
JPY	327 251	15 488	-	342 739
GBP	219 315	4 464	50 709	274 488
Other	36 371	44 497	18 152	99 020
Total	**2 347 041**	**216 318**	**125 058**	**2 688 417**

[a] Includes assets in freely convertible currencies. The excluded assets in non-convertible currencies amounted to USD 724 000 equivalent for cash and investments and USD 1 399 000 equivalent for promissory notes.

46. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 99 020 000 equivalent at 31 December 2005 (compared with USD 177 975 000 equivalent at 31 December 2004). These are allocated to currency groups as indicated in Table 11.

Table 11: Allocation of Assets to Currency Groups at 31 December 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	1 155 930	-	35 459	1 191 389
EUR	816 240	63 561	-	879 801
JPY	342 739	-	-	342 739
GBP	274 488	-	-	274 488
Total	**2 589 397**	**63 561**	**35 459**	**2 688 417**

47. The alignment of assets by currency group against the SDR valuation basket at 31 December 2005 is shown in Table 12. The balance of the General Reserve at 31 December 2005 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 71 651 000, respectively.

Table 12: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 31 December 2005
(USD '000 equivalent)

Currency Group	Asset Amount	Less: Commitments Denominated in USD	Net Asset Amount	Net Asset Amount (%)	SDR Weights (%)
USD	1 191 389	(166 651)	1 024 738	40.6	40.5
EUR	879 801	-	879 801	34.9	35.2
JPY	342 739	-	342 739	13.6	12.5
GBP	274 488	-	274 488	10.9	11.8
Total	**2 688 417**	**(166 651)**	**2 521 766**	**100.0**	**100.0**

48. As at 31 December 2005, there was a shortfall in the British pound sterling and in the euro currency group holdings, which was offset by an excess of Japanese yen and, to a small extent, of United States dollar currency group holdings. The shortfall in the British pound sterling is carried over from the first quarter of 2005 and is a result of the liquidation, on 1 March 2005, of the European equities portfolio, which included a large portion of securities denominated in British pound sterling. The shortfall in euro currency group holdings is partially due to foreign exchange transactions into United States dollars executed for the purpose of loans and grants disbursements. A currency realignment will be undertaken in the first quarter of 2006, taking into account the new SDR weights effective as of 1 January 2006.

Maturity of Investments

49. Table 13 provides details of the composition of the overall investment portfolio by maturity as at 31 December 2005 and compares this with the maturity composition at 31 December 2004. The average life to maturity at 31 December 2005 was seven years (the same as in 31 December 2004).

Table 13: Composition of the Investment Portfolio by Maturity of Investments
(USD '000 equivalent)

Period	31 December 2005		31 December 2004	
	Amount	%	Amount	%
Due in one year or less	545 217	23.22	446 029	17.4
Due in one year to five years	1 181 197	50.31	1 200 969	46.9
Due in five to ten years	169 883	7.24	230 875	9.0
Due after ten years	451 469	19.23	403 947	15.8
No fixed maturity[a]	-	-	278 155	10.9
Total	**2 347 765**	**100.0**	**2 559 975**	**100.0**

[a] No fixed maturity refers to equities securities.

Diversification by Country

50. The diversification of the investment portfolio by developing countries, developed countries and development institutions is shown by type of instrument in Table 14. The main change during 2005 was the increased allocation to fixed-interest investments issued by international development institutions, which was offset by a reduced allocation to developed countries. This was due to the liquidation of the equities holdings in 2005, and their replacement with the held-to-maturity portfolio, which entails a portion of fixed-interest investments issued by international development institutions.

Table 14: Diversification of the Investment Portfolio by Country
(USD ’000 equivalent)

31 December 2005							
	Cash	**Time Deposits**	**Fixed-Interest Securities**	**Equities[a]**	**Other Assets**	**Total**	**%**
Latin America and the Caribbean	-	-	-	-	-	-	-
North Africa and the Near East	-	10 218	-	-	-	10 218	0.4
Sub-Saharan Africa	-	-	-	-	-	-	-
East and South Asia	69	655	-	-	-	724	-
Subtotal: developing countries	**69**	**10 873**	**-**	**-**	**-**	**10 942**	**0.5**
Developed countries	235 142	90 219	1 992 017	-	(154 794)	2 162 584	92.1
International development institutions	-	-	174 239	-	-	174 239	7.4
Total	**235 211**	**101 092**	**2 166 256**	**-**	**(154 794)**	**2 347 765**	**100.0**
31 December 2004							
	Cash	**Time Deposits**	**Fixed-Interest Securities**	**Equities[a]**	**Other Assets**	**Total**	**%**
Developing countries	332	25 839	-	-	-	26 171	1.0
Developed countries	150 828	181 272	1 967 395	278 475	(164 379)	2 413 591	94.3
International development institutions	-	-	120 213	-	-	120 213	4.7
Total	**151 160**	**207 111**	**2 087 608**	**278 475**	**(164 379)**	**2 559 975**	**100.0**

[a] Equities are aggregated under the region/country of the stock exchange in which they are listed and purchased.

IX. RISK MEASUREMENT

51. The investment portfolio is subject to fluctuations in returns, with the exception of held-to-maturity investments, 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 31 December 2005, the standard deviation of IFAD’s investment portfolio was 1.4%, compared with 1.7% for the investment policy (as against 1.8% for the investment portfolio and 2.0% for the investment policy at 31 December 2004).

