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Investments of the United Nations Joint Staff Pension Fund

Report of the Secretary-General

I. Introduction

1. The management of the investments of the assets of the United Nations Joint Staff Pension Fund (UNJSPF) is the fiduciary responsibility of the Secretary-General of the United Nations, who acts in consultation with the Investments Committee, taking into account the observations on broad policy of the United Nations Joint Staff Pension Board (UNJSPB) and the General Assembly. The Investments Committee provides advice to the Secretary-General on investment strategy and reviews the investments of the Fund at its quarterly meetings. The Under-Secretary-General for Management has been designated as the representative of the Secretary-General for the investments of the Fund and has been delegated the responsibility for the management and administration of the investment of the assets of the Fund on behalf of the Secretary-General. The representative is assisted by the staff of the Investment Management Service. All investments must, at the time of initial review, meet the criteria of safety, profitability, liquidity and convertibility.

2. The present report gives information on the management of the investments of the Fund during the period from 1 April 2002 to 31 March 2004 and provides information on the investment returns, diversification of the investments and the development-related investments of the Fund.

II. Economic review

3. As the biennium began in the first quarter of 2002 and two years after equity markets around the world began their precipitous descent in March 2000, global economies still suffered from the aftershocks. During April and May 2002, the economy of the United States of America showed signs of improvement but by the end of the quarter economic data again began to show signs of deterioration as gross domestic product (GDP) growth in the United States slowed to 1.3 per cent. In the

third quarter of 2002, GDP grew faster, rising 4.2 per cent. Consumer sentiment as measured by the Conference Board's index of consumer confidence, however, plunged to a nine-year low in October 2002. The only positives were resilient housing sales and Government spending, which rose by 2.9 per cent in the third quarter of 2002. Continued low inflation raised expectations that the Federal Reserve Bank might further cut interest rates by year-end, despite levels at a 41-year low. The Federal Reserve Bank did indeed pitch in once again in November, lowering the Federal Funds rate to a record low 1.25 per cent and the discount rate to 0.75 per cent in an effort to offset an unemployment rate that rose to an eight-year high of 6.0 per cent from 5.6 per cent in September.

4. The same factors that plagued the economy at the close of 2002 continued to have an impact on the United States economy in the first quarter of 2003 as the threat of war in Iraq, the outbreak of war and turmoil in financial markets took their toll on consumer confidence and spending and on industrial production and business capital expenditures. The Federal Reserve Bank again cut the overnight lending rate by 25 basis points. In the fourth quarter of 2003, GDP rebounded ahead at an 8.2 per cent growth rate, the strongest economic pick-up reported in two decades.

5. Job creation remained anaemic into 2004 but finally, in March 2004, job growth of 308,000 confirmed the positive upswing in the United States economy. Still, the record federal budget deficit and the war in Iraq weighed on the minds of consumers and the presidential election looms large in November 2004. Another cause for concern emerged when the March consumer price index rose an unexpected 0.5 per cent and, more ominously, 0.4 per cent ex-food and energy, following core consumer price index increases of a tame 0.2 per cent in both January and February. Fears of sooner-than-expected interest rate hikes arose and cast doubts on the sustainability of the corporate profit expansion begun just a year earlier.

6. The Canadian economy benefited from less exposure to the bursting of the technology bubble, from being a net exporter of energy and from a weak currency, and continued to outpace the economies of the Group of Seven countries in the first quarter of 2003 as GDP grew at 6 per cent. The Bank of Canada had raised interest rates four times in the past year and the higher interest rates had increased demand for Canadian interest-bearing securities and caused the Canadian dollar to rise to a three-year high. The conflict in Iraq and a strike in Venezuela caused a sharp rise in the price of oil, hitting US$ 37.83 a barrel at the beginning of March. Even though oil companies benefited, industries and businesses in general worried over higher costs as a result. In the second quarter of 2003, Canada found itself in the enviable position of being the only Group of Seven country with a budget surplus, while its current account was also in surplus but the economy was beginning to feel the impact of slow United States economic growth, severe acute respiratory syndrome (SARS), mad cow disease and a stronger Canadian dollar. The Bank of Canada lowered its overnight rate on 15 July by one quarter of 1 per cent to 3 per cent based on a greater than expected decline in expectations for both inflation and economic activity and followed up by cutting rates twice in the third quarter of 2003. This took the upward pressure off the Canadian dollar, which nonetheless rose by 18.2 per cent versus the United States dollar in 2003, contributing to the slowdown in GDP growth to 1.7 per cent for the year.

