United Nations A/C.5/61/2

General Assembly

Distr.: General
10 October 2006

Original: English

Sixty-first session
Fifth Committee
Agenda item 126
United Nations pension system

Investments of the United Nations Joint Staff Pension Fund and steps and efforts undertaken to increase diversification

Report of the Secretary-General

I. Introduction

1. The management of the investments of the assets of the United Nations Joint Staff Pension Fund is the fiduciary responsibility of the Secretary-General of the United Nations, who acts in consultation with the United Nations Investments Committee, taking into account the observations on broad policy of the United Nations Joint Staff Pension Board 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 the Representative of the Secretary-General for the Investments of the Fund and has been delegated the responsibility for the oversight 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 2004 to 31 March 2006 and provides information on investment returns, diversification of investments and development-related investments of the Fund.

II. Changes during the biennium

3. During the biennium ended 31 March 2006, a new long-term strategic asset allocation was adopted to reflect the Fund's long-term asset exposure more accurately. The new benchmark consists of 60 per cent Morgan Stanley Capital International (MSCI) All Country Index, 31 per cent Lehman Brothers Global

Aggregate Bond Index, 6 per cent National Council of Real Estate Investment Fiduciaries Property Index and 3 per cent 91-Day United States Treasury Bills, whereas the old benchmark consisted of 60 per cent MSCI World Index and 40 per cent Citigroup World Government Bond Index (CWGBI). The equity benchmark was changed from MSCI World Index to MSCI All Country Index to reflect the Fund's long-term strategic exposures to emerging markets. The bond benchmark was changed from CWGBI to Lehman Brothers Global Aggregate Index to more accurately reflect the Fund's long-term strategic exposures to the non-government sector. The tactical asset allocation range was further decided to be a deviation of plus or minus 3 percentage points from the strategic asset allocation.

4. There has been one change in the Fund's advisory arrangements. The contract of one of the Fund's European small-capitalization account managers, namely, Lombard Odier Darier Hentsch & Cie, was terminated due to its persistent underperformance for the past few years. The Fund now has five discretionary advisers who manage small-capitalization accounts. As at 31 March 2006, the amount under management by the discretionary managers was $1,684 million. The Fund has four non-discretionary advisers for large-capitalization stocks, real estate and fixed-income assets.

5. The assets of the Fund, as required by article 18 of the Regulations of the Fund, are acquired, deposited and held in the name of the United Nations separately from the assets of the United Nations but on behalf of the participants and beneficiaries of the Fund. However, as is also provided in the introduction, paragraph (e), of annex I to the Regulations of the Fund, such Fund assets may be held in the name of nominees. In addition to the registration of assets, Fund custody contracts require that assets held by the custodian on behalf of the Fund be identified and segregated as such. In that regard, various depositories, in countries where the Fund has investments, are used by Fund custodians and sub-custodians, and the custodian is obliged, by the terms of the custody agreement with the Fund, to bring to its attention any circumstances that prevent compliance with the registration, segregation and identification requirements. In 2006, the Fund changed its custodian and master record keeper arrangements and now has only one global custodian responsible for both custodianship of all assets and the master record keeper function. After global competitive bidding, which was undertaken in accordance with the United Nations procurement rules and regulations and in close cooperation with the United Nations Procurement Service, the Global Custodian contract was awarded to the Northern Trust Company. The transfer of all assets to the single global custodian began on 3 April 2006.

III. Economic review

6. During the biennium ended March 2006, the United States economy was dominated by rising interest rates and increasing oil prices. Despite these headwinds, the economy throttled forward, characterized by low unemployment, rocketing home prices and robust consumer spending. As the biennium began in the second quarter of 2004, there were mixed economic signals, as the Institute for Supply Management manufacturing index fell, though it remained near its 20-year high. This was offset by the shattering of the $2.00-per-gallon threshold for gasoline. Despite the creation of 867,000 new jobs since the beginning of 2004, sentiment was dominated by the 36 per cent rise in gasoline prices during the same

period, and more importantly by escalating casualties in Iraq. The net result was that gross domestic product (GDP) growth slowed to 3.0 per cent in the second quarter of 2004, from 4.5 per cent in the first quarter, following a 1 per cent consumer spending increase, the weakest such increase since the recession of 2001. The Federal Reserve ignored the dreary economic data and on the final day of the quarter delivered the first of its hikes in interest rates, by 25 basis points, to 1.25 per cent. The Federal Reserve's three rate hikes during the third quarter, together with frenzied rise in oil prices, weighed on consumer pocketbooks and psychology, and raised costs and squeezed margins for businesses as well. Oil closed over $50 per barrel in New York for the first time on 1 October, and hurricanes in the south-eastern states also trimmed economic activity. In the fourth quarter, the crescendo of presidential election campaigning dragged down economic activity. The re-election of President Bush was welcomed by a strong equity market rally despite an economy burdened by a record fiscal federal budget deficit of $412.6 billion in 2004 and record trade deficits. Apart from the world economy, the Asian tsunami had dreadful consequences in terms of human life.

