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**IFAD**  
**INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT**  
**Executive Board – Eighty-seventh Session**  
Rome, 19-20 April 2006

**REPORT ON IFAD'S INVESTMENT PORTFOLIO**  
**FOR THE FIRST QUARTER OF 2006**

**I. INTRODUCTION**

1. The following report on IFAD's investment portfolio presents data relating to the first two months of 2006, as the final data relating to March 2006 will become available from IFAD's Custodian only after finalization of this report. Accordingly, the information relating to the entire first quarter of 2006 covering performance attribution, currency composition and risk measurement will be presented as an annex to the report on the second quarter of 2006. The present report consists of four sections: investment policy; asset allocation; investment income; and rate of return and performance comparison.

**II. INVESTMENT POLICY**

2. There were no changes to the investment policy during the first two months of 2006.
3. Early in the first quarter of 2006, IFAD initiated a review of the investment portfolio's expected rate of return under different asset allocation scenarios. This analysis is done in cooperation with IFAD's financial advisor, the World Bank.

**III. ASSET ALLOCATION**

4. Table 1 shows the movements affecting the investment portfolio's major asset classes in the first two months of 2006 and compares the portfolio's asset allocation to the policy allocation. During the first two months of 2006, there was a net inflow of USD 7 912 000 equivalent into the internally managed portfolio, representing cash receipts and encashments of Member States' contributions, less disbursements for loans, grants and administrative expenses. Furthermore, USD 890 000 equivalent of received coupons was transferred from the held-to-maturity portfolio to the short-term liquidity portfolio.

5. Changes in the portfolio's allocation ratios also reflected positive movements in investment income and in exchange rates as other major currencies appreciated against the United States dollar. The government bonds and the inflation-indexed bonds portfolios, in particular, increased in value, as non-dollar investments made up about 75% and 90% respectively of their average holdings during the period.

**Table 1: Summary of Movements in Cash and Investments – First Two Months of 2006**  
(USD '000 equivalent)

	Short-term Liquidity	Held-to-Maturity (HTM)	Government Bonds	Diversified Fixed-interest	Inflation-indexed Bonds	Overall
<b>Opening balance (31 December 2005)</b>	<b>103 530</b>	<b>390 880</b>	<b>930 960</b>	<b>498 461</b>	<b>423 934</b>	<b>2 347 765</b>
Net investment income/(loss)	701	2 149	1 866	2 338	(381)	6 673
Transfers due to allocation	890	(890)	-	-	-	-
Transfers due to expenses	(687)	25	310	181	171	-
Other net flows <sup>a</sup>	7 912	-	-	-	-	7 912
Movements on exchange	744	2 012	9 381	(2)	5 988	18 123
<b>Closing balance (28 February 2006)</b>	<b>113 090</b>	<b>394 176</b>	<b>942 517</b>	<b>500 978</b>	<b>429 712</b>	<b>2 380 473</b>
Actual portfolio allocation (%)	4.8	16.6	39.6	20.9	18.1	100.0
Reclassification of HTM portfolio by asset class <sup>b</sup>	-	(394 176)	140 671	253 505	-	-
<b>Closing balance with HTM portfolio reclassified</b>	<b>113 090</b>	<b>-</b>	<b>1 083 188</b>	<b>754 483</b>	<b>429 712</b>	<b>2 380 473</b>
Actual asset allocation with HTM portfolio reclassified (%)	4.8	-	45.5	31.6	18.1	100.0
Policy allocation (%)	5.5	-	49.0	25.5	20.0	100.0
<b>Difference in asset allocation (%)</b>	<b>(0.7)</b>	<b>-</b>	<b>(3.5)</b>	<b>6.1</b>	<b>(1.9)</b>	<b>-</b>

<sup>a</sup> Cash receipts and encashments of Member States' contributions, net of disbursements for loans, grants and administrative expenses.

<sup>b</sup> The assets of the held-to-maturity portfolio have been reclassified as part of the government bonds (USD 140 671 000 equivalent) and diversified fixed-interest (USD 253 505 000 equivalent) portfolios according to the investment guidelines.

6. As at 28 February 2006, the investment portfolio showed an excess allocation in the diversified fixed-interest portfolio, offset by shortfalls in the remaining portfolios, especially in government bonds. The excess allocation to this portfolio is largely attributable to the reclassification of almost 65% of the held-to-maturity portfolio into the diversified fixed-interest asset class, thereby increasing its allocation.

#### IV. INVESTMENT INCOME

7. During first two months of 2006, fixed-interest markets performed rather neutrally, especially in the United States of America and in the Eurozone. Only the market in the United Kingdom of Great Britain and Northern Ireland showed a positive performance as a result of the country's slow economic growth outlook and strong demand for long-term securities from pension funds. On the other hand, the Japanese government bond market experienced some losses on the expectation that the Bank of Japan will cease its quantitative easing policy and eventually move away from its zero-interest-rate policy, thereby hurting fixed-interest investments. Inflation-linked markets were somewhat negatively impacted by slightly lower inflation expectations.