7. During 2002, European economies continued their economic expansion, after the decelerations experienced during the previous biennium. However, the rebound was mild, with GDP growth of only 1.0 per cent. Interest rates remained low, as well as inflation, which remained under control and below the 2 per cent level. GDP growth continued, owing mostly to the fiscal deficits that incurred in several of the major economies on the continent, in order to maintain domestic demand. The beginning of the year 2003 showed signs of economic deceleration throughout Europe. The main European currencies strengthened versus the United States dollar during the period; in particular the euro experienced an upward trend, culminating in an appreciation of over 40 per cent, creating a lot of concerns and worries about the performance of the European export sector.

8. The Japanese economy continued suffering from deflation, even though the Government tried to stimulate demand by using anti-deflationary measures. The Bank of Japan also introduced unconventional measures by buying stocks directly from financial institutions. Nominal GDP declined 3.9 per cent from the previous year in the first quarter of 2002; it was one of the largest declines in decades. While things have picked up since, the economy had negative growth for eight consecutive quarters until the first quarter of 2003. While the Japanese economy remained fragile, it started to show some rekindling in the second half of 2003. As global demand recovered, especially in the United States and China, business confidence in large corporations turned positive in the third quarter of 2003 and some progress was made to address non-performing loans in the financial sectors. The yen appreciated steadily over the period. In early 2002, it was near 135 yen per United States dollar. Since then the currency has risen to 107 despite massive intervention by the Bank of Japan.

9. During the biennium the SARS virus seriously affected many economies in the Asian/Pacific region. Economic activities, including exports, production and consumption, were paralysed and real GDP for Hong Kong, Special Administrative Region of China, and Singapore were negative in the second quarter of 2003. However, economies quickly recovered as the SARS virus was contained, and were also helped by strong United States demand growth, especially for technology related products. The Australian economy grew steadily during the biennium. Broad-based growth was seen in this region where exports are strong, in particular commodity demand from China. The Australian dollar sharply strengthened versus the United States dollar, from US$ 0.485 per Australian dollar in September 2001 to US$ 0.75 per Australian dollar at the end of 2003.

10. The emerging economies in Asia staged a generally strong recovery during the period under review. China remained the fastest growing economy in the region, with GDP growth of almost 10 per cent per annum from March 2002 to March 2004. In Latin America and the Caribbean, economies benefited from strong commodity prices. In Brazil, the current account surplus grew from less than US$ 600 million in March 2002 to above $2,600 million in March 2004. However, GDP growth in Brazil remained sluggish owing to tight, though easing, monetary conditions. Mexico also suffered from a lack of growth, as unemployment rose and domestic consumption was slow. At the same time, its current account deficit shrank considerably. In Eastern Europe, the economic performance among countries was uneven. A high current account and budget deficit in Hungary caused speculative attacks on its currency, forcing rate hikes, which in turn crippled economic growth. Polish unemployment remained above 18 per cent throughout the period under

review, pointing to deep structural issues that have yet to be addressed. The economy of the Russian Federation enjoyed strong growth benefiting from high energy prices. In South Africa, GDP growth plummeted to 1.5 per cent year-on-year in December 2003. A strong South African rand negatively affected the country's budget and job creation.

III. Diversification

11. Diversification is the investment of assets among a variety of securities or among securities in a variety of markets with the goal of reducing risk in a portfolio without reducing the expected return. The Fund's policy of broad diversification of its investments by currency, types of asset classes and geographical areas continued to be the most reliable method of reducing risk and improving returns over long periods of time. UNJSPF is unique among major pension funds in its commitment to global investment.