7. In the first quarter of 2005, February brought another Federal Reserve interest rate hike of 25 basis points, and in March another 25 basis points were added, the seventh increase in as many meetings, to raise the cost of federal funds to 2.75 per cent. In the second quarter, the Federal Reserve increased rates twice, to 3.25 per cent, but the United States economy grew by 3.4 per cent in the second quarter of 2005, the ninth straight quarter of growth exceeding 3 per cent and the longest such string since 1986, despite the increase in the price of oil to a record level of more than $61 per barrel. In the third quarter, consumers in the United States began to feel the pinch of record gasoline prices, and worries about terrorism resurfaced, as London bravely endured subway and bus bombings, but the Federal Reserve raised interest rates twice again. As third-quarter GDP growth accelerated to 3.8 per cent, Federal Reserve Chairman Alan Greenspan, who was to leave his post in January 2006, raised rates yet twice more in the fourth quarter of 2005.

8. During the first quarter of 2006, economic data in the United States of America caused concern that the economy was slowing. The Federal Reserve had raised interest rates to 4.25 per cent, from 1 per cent on 30 June 2004, and again hiked them on 31 January 2006, to 4.50 per cent, the last increase in the Greenspan era. At the end of March, Greenspan's successor, Ben Bernanke, increased the federal funds rate to 4.75 per cent, the fifteenth increase in a row and the longest stretch of rate hikes in 25 years. Despite volatility throughout the quarter, oil and gas prices approached an eight-week high late in March. Copper, zinc and platinum all reached record levels because of demand from China and India, while gold reached $600 per ounce for the first time since 1981 due to political uncertainty and hedge-fund buying to gain healthier inflation-adjusted returns to offset rising oil prices. Yet consumer confidence rose to its highest level since May 2002, and the spending that this confidence supported would buoy the quarter, as the availability of good jobs and rising wages trumped all other economic considerations.

9. In the second quarter of 2004, the Bank of Canada had left its benchmark lending rate unchanged in June, at a four-decade low of 2 per cent, where it had been since a cut in April, the last of five cuts in the past year. In elections in June, the governing party lost its majority in the Parliament, ending 11 years of Liberal control, but continued to rule as a minority Government. In the third quarter, the Canadian economy picked up speed. Business spending for technology continued to

be strong, hiring was widespread and profit growth surged, as Canada benefited from higher commodity prices as a supplier of natural resources. The Canadian dollar rose on the strength of increasing rate expectations and due to better economic fundamentals. During the third and fourth quarters, the Bank of Canada raised interest rates twice to prevent inflation from rising above its 2 per cent target. The commodity boom benefited Canada, making up a third of the country's exports and 10 per cent of its GDP. Canada experienced a current-account and a budget-account surplus, while job growth was strong and consumer confidence was close to a 14-year high.

10. At the beginning of 2005, the Bank of Canada had left its target rate unchanged at 2.5 per cent, where it had been since October 2004. The Canadian economy remained strong in the second quarter of 2005, supported by its huge resource base and resilient consumer spending, feeding estimated GDP growth of 2.7 per cent for 2005. In the third quarter, the Canadian economy appeared to be operating at full capacity. In September the Bank of Canada raised its overnight lending rate by 25 basis points, to 2.75 per cent, hiked it a second time six weeks later and raised interest rates for a third time in December, to 3.25 per cent. Canada's trade surplus for 2005 was a healthy Can$ 66 billion as a result of soaring commodity prices, corporations generated record profits, and the Government paid down debt.

11. In the first quarter of 2006, the Canadian economy remained strong and the unemployment rate of 6.3 per cent was the lowest in 32 years. On the political front, the ruling party lost the elections as a result of a public inquiry in Quebec over kickbacks among party fund-raisers.

12. During fiscal year 2004, European economies continued their economic expansion, following the decelerations experienced during the previous biennium. The rebound was strong, with GDP growth accelerating towards 2.0 per cent, coming off a low base. Interest rates remained low, as did inflation, which remained under control and below the 2 per cent level. GDP growth was strong, as the industrial production index increased to over 102.00, whereas it had spent much of the previous biennium below 100.00. Several of the major economies on the continent continued to run fiscal deficits in order to maintain or boost domestic demand, since the recovery was largely export-led. The Bank of England raised its base rate by 100 basis points during 2004, as economic growth improved to 4.75 per cent at the end of the fiscal year, while the European Central Bank maintained the base rate unchanged at 2 per cent.