52. Value-at-risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount the portfolio could lose in value over a three-month time horizon, with a 95% confidence level. Table 15 shows the VaR of IFAD’s investment portfolio and policy. At 31 December 2005, both the investment portfolio and the policy showed a lower VaR than at previous year-end, which indicates a risk reduction in 2005 for both the portfolio and the policy. This was primarily due to the liquidation of the riskier equities holdings on 1 March 2005 and the funding of the held-to-maturity portfolio on the same date.

Table 15: Value-at-Risk
(forecast horizon of three months, confidence level of 95%)

Date	Investment Portfolio VaR %	Investment Portfolio Amount USD ’000	Investment Policy VaR %	Investment Policy Amount USD ’000
31 December 2005	1.2	28 200	1.4	32 900
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
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[a]	2.1	46 100	2.3	51 500
31 March 2003	1.7	36 200	2.4	50 800
31 December 2002[b]	1.8	38 100	2.4	50 300
30 September 2002 [b]	2.1	42 500	2.4	49 100
30 June 2002 [b]	2.5	49 000	2.4	46 800
31 March 2002[b]	2.9	54 700	2.4	45 700
31 December 2001	5.5	105 100	6.2	119 100

[a] 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 those dates.

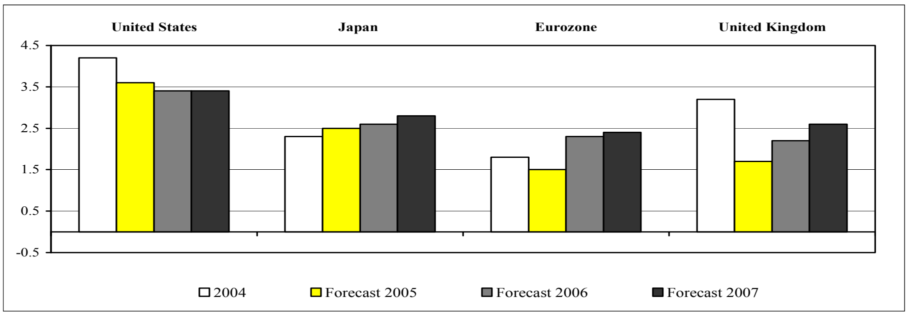
[b] A new investment policy with a reduced equities allocation of 10% was fully implemented in 2002, with the exception of the asset class of inflation-indexed bonds. Changes in the investment portfolio VaR during 2002 reflect the gradual implementation of the current investment policy. The investment policy VaR reflects the investment policy as of 31 March 2002 with 10% equities holdings and, as of 1 March 2005, without any equities holdings.

53. As indicated in Table 15, at 31 December 2005 the investment portfolio’s VaR remained below the investment policy VaR at the same date, indicating that the portfolio had a lower risk than the policy. In fact, all externally managed asset classes within the investment portfolio, i.e. government bonds, diversified fixed-interest and inflation-indexed bonds, showed a lower or very similar VaR compared with the policy VaR. This is explained by the portfolio managers keeping the portfolios’ durations shorter than their benchmark, thereby protecting the portfolios against the negative impact of the rising interest rates.

ANNEX I

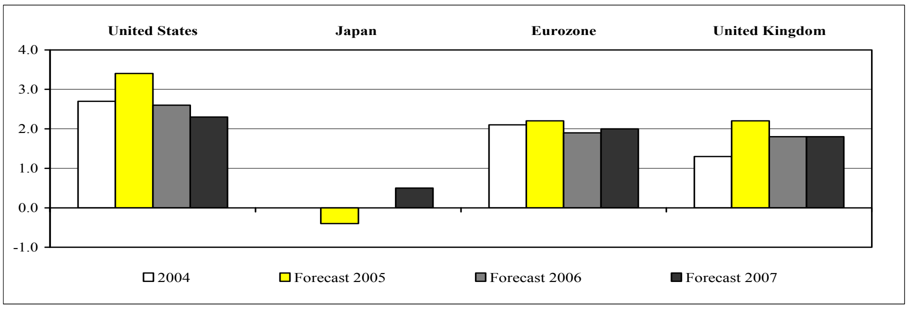
KEY ECONOMIC INDICATORS

Figure 1: Percent Change in Real GDP



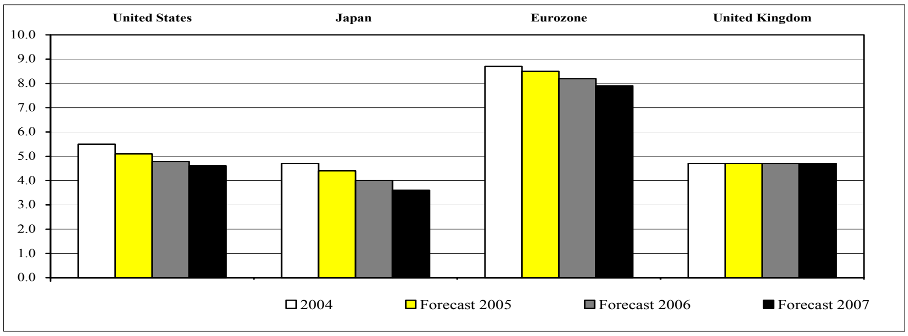
Source: J.P. Morgan ("MorganMarkets")