12. The financial markets were, for the most part, very volatile around the announcements of improving economic data and the start of the war in Iraq in the first quarter of 2003. During the biennium under review, for a brief period, both equities and bonds showed positive returns. The equities exposure was increased to 59.7 per cent during the biennium, from 57.0 per cent on 1 April 2002, as the global economies recovered. Equities hit their lowest level of exposure during the biennium of 47.6 per cent in September 2002. The bond portfolio was increased to 28.9 per cent on 31 March 2004 from 27.9 per cent on 1 April 2002. Bonds reached a high of 34.5 per cent of the total portfolio in September 2002. Exposure to real estate grew to 6.3 per cent from 5.4 per cent during the biennium, and benefited from the historic lows in global interest rates. Short-term investments decreased to 5.1 per cent from 9.7 per cent during the same period, as investments in equities were increased with improved outlook. Short-term investments reached their highest exposure of 12.7 per cent in November 2002.

13. In addition to changing the proportions of the various asset classes in the portfolio, changes were made within asset classes to implement the Fund's investment strategy and to take advantage of new trends in economic cycles and financial markets as well as movements in currencies and interest rates. Exposure to European currencies was increased, while exposure to the United States dollar was reduced, in anticipation of a dollar decline. During the biennium, the proportion of investments in United States dollars was decreased to 48.9 per cent from 56.6 per cent, the proportion of investments in major European currencies was increased to 35.3 per cent from 27.8 per cent, and the proportion of investments in Japanese yen was reduced to 4.4 per cent from 5.3 per cent. This broad diversification of the Fund reduces risk across currencies and markets.

14. In terms of geographical diversification, the proportion of the Fund invested in North America declined to 43.3 per cent in March 2004 from 49.4 per cent in March 2002. Investments in Europe increased to 37.1 per cent from 34.0 per cent, while in Asia and the Pacific, the proportion of investments increased by 0.7 per cent during the same period. With geographic changes, currency diversification also changed. Diversification in terms of asset class, currency and region had a significant impact on the performance of the Fund. Investing in only one currency other than the United States dollar would have had a negative impact on the performance, as the

movements of the currencies against the dollar are not synchronized. There were several times when the total returns were negative in local currencies but positive in dollar terms. Areas of the Fund's investment are shown in table 1 below:

Table 1
Total Fund: countries/areas of investments[a]
Market value as at 31 March 2004
(In millions of United States dollars)

Countries/areas	*Total*	*Percentage*
Argentina	0.0	0.00
Australia	589.4	2.21
Austria	52.4	0.20
Belgium	131.0	0.49
Brazil	105.8	0.40
Canada	855.9	3.21
Chile	48.7	0.18
China	90.6	0.34
Denmark	350.7	1.31
Egypt	0.0	0.00
Emerging markets	84.7	0.32
Finland	223.4	0.84
France	1 614.3	6.05
Germany	1 374.5	5.15
Ghana	3.34	0.01
Greece	125.3	0.47
Hong Kong Special Administrative Region, China	152.1	0.57
Hungary	113.1	0.42
Iceland	0.0	0.00
India	67.1	0.25
Ireland	356.4	1.34
Israel	76.2	0.29
Italy	603.5	2.26
Japan	1 509.7	5.66
Jordan	4.6	0.02
Kenya	0.0	0.00
Malaysia	39.1	0.15
Mauritius	0.0	0.00
Mexico	203.1	0.76
Netherlands	544.6	2.04
New Zealand	251.9	0.94
Norway	171.9	0.64
Pakistan	0.0	0.00