13. During fiscal year 2005, signs of inflation began to emerge, most notably in the form of rapidly increasing commodity prices. GDP growth in Europe subsided, its rate in most of 2005 in the range of 1.25 to 2.0 per cent. The industrial production index continued to rise to 105.00, the highest level since 1991. This growth was largely export-led, with strong industrial demand from the emerging economies of Asia and Latin America and the Caribbean. Consumer confidence was slow to recover, as European consumers continued to struggle with higher inflation and increasing uncertainty concerning employment. The European Central Bank raised interest rates by 25 basis points, to 2.25 per cent, in 2005, while the Bank of England reduced interest rates by 25 basis points, to 4.50 per cent. The main European currencies strengthened earlier in the biennium, but closed the fiscal year largely unchanged.

14. Japan's economy has entered a steady path of recovery after a decade-long deflationary period. The current economic expansion has lasted for more than four years, according to the official business cycle reference dates. The recent recovery is attributable to a good balance between domestic and external demand, and also between the corporate and household sectors. The banking system returned to normal after the non-performing loan problem was solved. Japanese corporations improved profitability through restructuring and became more aggressive in terms of capital expenditure because of pent-up demand for equipment replacements and a high level of free cash flows. The property markets continuously showed improvement. The vacancy rate in Tokyo's five main business districts declined steadily from 8.57 per cent in June 2003 to 3.41 per cent in March 2006. The prices of some prime locations in the metropolitan area have started to rise. Deflationary pressure eased, reflecting the recovery of the economy. The consumer price index excluding fresh food, which had been negative since 1998, became positive in November 2005. External demand, supported by a strong global economy, led, in particular, by China, contributed to the economic growth as well. On 9 March 2006, the Bank of Japan ended its five-year policy of quantitative easing after projecting a sustainable zero to positive level of the consumer price index.

15. The Japanese yen was 103.7 against the United States dollar at the beginning of April 2004 and depreciated to 117.8 against the dollar at the end of March 2006. During the biennium, the yen traded in the range of 101.7 to 121.4 against the dollar.

16. The Australian economy slowed from its strong growth in 2003. GDP growth fell from 4.3 per cent in 2003 to 1.9 per cent in the first quarter of 2005 and picked up to 2.7 per cent in the fourth quarter of 2005. Employment continued expanding, and the jobless rate fell to 5.0 per cent in 2005, the lowest in decades; however, housing investments slowed after being very active in the past years. The Reserve Bank of Australia continued to raise interest rates from the end of 2003 to the beginning of 2005.

17. The economy of Hong Kong SAR grew by 8.6 per cent and 7.3 per cent in 2004 and 2005, respectively. Strong positive momentum prevailed through private consumption, service exports and property prices. Private consumption was boosted by the relaxation of travel restrictions by the Government of China and an influx of mainland Chinese tourists to the territory. Another important development was growing evidence of mainland Chinese small and mid-size companies establishing a presence in Hong Kong SAR to take advantage of the existing infrastructure. Interest rates were increased to follow the United States increases. However, property markets showed recovery from their bottom in the middle of 2003, reflecting strong demand and high affordability. The Singapore economy grew strongly during the biennium: GDP grew by 6.4 per cent in 2005, following 8.7 per cent growth in the previous year, owing mainly to strong activities in manufacturing.

18. The emerging economies in Asia continued to exhibit strong momentum during the period under review. China remained the fastest-growing economy in the region, with GDP growth of over 10 per cent per annum during 2004 and 2005. During this period, China remained the most important factor not only for regional and global economic growth, but also for the outlook on world commodity prices and for the stability of the United States Treasury market. The economy of the

Republic of Korea maintained, through 2005, its industrial production expansion, driven mainly by exports. However, the country's domestic economy remained sluggish throughout the period. The economy of Taiwan Province of China also maintained its economic growth during the period, driven primarily by exports, but the pace slowed during the second year. GDP growth in India remained at high levels, 7.5 per cent in 2004 and 8.1 per cent in 2005, having entered into a high-growth secular trend. The Indian economy benefited from record low interest rates that spurred domestic consumption. In Latin America and the Caribbean, economies continued to benefit from strong commodity prices. The two largest economies, Brazil and Mexico, rebounded in 2004 but slowed during 2005. GDP growth in Brazil slowed due to tight monetary conditions. Mexico also suffered from lack of growth, as unemployment rose and domestic consumption was slow. In Eastern Europe, the economic performance among countries was uneven. A high current account and budget deficit in Hungary continued to be a cause of concern with regard to its currency, forcing interest rate hikes, which in turn crippled economic growth. Polish unemployment remained above 17 per cent throughout the period under review, pointing to deep structural issues that have yet to be addressed. The Russian economy continued to enjoy strong growth benefiting from high energy prices. In South Africa, GDP growth, at over 4.5 per cent for the period, was also a beneficiary of high commodity prices. Most emerging markets were maintaining sound macroeconomic policies and low levels of inflation, making economic growth more sustainable and stable.