Figure 2: Consumer Prices - Annualized Rates



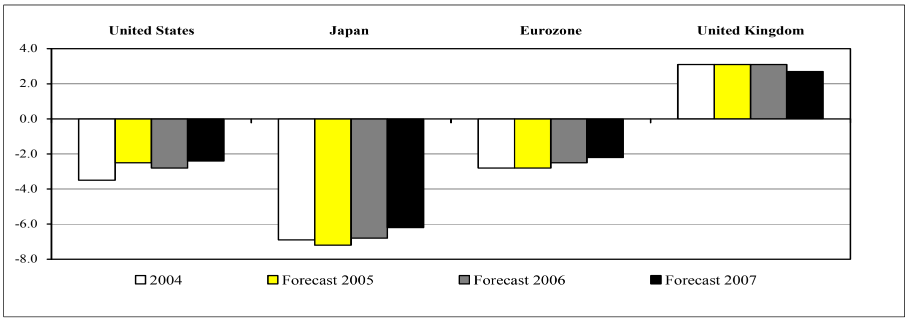
Source: J.P. Morgan ("MorganMarkets")

Figure 3: Unemployment Rate - Annual Average



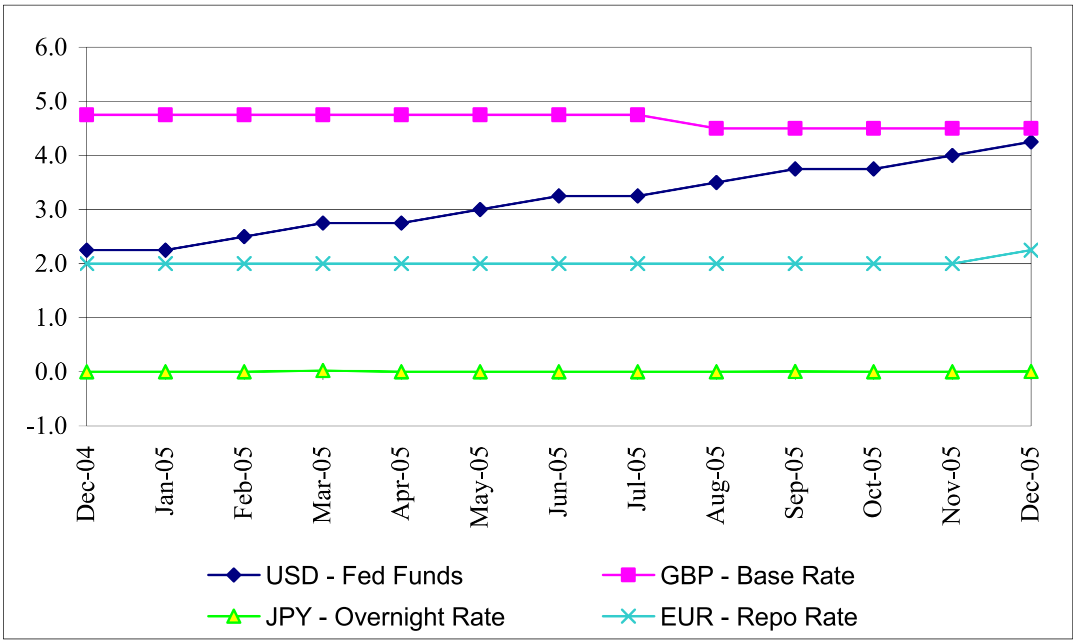
Source: J.P. Morgan ("MorganMarkets")

Figure 4: Budget Deficits and Surpluses as Percent of GDP



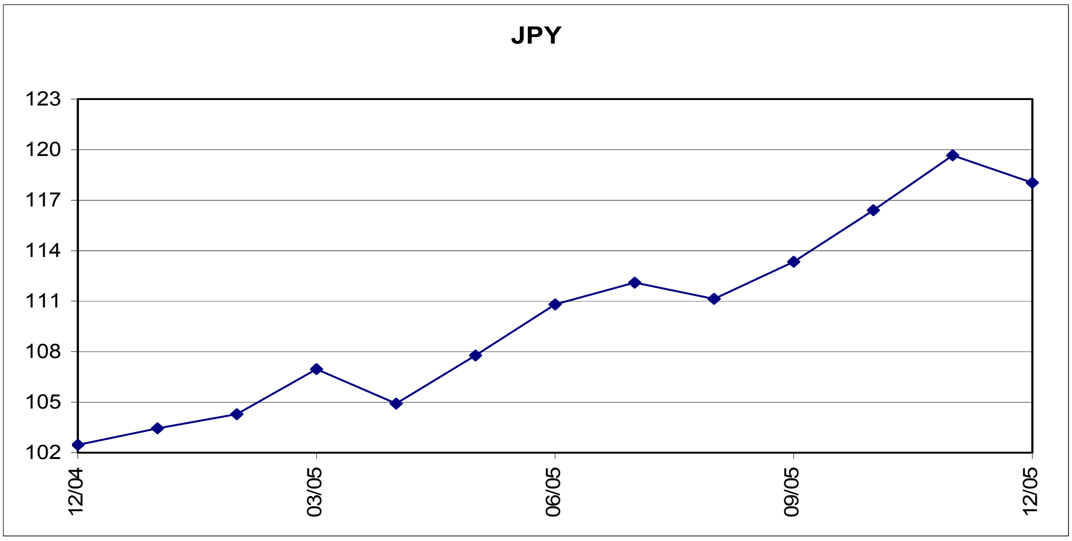
Source: J.P. Morgan ("World Financial Markets")