Countries/areas	*Total*	*Percentage*
Peru	0.0	0.00
Philippines	0.0	0.00
Poland	2.7	0.01
Portugal	156.3	0.59
Qatar	30.1	0.11
Republic of Korea	453.7	1.70
Saudi Arabia	12.7	0.05
Singapore	64.4	0.24
Slovenia	156.3	0.59
South Africa	203.1	0.76
Spain	447.1	1.68
Sweden	780.4	2.92
Switzerland	538.8	2.02
Taiwan Province of China	32.7	0.12
Tunisia	0.0	0.00
Turkey	0.0	0.00
United Kingdom of Great Britain and Northern Ireland	2 278.4	8.54
Zimbabwe	0.0	0.00
Regional institutions (Africa)	124.2	0.47
Regional institutions (Asia)	235.9	0.88
Regional institutions (Europe)	454.5	1.70
Regional institutions (Latin America)	76.1	0.29
International institutions	1 184.6	4.44
Total outside the United States	**16 011.8**	**60.0**
United States	10 673.3	40.0
Total Fund	**26 685.1**	**100.0**

[a] Country of investment is generally based on domicile of issuer. Convertible securities are classified by security into which they are convertible. Various investment trusts, which trade in currencies other than the currency of investments, are classified under the countries.

IV. Investment returns

A. Total return

15. The market value of the Fund’s assets increased to US$ 26,589 million on 31 March 2004 from $21,789 million on 31 March 2002, an increase of $4,800 million, or 22.0 per cent. The total investment return for the year ended 31 March 2003 was negative 3.8 per cent and positive 28.7 per cent for the year ended 31 March 2004. After adjustment by the United States consumer price index, these returns represent real rates of return of negative 6.6 per cent and positive 26.5 per

cent, respectively. The total annualized real rate of return for the biennium was therefore positive 8.7 per cent.

16. Owing to the strong performance in 2004, with positive 28.7 per cent for total assets, the Fund recorded the historical high in terms of value in March 2004, recovering from negative returns in real terms for the years from 2001 to 2003. During the biennium, all asset classes contributed to the return. As an asset class, bonds contributed most, with returns of 28.4 per cent in 2003 and 15.7 per cent in 2004. Equities showed a negative return of 23.1 per cent in 2003, but sharply rebounded by 42.5 per cent in 2004. Real estate performance was 8.5 per cent in 2003 and 23.9 per cent in 2004. Table 2 below shows the total return for the past four years.

Table 2
Total Fund: total return based on market value for the years ending 31 March
(Percentage)

	2001	*2002*	*2003*	*2004*
Equities				
United States equities	-17.2	2.8	-23.9	29.3
Equities outside United States	-30.3	-6.1	-21.7	56.5
Total equities	-24.2	-1.3	-23.1	42.5
Bonds				
United States dollar bonds	13.0	4.9	15.9	6.8
Non-United States dollar bonds	-4.2	2.1	34.9	19.4
Total bonds	2.0	3.1	28.4	15.7
Real estate	11.3	8.4	8.5	23.9
Short-term investments	4.2	3.5	11.1	8.1
Total Fund	**-15.0**	**0.7**	**-3.8**	**28.7**

17. The rates of return shown in the present report have been calculated by an outside consultant, using a generally accepted method that was fully explained in the report on the management of the investments submitted to the Board at its thirty-fourth session (JSPB/34/R.10). The calculation includes actual income received from dividends and interest as well as realized capital gains and losses. It also takes into account changes in the market value of the investments and the timing of cash flows.

B. Long-term rates of return

18. Historically equity markets had strong positive returns from 1993 to 2000 but declined sharply in the following three consecutive years. For the past three years of 2002, 2003 and 2004, the returns for the total Fund were positive 0.7 per cent, negative 3.8 per cent and positive 28.7 per cent, respectively.

19. The cumulative annualized total returns for the past 5, 10, 15, 20 and 25 years were approximately 4.6 per cent, 8.6 per cent, 9.0 per cent, 10.7 per cent and 10.7 per cent, respectively. The cumulative annualized total rate of return over the 44-year period for which data was available was 8.6 per cent, representing a yearly real rate of return of 4.1 per cent after adjustment by the United States consumer price index.

C. Comparisons of investment returns

20. The Fund continues to be the most widely diversified pension fund that maintains its accounts in United States dollars but has liabilities in several other currencies. At the end of the period under review, UNJSPF had more than half of its assets in currencies other than the United States dollar.