IV. Diversification

19. Diversification is the investment of assets among a variety of securities or among securities in a variety of markets with the goal of controlling risk in a portfolio without proportionately reducing the expected return. The Fund's policy of broad diversification of its investments by currency, asset classes and geographical areas continues to be the reliable method of improving the risk/return profile of the Fund's portfolio over long periods of time. The United Nations Joint Staff Pension Fund is unique among major pension funds in its commitment to global investment.

20. During the biennium ended 31 March 2006, exposure to equities was kept consistently above the neutral 60 per cent long-term strategic guideline, as the economy propelled strong corporate earnings and positive equity market performance. Equities were at 62.3 per cent of the portfolio at the end of the biennium. Bonds were kept at the low end of the 31 per cent long-term strategic target guideline, plus or minus 3 per cent, as the Federal Reserve's unrelenting rate hikes throughout the biennium affected fixed-income returns in the largest and deepest market, the United States of America. Bonds began the biennium at 28.9 per cent of the portfolio and declined to 28.3 per cent at the end of March 2006. Exposure to real estate fell from 6.3 per cent of the Fund on 1 April 2004 to 4.1 per cent at the end of the biennium, while committed amount was kept at about 6 per cent, as targeted. Cash and short-term investments started the biennium at 5.1 per cent in April 2004, peaked at 9.5 per cent in October 2004 and ended the biennium at 5.3 per cent. The investment portfolios are continuously being rebalanced following the quarterly meetings of the Investments Committee to achieve the tactical asset allocation decided by the Representative of the Secretary-General.

21. 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. United States equities were kept underweight while European equities and currencies were kept overweight during the entire biennium, as Europe benefited from a benign interest-rate environment. Exposures to Japanese equities were increased from the very low levels of the previous biennium as that country's economy bottomed and began to climb. Investments in emerging-market equities were also increased, slowly in the first half of the biennium and then more aggressively in the second half. Equities, globally, moved to more cyclical exposures, achieving modest overweights in energy, materials and industrials. These cyclical exposures are currently being trimmed after posting strong returns in the last biennium. This broad diversification of the Fund reduces risk across currencies and markets.

22. The fixed-income portfolio is invested in 14 different currencies, 39 per cent of it in United States dollars and 61 per cent in non-dollar currencies. In terms of geographical diversification, the portfolio was invested in 31 countries and 6 supranational and regional institutions as of March 2006. Additionally, exposure to Japanese bonds was increased from underweight to neutral to reduce the benchmark risk.

23. In terms of geographical diversification, the proportion of the Fund invested in North America increased from 43.2 per cent in March 2004 to 44.8 per cent in March 2006. Investments in Europe declined from 37.2 per cent to 32.4 per cent, while in Asia and the Pacific, the proportion of investments increased from 10.1 per cent to 14.1 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 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 investments are shown in table 1.

Table 1
Market value of Fund investments by country or area as at 31 March 2006[a]

Country/area	*Amount (millions of United States dollars)*	*Percentage*
Argentina	2.0	0.01
Australia	443.0	1.34
Austria	115.8	0.35
Belgium	185.6	0.56
Brazil	175.7	0.53
Canada	812.7	2.45
Chile	47.3	0.14
China	170.5	0.51
Cyprus	63.8	0.19
Czech Republic	19.6	0.06
Denmark	226.5	0.68
Egypt	23.1	0.07
Estonia	32.4	0.10
Euro (cash)	12.7	0.04
Finland	86.9	0.26
France	2 000.8	6.04
Germany	1 404.3	4.24
Greece	140.9	0.43
Hong Kong SAR	131.5	0.40
Hungary	68.7	0.21
India	89.2	0.27
Ireland	187.5	0.57
Israel	49.4	0.15
Italy	754.1	2.28
Japan	3 912.7	11.81
Jordan	0.0	0.00
Lithuania	29.5	0.09
Malaysia	41.6	0.13
Mexico	310.7	0.94
Netherlands	658.5	1.99
New Zealand	44.2	0.13
Norway	113.1	0.34
Poland	80.5	0.24
Portugal	151.6	0.46
Qatar	13.6	0.04
Republic of Korea	495.8	1.50
Russian Federation	41.4	0.13

Country/area	*Amount (millions of United States dollars)*	*Percentage*
Singapore	137.8	0.42
South Africa	276.2	0.83
Spain	541.6	1.64
Sweden	416.4	1.26
Switzerland	783.9	2.37
Taiwan Province of China	67.8	0.20
Turkey	46.8	0.14
United Kingdom	2 553.5	7.71
Zimbabwe	0.0	0.00
Emerging markets	124.5	0.38
International institutions	119.9	0.36
Regional institutions (Africa)	120.5	0.36
Regional institutions (Asia)	171.2	0.52
Regional institutions (Europe)	540.7	1.63
Regional institutions (Latin America)	30.6	0.09
Regional institutions (Middle East)	16.1	0.05
Total outside the United States	19 084.7	57.63
United States	14 033.0	42.37
Total	**33 117.7**	**100.00**

[a] "Country of investment" is generally based on the domicile of the issuer. Convertible securities are classified according to the security into which they are convertible. Various investment trusts that trade in currencies other than the currency of investment are classified according to the country or area of investment.