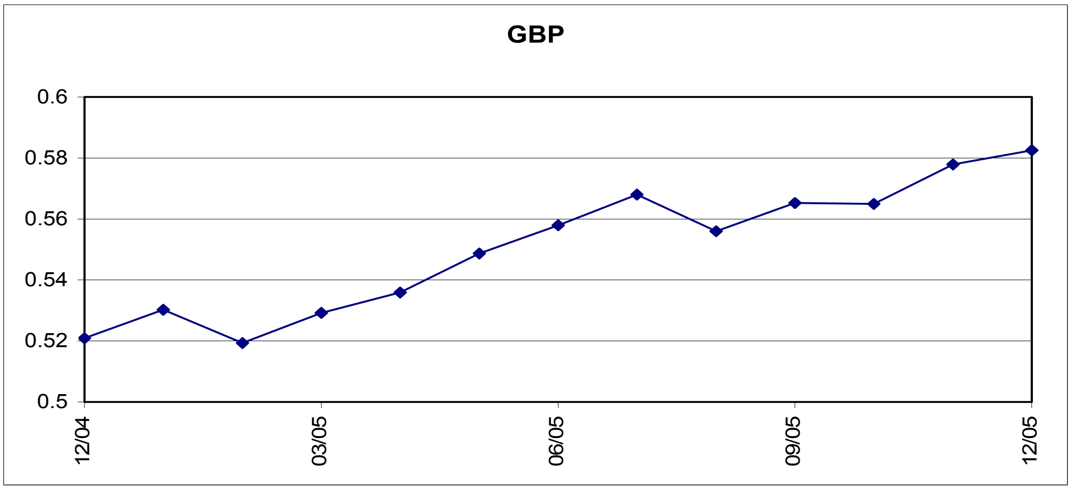
CENTRAL BANK INTEREST RATES

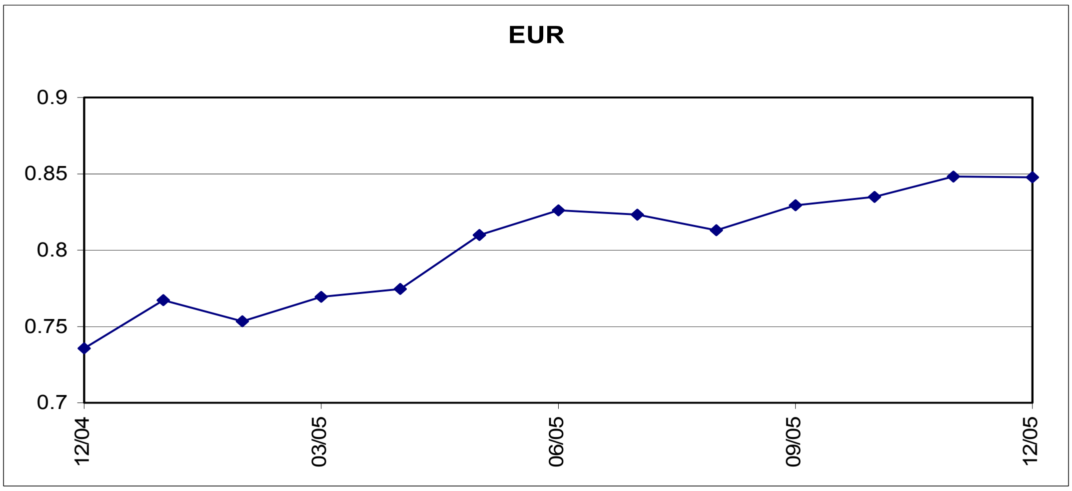


Source: Bloomberg

VALUE OF THE UNITED STATES DOLLAR AT MONTH-END EXCHANGE RATES





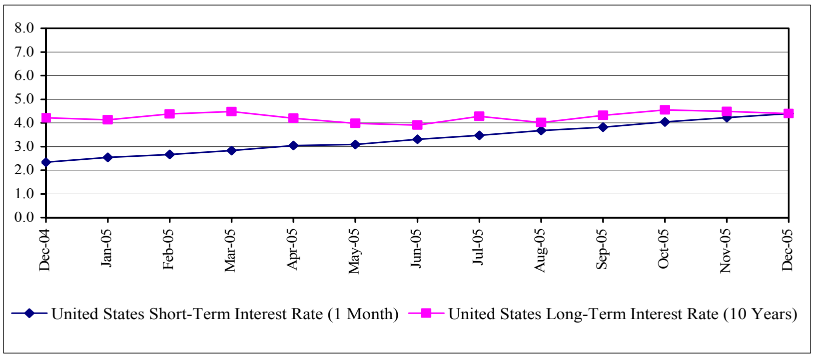


Source: Northern Trust

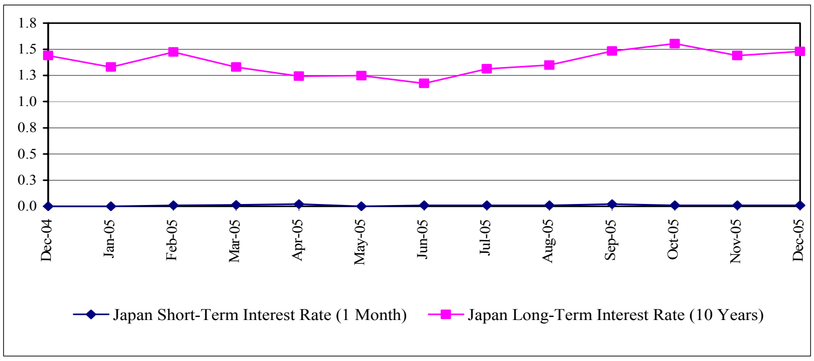
ANNEX IV

SHORT- AND LONG-TERM INTEREST RATES

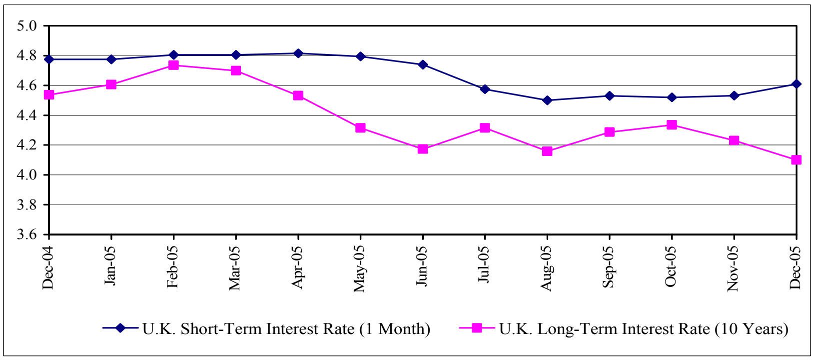
United States



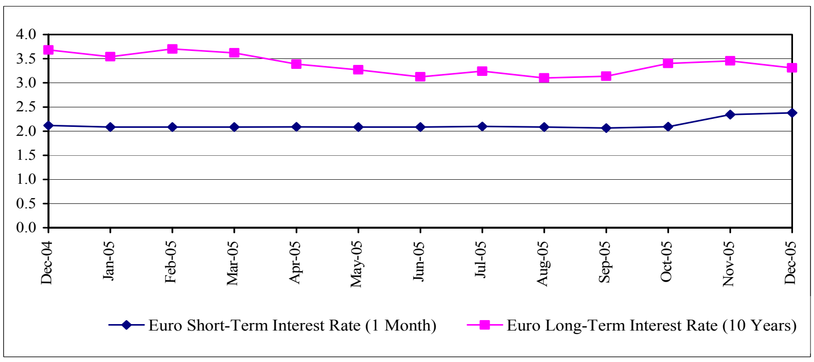
Japan



United Kingdom



Eurozone



Source: Bloomberg

ANNEX V

GOVERNMENT BOND RETURNS PER COUNTRY INCLUDED IN THE CUSTOMIZED JP MORGAN GLOBAL GOVERNMENT BOND INDEX [a]
(percentage in local currency terms)

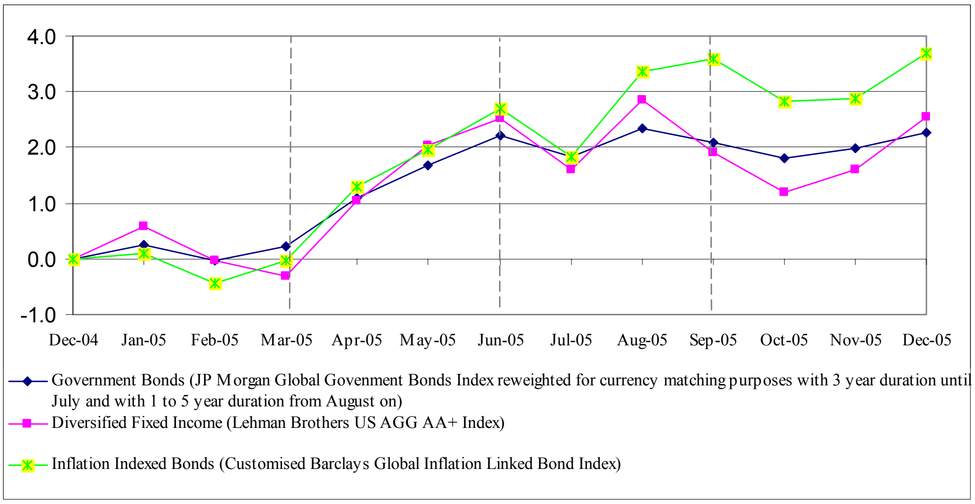
Country	Fourth Quarter 2005	Third Quarter 2005	Second Quarter 2005	First Quarter 2005	Year 2005	Year 2004
Australia	1.62	0.70	2.89	(0.29)	4.98	5.50
Belgium	(0.42)	(0.16)	2.15	0.54	2.11	4.90
Canada	(0.11)	(0.27)	2.38	0.02	2.00	5.03
Denmark	(0.44)	(0.09)	2.41	0.19	2.05	1.96
France	(0.37)	(0.12)	2.18	0.48	2.18	4.83
Germany	(0.37)	(0.15)	2.18	0.51	2.17	4.82
Italy	(0.33)	(0.07)	2.13	0.53	2.27	4.81
Japan	0.06	(0.61)	0.38	0.21	0.03	0.75
Netherlands	(0.42)	(0.07)	2.15	0.43	2.09	3.25
Spain	(0.41)	(0.05)	1.12	0.52	1.17	4.65
Sweden	(0.44)	(0.42)	2.71	0.93	2.79	6.06
United Kingdom	1.10	0.64	2.79	0.37	4.97	5.09
United States	0.63	(0.36)	1.80	(1.34)	0.70	1.40
Total Return [b]	**0.18**	**(0.12)**	**1.97**	**(0.04)**	**1.99**	**3.53**

[a] The index had a duration of one to five years from August 2005. Index duration was customized to approximately three years from 1 October 2003 until July 2005. Index duration was approximately six years in the first nine months to 30 September 2003.
[b] The total return is calculated by applying customized country weights due to IFAD’s currency matching needs.