21. During the year ended 31 March 2003, the Fund outperformed its benchmark, which is composed of 60 per cent Morgan Stanley Capital International (MSCI) World Index and 40 per cent Citigroup World Government Bond Index (CWGBI) with a return of negative 3.8 per cent versus negative 6.5 per cent for the benchmark. For the year ended 31 March 2004, the Fund underperformed the benchmark with the return of 28.7 per cent versus 31.5 per cent. Over the past 20 years, the Fund achieved a cumulative return of 10.7 per cent, slightly outperforming the benchmark (10.6 per cent). In the earlier years, the Fund underperformed, mainly owing to its low weighting in equities, but the Fund has caught up rapidly since 2000 owing to outperformance in both equities and bonds. Over the past 20 years, the MSCI World Index had a total annualized return of 11.1 per cent, compared with an annualized return of 10.7 per cent achieved by the Fund’s total equities. During the same period, the CWGBI had an annualized return of 9.7 per cent, compared with an annualized return of 11.0 per cent achieved by the Fund’s bond portfolio. Tables 3 and 4 below show the total rate of return by asset class since 1961.

Table 3
Total Fund: annual total rate of return, percentages based on market value, 31 March 1962-31 March 2004

	Equities				*Bonds*							
Year	*United States*	*Outside United States*	*Total*	*MSCI World Index*[a]	*United States*	*Outside United States*	*Total*[b]	*CWGBI Bond Index*[c]	*Real estate*	*Short term*	*Total Fund*	*Year*
1961	18.8	37.8	19.4	-		-	8.0	-	-	-	12.7	1961
1962	12.37	0.87	11.65	-	-	-	3.91	-	-	-	6.61	1962
1963	(0.60)	(16.34)	(0.59)	-	-	-	5.49	-	-	-	4.07	1963
1964	18.18	7.48	17.45	-	-	-	2.12	-	-	-	8.24	1964
1965	10.89	8.30	10.44	-	-	-	4.41	-	-	-	6.98	1965
1966	4.53	3.22	4.31	-	-	-	(2.14)	-	-	-	0.66	1966
1967	11.76	(2.32)	8.98	-	-	-	3.97	-	-	-	7.91	1967
1968	2.86	28.30	7.46	-	-	-	(4.89)	-	-	-	1.60	1968
1969	13.35	20.07	14.64	-	-	-	2.66	-	-	-	9.09	1969
1970	(5.10)	(2.18)	(4.49)	-	-	-	1.41	-	-	-	(1.75)	1970
1971	13.94	3.31	11.46	9.28	-	-	14.10	-	-	8.73	13.53	1971
1972	14.13	34.30	18.33	16.92	-	-	9.41	-	11.58	7.15	16.98	1972
1973	5.85	20.77	9.49	13.47	-	-	7.40	-	4.78	5.92	8.55	1973
1974	(16.70)	(21.48)	(18.10)	(16.40)	-	-	1.92	-	10.18	10.70	(13.55)	1974
1975	(11.20)	11.60	(5.16)	(6.09)	6.20	14.63	6.55	-	(1.03)	12.35	0.18	1975
1976	16.37	10.76	14.58	15.59	11.22	1.91	10.02	-	5.16	7.70	13.16	1976
1977	(8.25)	(3.75)	(6.62)	(0.95)	10.40	15.20	11.06	-	3.70	5.20	(0.26)	1977
1978	(5.60)	20.31	4.16	6.11	5.62	24.39	8.72	-	8.25	7.67	6.12	1978
1979	22.36	21.67	22.07	21.27	4.70	12.50	6.63	8.04	16.86	8.56	15.07	1979
1980	10.89	(10.31)	1.08	(0.18)	(9.53)	(4.64)	(7.63)	(13.16)	17.42	11.75	(0.39)	1980
1981	43.19	39.60	41.45	34.80	14.99	9.45	12.51	20.38	14.71	15.76	26.60	1981
1982	(17.88)	(19.64)	(18.77)	(15.00)	11.08	0.40	6.20	(0.69)	17.51	17.95	(7.85)	1982
1983	40.91	23.60	33.55	31.60	32.53	14.54	24.89	20.54	7.07	12.76	27.05	1983
1984	5.08	32.46	15.66	17.30	5.46	12.42	8.67	8.20	13.33	13.07	13.01	1984
1985	20.75	(6.82)	9.54	7.20	17.86	(8.22)	4.53	5.50	13.47	3.62	8.09	1985
1986	34.95	58.48	43.44	56.02	54.30	50.33	51.21	48.70	10.75	6.95	41.52	1986
1987	21.63	43.88	30.01	43.22	9.14	32.63	22.59	17.42	12.67	11.97	24.69	1987