Table 2
Fund investments in developed markets

	Fixed income		*Equity*	
	31 March 2004	*31 March 2006*	*31 March 2004*	*31 March 2006*
Canada	X	X	X	X
United States	X	X	X	X
Austria	—	—	X	X
Belgium	X	X	X	X
Denmark	X	X	X	X
European Union	—	—	—	—
Finland	X	—	X	X
France	X	X	X	X
Germany	X	X	X	X
Greece	X	X	X	X
Ireland	X	X	X	X
Italy	X	X	X	X
Netherlands	X	X	X	X
Norway	X	X	—	—
Portugal	X	X	—	—
Spain	X	X	X	X
Sweden	X	X	X	X
Switzerland	X	—	X	X
United Kingdom	X	X	X	X
Australia	X	X	X	X
Hong Kong SAR	—	—	X	X
Japan	X	X	X	X
New Zealand	X	X	X	—
Singapore	—	X	X	X
Total	**20**	**19**	**21**	**20**

Table 3
Fund investments in emerging markets

	Equity		*Fixed income*[a]	
	31 March 2004	*31 March 2006*	*31 March 2004*	*31 March 2006*
Argentina	X	X	X	X
Bahrain	—	X		
Baltics	X	—		
Botswana	X	X	X	—
Brazil	X	X	X	X
Chile	X	X		
China/Hong Kong SAR	X	X		
Colombia	X	X	X	—
Congo	—	—		
Côte d'Ivoire	X	X	X	X
Croatia			X	—
Cyprus			—	X
Czech Republic	X	—		
Dominican Republic			X	X
Ecuador			X	X
Egypt	X	X	X	X
Estonia			—	X
Ghana	X	X	—	X
Hungary	X	X	X	—
India	X	X		
Indonesia	X	X	X	X
Iraq			—	X
Israel	X	X		
Jordan	—	X	—	X
Kazakhstan	—	X		
Kenya	X	X		
Kuwait	—	X		
Lebanon	—	X		
Lithuania			—	X
Malaysia	X	X		
Marshall Islands	—	—		
Mauritius	X	X	X	—
Mexico	X	X	X	X
Morocco	X	X	X	X
Namibia	X	X		
Nepal			X	X

	Equity		*Fixed income*[a]	
	31 March 2004	*31 March 2006*	*31 March 2004*	*31 March 2006*
Nigeria	X	X	—	X
Oman	—	X	—	X
Pakistan	X	X		
Palestine	—	X		
Panama	—	X		
Peru	X	X	—	X
Philippines	X	X		
Poland	X	X	X	X
Qatar	X	X		
Republic of Korea	X	X		
Republic of Moldova			X	X
Russian Federation	X	X	X	X
Saudi Arabia	—	X		
Senegal	X	—		
Singapore	X	X		
South Africa	X	X		
Sri Lanka	X	—		
Taiwan Province of China	X	—		
Thailand	X	X		
Tunisia	X	X		
Turkey	X	X		
Turkmenistan	X	X		
Ukraine	X	—	—	X
United Arab Emirates	—	X		
Uruguay			X	X
Venezuela (Bolivarian Republic of)	X	—	X	X
Viet Nam	X	X		
Zambia	X	—	—	X
Zimbabwe	—	X		
Total	**42**	**45**	**20**	**26**

[a] Allocation by sovereign risk.

V. Investment returns

A. Total return

24. The market value of the Fund's assets increased from $26,589 million on 31 March 2004 to $33,118 million on 31 March 2006, an increase of $6,529 million, or 24.6 per cent. The total investment return was 10.4 per cent for the year ended 31 March 2005 and 13.3 per cent for the year ended 31 March 2006. After adjustment by the United States consumer price index (CPI), these returns represent real rates of return of 7.1 per cent and 9.6 per cent, respectively. The total annualized rate of return for the biennium was therefore 11.8 per cent. After adjustment by the CPI, the real annualized rate of return for the biennium was 8.3 per cent.

25. Due to a strong market performance during fiscal years 2005 and 2006, the Fund recorded a historical high in terms of market value in March 2006. During the biennium, all of the asset classes — equities, bonds, real estate and short-term investments — contributed to the return; equities contributed the most, with returns of 11.8 per cent in 2005 and 21.3 per cent in 2006. Equities denominated in currencies other than the United States dollar had a greater impact on the performance since the United States dollar depreciated against major currencies. Bonds showed a positive return of 7.8 per cent in 2005, followed by a negative return of 2.8 per cent in 2006. Real estate performance was strong: 15.8 per cent in 2005 and 30.5 per cent in 2006.