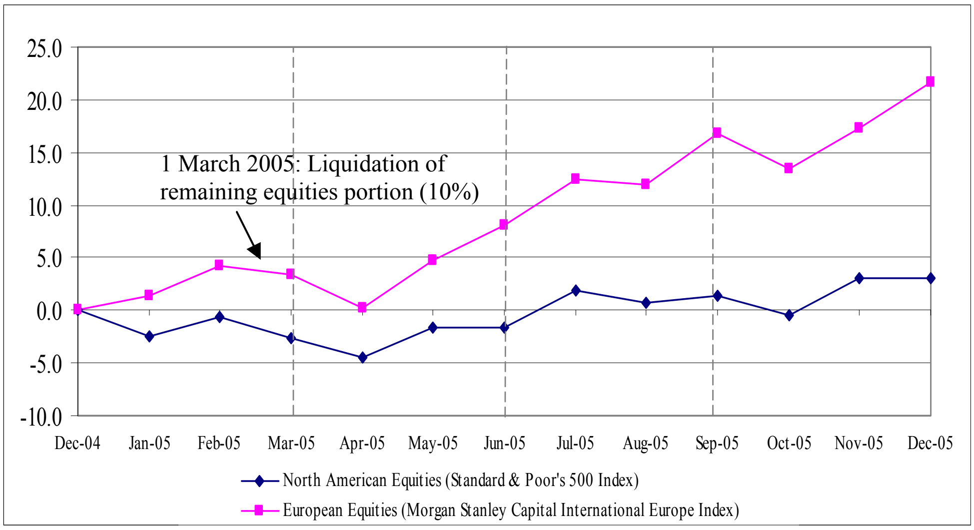
ANNEX VI

FIXED-INTEREST AND EQUITIES MARKET DEVELOPMENT IN 2005
(percentage in local currency terms)

Fixed-Interest Markets



Equities Markets



SUMMARY OF MOVEMENTS IN CASH AND INVESTMENTS IN THE EQUITIES PORTFOLIO – 2005

(USD ’000 equivalent)

	North American Equities [a]	European Equities [a]	Total Equities [a]
Opening balance (31 December 2004)	**168 123**	**115 021**	**283 144**
Net investment income	701	4 505	5 206
Transfers due to allocation	(168 981)	(116 841)	(285 822)
Transfers due to expenses/other income	157	(75)	82
Other net flows	-	-	-
Movements on exchange	-	(2 586)	(2 586)
Closing balance (31 December 2005) [b]	**-**	**-**	**-**
Actual allocation (%)	-	-	-

[a] Movements occurred during the two-month period from 1 January up to liquidation on 1 March 2005
[b] The remaining equities balance of USD 24 000 equivalent at 30 June 2005, reflecting tax receivables on dividends, is included in the balance of the internally managed short-term liquidity portfolio.

GROSS INCOME 2001-2005
(USD ’000 equivalent)

Overall Portfolio

	2005[c]	2004	2003	2002[b]	2001[a]
Capital gains/(losses)	(12 857)	31 529	38 400	(35 579)	(106 193)
Interest income	84 612	76 768	69 938	61 541	59 241
Dividends	755	6 204	4 709	7 652	13 614
Amortization	(1 619)				
Securities lending and commission recapture	802	738	430	436	841
Total gross income	**71 693**	**115 239**	**113 477**	**34 050**	**(32 497)**

Fixed-Interest Portfolio

	2005[c]	2004	2003	2002[b]	2001[a]
Capital gains/(losses)	(17 399)	12 748	(4 476)	55 177	2 136
Interest income	84 596	76 716	69 932	61 241	58 356
Dividends	-	-	-	-	-
Amortization	(1 619)	-	-	-	-
Securities lending and commission recapture	780	597	303	113	155
Total gross income	**66 358**	**90 061**	**65 759**	**116 531**	**60 647**

Equities Portfolio

	2005[c]	2004	2003	2002[b]	2001[a]
Capital gains/(losses)	4 542	18 781	42 876	(90 756)	(108 329)
Interest income	16	52	6	284	885
Dividends	755	6 204	4 709	7 652	13 614
Securities lending and commission recapture	22	141	127	323	686
Total gross income	**5 335**	**25 178**	**47 718**	**(82 497)**	**(93 144)**

[a] Net investment income earned in 2001 reflects the previous investment policy, which included up to 45% allocation to equities.
[b] In 2002, the equities allocation was reduced to 10%.
[c] In March 2005, the remaining equities portion was liquidated.

COMPOSITION OF THE FIXED-INTEREST PORTFOLIO BY TYPE OF INSTRUMENT AT 31 DECEMBER 2005
(USD ’000 equivalent)

	Short-Term Liquidity	Held-to-Maturity	Government Bonds	Diversified Fixed-Interest	Inflation-Indexed Bonds	Total Fixed-Interest
Cash[a]	50 122	10 916	83 094	33 410	57 669	235 211
Time deposits and other obligations of banks[b]	53 408	-	10 482	37 202	-	101 092
Global government bonds	-	278 493	839 619	174 562	344 080	1 636 754
Mortgage-backed securities	-	-	-	339 398	-	339 398
Asset-backed securities	-	-	-	56 322	-	56 322
Corporate bonds	-	101 471	14 012	18 299	-	133 782
Equities	-	-	-	-	-	-
Unrealized market value gain/(loss) on forward contracts	-	-	(886)	24	3 165	2 303
Unrealized gain/(loss) on futures	-	-	-	(50)	356	306
Options	-	-	-	-	14	14
Subtotal cash and investments	**103 530**	**390 880**	**946 321**	**659 167**	**405 284**	**2 505 182**
Receivables for investment sold	-	-	21 962	46 029	19 446	87 437
Payables for investments purchased	-	-	(37 323)	(206 735)	(796)	(244 854)
Total	**103 530**	**390 880**	**930 960**	**498 461**	**423 934**	**2 347 765**

[a] Includes cash in non-convertible currencies amounting to USD 69 000 equivalent (compared with USD 332 000 in 2004).
[b] Includes time deposits in non-convertible currencies amounting to USD 655 000 equivalent (compared with USD 386 000 in 2004).