	Equities				*Bonds*							
Year	*United States*	*Outside United States*	*Total*	*MSCI World Index*[a]	*United States*	*Outside United States*	*Total*[b]	*CWGBI Bond Index*[c]	*Real estate*	*Short term*	*Total Fund*	*Year*
1988	(12.18)	2.15	(4.74)	5.81	3.26	20.24	12.65	11.42	9.19	7.67	3.10	1988
1989	13.20	10.00	11.30	13.56	2.10	(5.50)	(2.40)	0.36	8.20	10.40	5.90	1989
1990	21.54	13.21	16.57	(2.30)	10.47	2.93	6.20	3.12	12.31	9.72	11.56	1990
1991	8.9	1.2	4.5	3.2	12.5	17.4	15.0	16.2	5.1	13.1	8.9	1991
1992	11.3	0.1	4.9	(0.5)	13.7	14.0	14.0	14.0	(4.1)	6.5	7.6	1992
1993	17.3	6.7	11.2	12.7	15.9	17.7	16.9	19.0	(6.6)	7.5	11.6	1993
1994	(2.7)	24.4	12.4	14.0	3.4	10.1	7.7	6.8	0.5	3.0	9.7	1994
1995	11.1	6.5	8.1	9.8	2.9	18.6	12.9	12.1	0.0	5.0	8.7	1995
1996	30.2	15.1	20.5	20.6	8.0	3.3	5.1	5.3	10.4	4.1	14.6	1996
1997	18.9	7.2	11.6	9.8	6.2	2.5	3.6	1.2	8.6	4.4	8.9	1997
1998	45.4	15.4	27.3	32.4	10.6	4.3	7.0	5.4	18.9	7.0	20.4	1998
1999	18.4	9.7	13.9	13.0	4.8	9.0	6.5	10.0	4.8	9.9	11.3	1999
2000	17.5	39.9	28.5	21.6	3.1	(5.7)	(2.5)	(0.3)	11.7	3.0	18.0	2000
2001	(17.2)	(30.3)	(24.2)	(25.1)	13.0	(4.2)	2.0	(1.7)	11.3	4.2	(15.0)	2001
2002	2.8	(6.1)	(1.3)	(4.2)	4.9	2.1	3.1	0.5	8.4	3.5	0.7	2002
2003	(23.9)	(21.7)	(23.1)	(24.2)	15.9	34.9	28.4	25.2	8.5	11.1	-3.8	2003
2004	29.3	56.5	42.5	43.9	6.8	19.4	15.7	13.5	23.9	8.1	28.7	2004

[a] MSCI — Morgan Stanley Capital International Index consists of 22 major equity markets.
[b] The proportion of bonds held outside the United States was not significant prior to 1975.
[c] CWGBI — Citigroup World Government Bond Index consists of 18 major bond markets.