8. Table 2 shows the net investment income for the first two months of 2006 and prior years by the investment portfolio's major asset classes. Aggregate net investment income in the first two months of 2006 amounted to USD 6 673 000 equivalent.

**Table 2: Net Investment Income by Asset Class –  
First Two Months of 2006 and Prior Calendar Years  
(USD '000 equivalent)**

Portfolio	First Two Months of 2006	2005	2004	2003	2002
Short-term liquidity	701	4 316	2 701	4 086	4 098
Held-to-maturity	2 149	10 108	-	-	-
Government bonds	1 866	25 013	38 675	36 735	85 541
Diversified fixed-interest	2 338	13 501	22 114	16 038	22 925
Inflation-indexed bonds	(381)	10 086	21 386	4 665	-
Equities	-	5 206 <sup>b</sup>	23 786	46 438	(86 378) <sup>a</sup>
<b>Overall portfolio</b>	<b>6 673</b>	<b>68 230</b>	<b>108 662</b>	<b>107 962</b>	<b>26 186</b>

<sup>a</sup> In 2002, the equities allocation was reduced to 10% as per the investment policy decision in 2001.

<sup>b</sup> The remaining 10% of equities allocation was liquidated during the first quarter of 2005.

9. Table 3 provides details on net investment income earned in the first two months of 2006 by the main subportfolios. All the subportfolios, except the inflation-linked subportfolio, contributed positively to the net investment income.

**Table 3: Net Investment Income by Subportfolio – First Two Months of 2006  
(USD '000 equivalent)**

	Short-term Liquidity	Held-to-Maturity	Government Bonds	Diversified Fixed-interest	Inflation-indexed Bonds	Overall
Interest from fixed-interest investments and bank accounts	707	2 440	6 282	3 673	1 451	14 553
Realized capital gains/(losses)	-	-	(2 183)	574	444	(1 165)
Unrealized capital losses	-	-	(1 923)	(1 726)	(2 103)	(5 752)
Amortization <sup>a</sup>	-	(266)	-	-	-	(266)
Income from securities lending and commission recapture	-	15	59	39	19	132
<b>Subtotal: gross investment income/(loss)</b>	<b>707</b>	<b>2 189</b>	<b>2 235</b>	<b>2 560</b>	<b>(189)</b>	<b>7 502</b>
Investment manager fees	-	-	(271)	(158)	(125)	(554)
Custody fees	(6)	(7)	(21)	(20)	(29)	(83)
Financial advisory and other investment management fees	-	(33)	(77)	(42)	(36)	(188)
Taxes	-	-	-	-	-	-
Other investment expenses	-	-	-	(2)	(2)	(4)
<b>Net investment income/(loss)</b>	<b>701</b>	<b>2 149</b>	<b>1 866</b>	<b>2 338</b>	<b>(381)</b>	<b>6 673</b>

<sup>a</sup> 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.

## V. RATE OF RETURN AND PERFORMANCE COMPARISON

10. Performance is measured against preassigned independent benchmarks, indicating the return that would be expected through passive management of defined sectors of the market. The indexes used are the JP Morgan customized global government bonds index for government bonds, Lehman Brothers United States aggregate bond index for diversified fixed-interest bonds and Barclay customized inflation-linked index for the inflation-indexed bonds portfolio.

11. Table 4 compares the return on each major subportfolio with the appropriate benchmark return. The overall portfolio returned a positive 0.29% in the first two months of 2006, net of investment expenses and excluding the impact of foreign exchange movements. This implied an outperformance of 14 basis points against its aggregate benchmark. All three externally managed portfolios contributed to this outperformance.

12. Further performance attribution against benchmarks will be included in the annex covering the entire first quarter of 2006 (to be included in the report on the second quarter of 2006).

**Table 4: Performance Compared with Benchmarks –  
First Two Months of 2006**  
(percentage in local currency terms)

Portfolio	Rate of Return (%)		Out/(Under) Performance
	Actual	Benchmark	
Short-term liquidity portfolio	0.75	0.75	0.00
Held-to-maturity portfolio	0.54	0.54	0.00
Government bonds portfolio	0.25	0.04	0.21
Diversified fixed-interest portfolio	0.50	0.35	0.15
Inflation-indexed bonds portfolio	(0.06)	(0.09)	0.03
<b>Overall portfolio gross rate of return</b>	<b>0.32</b>	<b>0.18</b>	<b>0.14</b>
<b>Less expenses</b>	<b>(0.03)</b>	<b>(0.03)</b>	<b>0.00</b>
<b>Overall portfolio net rate of return</b>	<b>0.29</b>	<b>0.15</b>	<b>0.14</b>