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

I. INTRODUCTION

1. The following report on IFAD's investment portfolio covers the three-month period ending 31 December 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.

II. INVESTMENT POLICY

2. During the fourth quarter of 2005, IFAD received comments from its financial advisor, the World Bank, on (i) different benchmarks to evaluate held-to-maturity investments performance and (ii) the security selection process for the quarterly reinvestment of the held-to-maturity portfolio. The comments are being reviewed and a final decision with regard to the benchmark for the held-to-maturity portfolio will be taken early in 2006.

III. ASSET ALLOCATION

3. Table 1 shows the movements affecting the investment portfolio's major asset classes in the fourth quarter of 2005 and compares the portfolio's actual asset allocation to the policy allocation. During this period, a total of USD 43 000 000 equivalent were reallocated to the short-term liquidity portfolio to meet disbursement requirements. During the fourth quarter, there was a net outflow of USD 35 617 000 equivalent, representing a difference between disbursements for loans, grants and administrative expenses, and encashment of Member States' contributions.

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

	Short-Term Liquidity	Held-to Maturity (HTM)	Government Bonds	Diversified Fixed-Interest	Inflation Indexed Bonds	Overall
Opening balance (30 September 2005)	**96 441**	**391 500**	**976 479**	**507 849**	**438 949**	**2 411 218**
Net investment income/ (loss)	2 195	3 130	3 165	3 303	(756)	11 037
Transfers due to allocation	42 740	260	(30 000)	(13 000)	-	-
Transfers due to expenses	(994)	22	408	320	244	-
Other net flows[a]	(35 617)	-	-	-	-	(35 617)
Movements on exchange	(1 235)	(4 032)	(19 092)	(11)	(14 503)	(38 873)
Closing balance (31 December 2005)	**103 530**	**390 880**	**930 960**	**498 461**	**423 934**	**2 347 765**
Actual portfolio allocation (%)	4.4	16.6	39.7	21.2	18.1	100.0
Reclassification of HTM portfolio by asset class [b]	-	(390 880)	**144 704**	**246 176**	-	-
Closing balance with HTM portfolio reclassified	**103 530**	**-**	**1 075 664**	**744 637**	**423 934**	**2 347 765**
Actual asset allocation with HTM portfolio reclassified (%)	4.4	-	45.8	31.7	18.1	100.0
Policy allocation (%)	5.5		49.0	25.5	20.0	100.0
Difference in asset allocation (%)	**(1.1)**	**-**	**(3.2)**	**6.2**	**(1.9)**	**-**

[a] Disbursements for loans, grants and administrative expenses net of cash receipts and encashments of Member States' contributions.
[b] The assets of the held-to-maturity portfolio have been reclassified as part of government bonds (USD 144 704 000 equivalent) and diversified fixed-interest (USD 246 176 000 equivalent) according to the investment guidelines.

4. Changes in the portfolio's allocation ratios in the fourth quarter of 2005 also reflected positive movements in investment income and negative movements on exchange as other major currencies depreciated against the United States dollar. Particularly the government bonds and the inflation-indexed portfolios decreased in value as non-United States dollar investments represented about 75% and 90% respectively of their average holdings in the fourth quarter of 2005.

5. In the fourth quarter of 2005, the allocation to the government bonds and inflation indexed portfolios decreased, while increasing in the short-term liquidity and in the diversified fixed-interest portfolio. The excess allocation in the diversified fixed-interest portfolio mainly stems from its currency composition as this portfolio is almost entirely invested in bonds denominated in United States dollars. Therefore, unlike that of the investment portfolio's other asset classes, its market value was not affected by the movements on exchange. Furthermore, at 31 December 2005, almost 65% of the held-to-maturity portfolio was reclassified in the diversified fixed-interest asset class thereby further increasing its allocation.

IV. INVESTMENT INCOME

6. In the fourth quarter of 2005, fixed-interest markets showed a globally mixed performance. Markets performed positively in the United Kingdom, as the Bank of England revised its forecasts for economic growth and inflation downwards. Also in the United States, expectation that the Federal Reserve would stop raising interest rates and that the economy would slow down supported a modest rally in most fixed-interest markets. In Japan, fixed-income markets showed modest gains. In contrast, the outlook of stronger economic growth, rising interest rates and fears of inflation caused bond markets to perform negatively in the Eurozone.

7. Table 2 shows net investment income for the fourth quarter of 2005, year 2005 and prior periods for the investment portfolio's major asset classes. Aggregate net investment income in the fourth quarter of 2005 amounted to USD 11 037 000 equivalent, which, added to the net income of USD 57 193 000 equivalent for the first nine months of 2005, resulted in a cumulative net income of USD 68 230 000 equivalent in 2005 (2004 – USD 108 662 000).

Table 2: Net Investment Income by Asset Class – Fourth Quarter of 2005 and Prior Periods
(USD '000 equivalent)

Portfolio	Fourth Quarter 2005[b]	First Nine Months 2005	2005	2004	2003	2002[a]
Short-term liquidity	2 195	2 121	4 316	2 701	4 086	4 098
Held-to-maturity	3 130	6 978	10 108	-	-	-
Government bonds	3 165	21 848	25 013	38 675	36 735	85 541
Diversified fixed-interest	3 303	10 198	13 501	22 114	16 038	22 925
Inflation-indexed bonds	(756)	10 842	10 086	21 386	4 665	–
Equities	-	5 206	5 206	23 786	46 438	(86 378)
Overall portfolio	**11 037**	**57 193**	**68 230**	**108 662**	**107 962**	**26 186**

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

8. Table 3 provides details on net investment income earned in the fourth quarter of 2005 by the main fixed-interest sub-portfolios. All the sub-portfolios with the exception of the inflation-linked sub-portfolio contributed positively to the net investment income.