Table 4

Total Fund: annual rates of return based on market value
Percentages for selected periods ending 31 March

	2004	*2003*	*2002*	*5 years through 2004*	*10 years through 2004*	*15 years through 2004*	*20 years through 2004*	*25 years through 2004*	*44 years through 2004*[a]
United States equities	29.3	-23.9	2.8	(0.3)	11.5	11.3	12.1	12.5	9.5
Equities outside United States	56.5	-21.7	-6.1	2.3	6.3	7.1	10.0	10.1	9.4
Total equities	**42.5**	**-23.1**	**-1.3**	**1.0**	**8.3**	**8.8**	**10.7**	**11.1**	**9.2**
United States bonds	6.8	15.9	4.9	8.6	7.7	8.8	10.7	10.6	8.1
Bonds outside United States[b]	19.4	34.9	2.1	8.2	7.8	9.3	10.9	9.9	8.9
Total bonds	**15.7**	**28.4**	**3.1**	**8.8**	**7.9**	**9.2**	**11.0**	**10.5**	**8.2**
Real estate related[c]	23.9	8.5	8.4	12.6	10.5	7.4	8.2	9.3	-
Short-term investments	8.1	11.1	3.5	6.6	6.6	7.1	7.3	8.6	-
Total Fund in United States dollars	**28.7**	**-3.8**	**0.7**	**4.6**	**8.6**	**9.0**	**10.7**	**10.7**	**8.6**
Inflation-adjusted return (based on US computer price index)	26.5	-6.6	-0.8	1.9	6.1	5.9	7.4	6.4	4.1

[a] The Fund's performance has been calculated for the past 44 years.
[b] The proportion of bonds held outside the United States was not significant prior to 1975.
[c] No real estate investments were held prior to 1972.

D. Risk return profile

22. Over the past 20 years, the Fund's average annual return of 11.3 per cent was in line with the benchmark's return of 11.4 per cent, but the Fund's volatility, 11.9 per cent, was substantially less than that of the benchmark, 14.4 per cent. The Fund had a better risk return profile because it has a well-diversified portfolio that includes all major asset classes and its holdings are concentrated in blue chip companies.

23. Within asset classes, the Fund's equity portfolio slightly underperformed (12.1 per cent average annual rate) versus the MSCI World Index (12.9 per cent), but the equity portfolio had a much better risk profile (17.7 per cent) compared with MSCI World Index (20.4 per cent). The bond portfolio (11.6 per cent) outperformed CWGBI (10.1 per cent) but had slightly higher volatility (12.2 per cent) compared with CWGBI (10.0 per cent). This can be explained by the fact that the Fund had some exposure to non-government bonds, which are not part of CWGBI.

V. Investments in developing countries

24. In its resolution 36/119 of 10 December 1981 on the investments of the Fund, the General Assembly endorsed the policy of diversification of the investments of the Fund in developing countries. The investments are made wherever this serves the interests of participants and beneficiaries. The Fund continued to pay attention to development-related investments during the last biennium. Direct and indirect investments in developing countries amounted to US$ 1.7 billion on 31 March 2004, an increase of 55 per cent from $1.1 billion at cost on 31 March 2002. Details of the investments are provided in table 5 below. Most of the increase was in the African region as the Fund added investments in South African equities and bonds. Investments in Asia increased, particularly in the Republic of Korea and China. Development-related investments accounted for approximately 8.7 per cent of the Fund's assets at book value. The holdings were 49 per cent in United States dollar denominated investments and 51 per cent in currencies other than the United States dollar.

25. IMS continued to have contacts with the World Bank, the International Monetary Fund, regional development banks and emerging market fund managers to explore possible investment opportunities in developing countries. Investment visits were undertaken in Africa, Asia and Eastern Europe during the period under review. The Fund continues to review its exposure in these markets in search of suitable investment instruments while taking into account the overall investment criteria and strategy of the Fund. Table 5 below shows the Fund's investments in developing countries by book value in 2002 and 2004.