26. The rates of return shown in the present report have been calculated by an outside master record keeper, using a generally accepted method that was explained in the report on the management of the investments submitted to the Board at its thirty-fourth session.[1] 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. Comparisons of investment returns

27. The Fund continues to be, geographically, 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, the Fund had almost half of its assets in currencies other than the United States dollar.

28. During the year ended 31 March 2005, the Fund outperformed its old benchmark, which was composed of 60 per cent MSCI World Index and 40 per cent CWGBI, with a return of 10.4 per cent, versus 8.9 per cent for the benchmark. For the year ended 31 March 2006, the Fund outperformed both the new and the old benchmarks with a return of 13.3 per cent, versus the returns of 12.3 and 8.8 per cent of the new 60/31 benchmark and the old 60/40 benchmark, respectively. Over the last 15 years, the Fund achieved an annualized return of 9.2 per cent, outperforming both the 8.7 per cent return of the new 60/31 benchmark and the 8.2 per cent return of the old 60/40 benchmark. In the earlier years, the Fund

[1] JSPB/34/R.10.

underperformed, due mainly to its low weighting in equities, but the Fund has caught up rapidly since 2000 due to overperformance in both equities and bonds.

29. Over the last 15 years, both MSCI All Country Index and MSCI World Index had a total annualized return of 8.9 per cent, compared with the annualized return of 9.6 per cent achieved by the Fund's total equities. During the same period, both the Lehman Brothers Global Aggregate Index (LBGA) and CWGBI had annualized returns of 7.0 per cent, compared with the annualized return of 8.1 per cent achieved by the Fund's bond portfolio.

C. Important issues to be addressed

30. The Fund's most immediate concern is that it continues to manage $33 billion as if it were a few million dollars. Today, one person is responsible for the management of over $15 billion, including the backup position, representing almost 50 per cent of the total fund. No other pension fund, such as one subject to the laws of the United States of America, would ever concentrate so large a part of the portfolio under one manager, either internal or external. The Fund also has one individual managing $9.5 billion in bonds.

31. As it stands, the Fund has a huge key-man risk in concentrating so much of the portfolio under single managers. This is not the fault of the Investment Management Service staff, who are struggling with such crushing mandates. A supplementary budget proposal is being submitted for five additional investment officer positions in the Investment Management Service. Even if the Service hires additional P-5 and P-4 portfolio managers, as requested, this will never add up to the proper number of Professional investment staff to adequately manage the portfolio. It is estimated that the Service's investment team would need at least 25 Professional staff from the P-3 to P-5 levels, and each investment team (a team each for North American equities, European equities, Asia and the Pacific, global emerging markets and fixed income) should be led by a D-1. Even if this were done, one might still question whether a team of five could be responsible for $10 billion, or almost one third of the total portfolio, without putting the Fund at risk. Unfortunately, it should also be recognized that even if the Service were to build a team for each portfolio, under the United Nations regulations the Fund cannot offer remuneration packages that are competitive with those offered by investment management firms located in New York to hire the best-qualified investment personnel.

32. In years past, the Secretary-General determined that the Fund did not have the internal expertise necessary to properly manage investments in smaller companies (a highly specialized area). Hence, with that portion of the portfolio, six external money-management companies were selected, a well-diversified strategy that concentrates no more than $365 million under any one manager. Manager diversification was done because it is extremely risky and unwise to concentrate more than that amount under any one manager on specific assignment (the firm could manage more if it were managed by a different team in the firm for a different area, such as mid- or large-capitalization stocks). By spreading around the management, a pension fund can control the first and greatest risk — lack of diversification.

33. A pension fund can achieve diversification of investments, first, by investing in different asset classes (stocks, bonds, real estate and, in other pension funds,

alternative investments) and then by choosing multiple investment managers in different regions within each asset class. It is imprudent for a large pension fund to concentrate its investments in one or two asset classes and under one or two managers.

34. At present, the Fund has four asset classes: stocks (equities), bonds (fixed income), real estate, and cash and short-term investments. The Fund added further diversification by breaking the equity asset class into North American, European, Asian and Pacific, and emerging-markets equities. Moreover, the North American, European, and Asian and Pacific equities are broken into subcategories, such as large-capitalization stocks (large companies) and small-capitalization stocks (small companies). Earlier this year, the Fund terminated the contract of one of the six small-capitalization managers for underperforming the benchmark for the past five years. It is currently in the process of terminating another for underperforming for the past three years. Both will be replaced through the regular United Nations procurement process.