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

	Fourth Quarter of 2005						Year to Date 2005
	Short-Term Liquidity	Held-to-Maturity	Government Bonds	Diversified Fixed-Interest	Inflation-Indexed Bonds	Overall	Overall
Interest from fixed-interest investments and bank accounts	787	3 585	9 283	5 309	2 464	21 428	84 612
Dividend income from equities	-	-	-	-	-	-	755
Realized capital gains/(losses)	-	-	(1 518)	(4 131)	(555)	(6 204)	(2 686)
Unrealized capital gains/(losses)	-	-	(4 192)	2 453	(2 414)	(4 153)	(10 171)
Amortization[a]	-	(433)	-	-	-	(433)	(1 619)
Income from securities lending and commission recapture	-	17	80	73	30	200	802
Subtotal: gross investment income/(loss)	**787**	**3 169**	**3 653**	**3 704**	**(475)**	**10 838**	**71 693**
Investment manager fees	-	-	(385)	(325)	(210)	(920)	(3 830)
Custody fees	(10)	(7)	(24)	(26)	(28)	(95)	(486)
Financial advisory and other investment management fees	-	(32)	(79)	(42)	(36)	(189)	(604)
Taxes	1 418 [b]	-	-	-	-	1 418	1 548
Other investment expenses	-	-	-	(8)	(7)	(15)	(91)
Net investment income/(loss)	**2 195**	**3 130**	**3 165**	**3 303**	**(756)**	**11 037**	**68 230**

[a] A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments as per the International Financial Reporting Standards.
[b] Outstanding Italian taxes received from the Italian tax authority in November 2005 as, given its tax-exempt status, IFAD is not liable for withholding tax on income.

IV. RATE OF RETURN AND PERFORMANCE COMPARISON

9. There was an overall positive return of 0.44% in the fourth quarter of 2005, net of investment expenses and movements on exchange. Cumulatively, the overall net return for 2005 was 2.95%.

10. 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 indices used are the JP Morgan customized global government bonds index for government bonds, Lehman Brothers United States aggregate index for diversified fixed-interest bonds, and Barclays customized inflation-linked index for the inflation-indexed bonds portfolio.

11. Table 4 compares the return on each major sub-portfolio with the appropriate benchmark return. The overall portfolio showed an outperformance of 10 basis points in the fourth quarter of 2005, due to the government bonds portfolio and, to a lesser extent, to the diversified-fixed interest portfolio outperformance.

Table 4: Performance Compared with Benchmarks – Fourth Quarter and Year 2005
(percentage in local currency terms)

	Fourth Quarter 2005			Year 2005		
	Rate of Return %		Out/(Under)	Rate of Return %		Out/(Under)
Portfolio	**Portfolio**	**Benchmark**	**Performance**	**Portfolio**	**Benchmark**	**Performance**
Short-term liquidity portfolio	1.33	1.33	0.00	3.78	3.78	0.00
Held-to-maturity portfolio	0.78	0.78	0.00	2.53	2.53	0.00
Government bonds portfolio	0.39	0.18	0.21	3.00	2.27	0.73
Diversified fixed-interest portfolio	0.74	0.62	0.12	2.96	2.55	0.41
Inflation-indexed bonds portfolio	(0.08)	0.08	(0.16)	2.64	3.75	(1.11)
Total fixed-interest portfolio	**0.48**	**0.38**	**0.10**	**2.89**	**2.73**	**0.16**
North American equities portfolio	-	-	-	0.45	(0.69)	1.14
European equities portfolio	-	-	-	4.08	4.21	(0.13)
Total equities portfolio [a]	-	-	-	**1.92**	**1.30**	**0.62**
Overall portfolio gross rate of return	**0.48**	**0.38**	**0.10**	**3.10**	**2.87**	**0.23**
Less expenses	**(0.04)**	**(0.04)**	**0.00**	**(0.15)**	**(0.15)**	**0.00**
Overall portfolio net rate of return	**0.44**	**0.34**	**0.10**	**2.95**	**2.72**	**0.23**

[a] Rate of return over the two-month period from 1 January up to liquidation on 1 March 2005.

(a) **Government bonds portfolio.** The portfolio returned 0.39%, outperforming its benchmark by 21 basis points. The outperformance stemmed mainly from the managers' favourable duration management particularly in the Eurozone as the shorter portfolio duration held by some managers when compared to the benchmark protected the portfolio from somewhat rising yields in the Eurozone.

(b) **Diversified fixed-interest portfolio.** The portfolio returned 0.74%, outperforming its benchmark by 12 basis points. The main driver of the outperformance was a favourable sector allocation, whereby managers overweighted outperforming sectors like United States Treasuries and asset-backed securities. A somewhat unfavourable securities selection, particularly in the mortgage-backed sector, slightly reduced the outperformance.

(c) **Inflation-indexed portfolio.** The portfolio returned a negative 0.08%, underperforming its benchmark by 16 basis points. The underperformance was due to a somewhat unfavourable securities selection in European markets, and to the managers' underweighted positions in the outperforming United Kingdom inflation-indexed markets.