Table 5
Development-related investment book value as at 31 March 2002 and 31 March 2004
(in thousands of US dollars)

	United States dollars	*Other currencies*	*Total 2002*	*Total 2004*
Africa				
Egypt	0		7 020	0
Ghana	1 830		7 122	1 830
Kenya		0	219	0
South Africa	36 227	109 624	25 318	145 851
Tunisia	0		4 350	0
Zimbabwe		22	2 935	22
Regional funds	12 753		6 652	12 753
Subtotal	**50 810**	**109 646**	**53 616**	**160 455**
Development institutions	95 097		54 547	95 097
Total Africa	**145 907**	**109 646**	**108 163**	**255 553**
Asia				
China	38 639	71 798	94 298	110 437
Hong Kong, Special Administrative Region, China	0	104 029	39 469	104 029
India	21 501	104	26 824	21 604
Jordan		845	4 359	845
Malaysia		23 371	21 898	23 371
Malta	0		19 926	0
Philippines		0	25 380	0
Qatar	29 490	0	20 680	29 490
Republic of Korea	124 147	198 877	114 877	323 024
Saudi Arabia	5 125	0	5 125	5 125
Singapore	0	48 157	36 487	48 157
Regional funds	21 611	20 589	84 057	42 200
Subtotal	**240 513**	**467 770**	**493 380**	**708 283**
Development institutions	23 008	0	19 751	23 008
Total Asia	**263 521**	**467 770**	**513 131**	**731 291**
Europe				
Cyprus	0	43 817	43 817	43 817
Subtotal	**0**	**43 817**	**43 817**	**43 817**
Total Europe	**0**	**43 817**	**43 817**	**43 817**

	United States dollars	Other currencies	Total 2002	Total 2004
Latin America				
Brazil	54 673	41 068	66 769	95 741
Chile	40 292	0	40 769	40 292
Mexico	84 409	162 218	117 698	246 627
Peru	0	0	0	0
Regional funds	30 564	0	5 463	30 564
Subtotal	**209 938**	**203 286**	**230 699**	**413 224**
Development institutions	39 647	0	54 885	39 647
Total Latin America	**249 585**	**203 286**	**285 584**	**452 871**
Other development institutions				
International Bank for Reconstruction and Development	101 808	50 400	101 808	152 208
Fiduciary Emerging Markets Bond Fund	19 660		12 151	19 660
Emerging Market Investors Fund	45 059		30 359	45 059
Total Other development institutions	**64 719**	**0**	**42 510**	**64 719**
Total	**825 539**	**874 919**	**1 095 013**	**1 700 458**

VI. Conclusion

26. For the second consecutive biennium, the financial markets experienced huge volatility as global economies struggled with overcapacity in many industries brought online by the frenzied capital expenditures during the approach of the millennium and the accompanying year 2000 concerns, now just a distant memory. Still, the after-effects of excess investment and the equity bubble that resulted are only now receding. During this past biennium, global economies experienced low inflation — and in some cases like Japan, deflation — as excess capacity led to oversupply and lack of demand. This in turn prompted a cascade of interest rate cuts to levels unseen in almost half a century in some countries like the United States. Government budget deficits also ballooned in the United States, Japan and many European countries as money was pumped into economies to bolster demand and stimulate growth. Only at the end of the biennium did that growth begin to emerge. In the interim, financial markets also contended with accounting fraud and corporate malfeasance, SARS, mad cow disease and war.

27. During the biennium, the Fund maintained its long-term, large capitalizations blue-chip orientation. During the period, the United States dollar reversed its upward moves of the previous biennium to experience an almost continual decline against other major currencies, ending the biennium down 41 per cent against the euro, 30 per cent versus the pound sterling, 29 per cent against the Japanese yen and 25 per cent against the Swiss franc. The Investment Management Service reallocated Fund assets to Europe from the United States in both equities and bonds early in the biennium.

28. The arrival of the new and current biennium brought brighter news on the economic front but financial markets were distracted because of a recurrence of inflation as a negative force, as commodity prices jumped owing to demand from emerging powerhouse China and oil prices surged owing to upheaval in the Middle East. If low inflation departs the economic scene, its long-time companion, low interest rates, is feared to follow shortly. Thus, uncertainty continues to prevail at the beginning of the current biennium. The Investment Management Service continues to monitor both perils and opportunities for the Fund's assets, always bearing in mind the long-term objectives of the Fund.