35. Internally, the Investment Management Service continues to manage each of the following portfolios with one person:

Rank	*Mandate*	*Assets managed*[a]
P-4	North American equities European equities	\$8.767 billion (back-up position) \$6.665 billion
P-4	Asian and Pacific equities	\$3.050 billion
P-5	Global emerging markets	\$989 million
P-5	Fixed income (bonds)	\$9.516 billion
No one	Real estate	\$1.360 billion

[a] Amounts include accrued income.

36. Table 4, updated since the Pension Board meeting in Nairobi, shows that things continue to worsen for the North American equity portfolio. It is very worrisome that there exists a chronic underperformance in North American equities over the past one-, three- and five-year periods against the benchmark. If the Fund had indexed this portfolio to the benchmark five years ago, returns would have been approximately \$475 million more. If it had been indexed a year ago, additional returns would have been more than \$100 million. Indexing large-capitalization North American equities has become a standard practice in multi-billion dollar pension funds, and it is difficult to understand why the Fund has not taken advantage of this scheme in the past. It should be considered imprudent to incur this opportunity cost of \$500 million, as indexation would have lowered the risk of the portfolio through greater diversification. Furthermore, the European equity portfolio has underperformed for the last three and five years. Over the one-year period depicted in table 4, performance has been better. This must be closely monitored.

37. The Pension Board in Nairobi understood the risk described above in its North American portfolio, not to mention the huge risk of concentrating so much of its stakeholders’ money under one lone portfolio manager. The Board voted to index

this portfolio to match the benchmark. Similarly, the Investments Committee, which is as talented a committee as one will find in any multi-billion dollar pension fund, voted unanimously to recommend indexing the North American equity portfolio. Again, had this been done a year ago, three years ago or five years ago, it would have meant lower risk and higher return.

Table 4
Fund value as at 31 March 2006

Asset manager	*Assets under management[a] (millions of United States dollars)*	*Percentage*					
		One year return		*Three year return*		*Five year return*	
		Pension fund	*Bench-mark*	*Pension fund*	*Bench-mark*	*Pension fund*	*Bench-mark*
North American equities excluding small-capitalization	8 767	12.2	13.6	15.1	18.5	3.6	4.6
European equities excluding small-capitalization	6 665	23.3	21.2	31.1	31.3	9.7	9.9
Asian and Pacific equities excluding small-capitalization	3 050	36.6	33.4	28.8	32.1	10.3	10.3
Global emerging markets	989	56.5	48.0	48.4	46.7	23.9	23.6
Fixed income	9 516	-2.8	-2.6	6.6	4.5	9.9	7.1
Real estate	1 360	30.5	20.2	23.2	15.1	17.1	11.7
CS Asset Management	307	22.3	27.8	24.0	28.1	9.1	8.6
DFA	365	27.4	23.8	39.3	30.8	n/a	n/a
Jennison	212	56.5	25.9	33.1	29.5	n/a	n/a
Baillie Gifford	296	38.1	35.4	46.6	48.9	n/a	n/a
Darier Hentsch	—	n/a		n/a		n/a	
SG Yamaichi	247	38.2	27.9	48.5	43.7	20.4	21.1
Africa Emerging Markets Fund	41	54.8		62.2		n/a	
Emerging Markets Fund	91	45.9		47.0		n/a	
Emerging Markets Middle East Fund A	—	n/a		n/a		n/a	
Taiwan Fund, Inc.	5	-0.5		19.0		n/a	
Short-term and cash	1 421	2.9	3.5	4.5	2.1	5.6	2.2
Total Fund value	33 331	13.3	12.3	17.2	17.2	9.3	7.9

[a] Market value amounts (assets under management) include accrued income.

38. This issue has not always been presented transparently in terms of the universe exposures that the Fund and the benchmark had in the past. While the Fund's equity portfolio has had exposure to small-capitalization equities, the benchmark used by the Fund did not have such exposures. The mismatch of the universes occurred because the investment in small-capitalization equities started as an opportunistic strategy, and therefore the change of benchmark was not necessary at that point. This resulted in "enhancing" the Fund's equity performance in some cases.

39. Considering that the small-capitalization equity exposure remained for a considerable time, and will likely remain in the future, the Investment Management Service, at the Investments Committee meeting in September 2005, recommended

the addition of a small-capitalization sub-index to the Fund's equity benchmark. The recommendation was to change the Fund's equity benchmark from MSCI World Index, which has exposure neither to emerging markets nor to small-capitalization equities, to a combination of MSCI World Index, MSCI Emerging Markets and a small-capitalization equity index in proportion to market weights. Part of the discussion in the Committee meeting, as recorded in the minutes, was as follows:

> While some members were of the view that it would be beneficial to have a benchmark that in greater detail would reflect the structure of the portfolio and all its components, some members maintained the view that such a detailed benchmark could be detrimental to investment performance, because it could be interpreted as a binding instruction by the portfolio managers and become a guideline for investment decision.
>
> However, the members of the Committee agreed that the current benchmark for fixed income, Citigroup World Government Bond Index, was inappropriate since it included only government bonds. Since about 26 per cent of the Fund's fixed-income portfolio was currently invested in non-governmental bonds, Lehman Brothers Global Aggregate Bond Index, which also included non-governmental bonds, was considered more appropriate. Similarly, the equity benchmark of MSCI World Index had no allocation to emerging markets. Since the Fund had approximately 6 per cent of its equity investments in emerging markets, it was agreed that MSCI All Country was a more suitable benchmark.

D. Long-term rates of return

40. The five-year moving cumulative annualized rate of return has fully recovered from the negative returns of 2003. The equity markets declined from March 2001 to March 2003 but recovered from March 2003 onwards. Equity markets had strong positive returns from 1993 to 2000 but declined sharply in the following three consecutive years. For 2004, 2005 and 2006, the Fund's returns were 28.7 per cent, 10.4 per cent and 13.3 per cent, respectively.

41. The cumulative annualized total returns for the last 5, 10, 15, 20 and 25 years were approximately 9.3 per cent, 8.6 per cent, 9.2 per cent, 9.6 per cent and 10.7 per cent, respectively. The cumulative annualized total rate of return over the 46-year period for which data were available was 8.7 per cent, representing a yearly real rate of return of 4.3 per cent after adjustment by the United States CPI.

Table 5
Fund annual total rate of return

(Percentages based on market value as at 31 March)

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

	Equities				Bonds						
Year	*United States*	*Outside United States*	*Total*	*MSCI World Index*[a]	*United States*	*Outside United States*	*Total*[b]	*CWGBI*[c]	*Real Estate*	*Short-term*	*Total Fund*
1987	21.63	43.88	30.01	43.22	9.14	32.63	22.59	17.42	12.67	11.97	24.69
1988	(12.18)	2.15	(4.74)	5.81	3.26	20.24	12.65	11.42	9.19	7.67	3.10
1989	13.20	10.00	11.30	13.56	2.10	(5.50)	(2.40)	0.36	8.20	10.40	5.90
1990	21.54	13.21	16.57	(2.30)	10.47	2.93	6.20	3.12	12.31	9.72	11.56
1991	8.9	1.2	4.5	3.2	12.5	17.4	15.0	16.2	5.1	13.1	8.9
1992	11.3	0.1	4.9	(0.5)	13.7	14.0	14.0	14.0	(4.1)	6.5	7.6
1993	17.3	6.7	11.2	12.7	15.9	17.7	16.9	19.0	(6.6)	7.5	11.6
1994	(2.7)	24.4	12.4	14.0	3.4	10.1	7.7	6.8	0.5	3.0	9.7
1995	11.1	6.5	8.1	9.8	2.9	18.6	12.9	12.1	0.0	5.0	8.7
1996	30.2	15.1	20.5	20.6	8.0	3.3	5.1	5.3	10.4	4.1	14.6
1997	18.9	7.2	11.6	9.8	6.2	2.5	3.6	1.2	8.6	4.4	8.9
1998	45.4	15.4	27.3	32.4	10.6	4.3	7.0	5.4	18.9	7.0	20.4
1999	18.4	9.7	13.9	13.0	4.8	9.0	6.5	10.0	4.8	9.9	11.3
2000	17.5	39.9	28.5	21.6	3.1	(5.7)	(2.5)	(0.3)	11.7	3.0	18.0
2001	(17.2)	(30.3)	(24.2)	(25.1)	13.0	(4.2)	2.0	(1.7)	11.3	4.2	(15.0)
2002	2.8	(6.1)	(1.3)	(4.2)	4.9	2.1	3.1	0.5	8.4	3.5	0.7
2003	(23.9)	(21.7)	(23.1)	(24.2)	15.9	34.9	28.4	25.2	8.5	11.1	-3.8
2004	29.3	56.5	42.5	43.9	6.8	19.4	15.7	13.5	23.9	8.1	28.7
2005	6.3	16.9	11.8	11.1	1.2	10.5	7.8	5.5	15.8	2.5	10.4
2006	13.1	28.8	21.3	18.6	2.4	-4.4	-2.8	-2.0	30.5	2.9	13.3
				MSCI All Country				*LBGA*			*60/31*
2006, new benchmarks				20.3				-2.6			12.3

[a] MSCI World Index consists of 22 major equity markets.
[b] The proportion of bonds held outside the United States of America was not significant prior to 1975.
[c] CWGBI (formerly known as Salomon Brothers World Government Bond Index) consists of 18 major bond markets.

Table 6
Fund annual rates of return based on market value

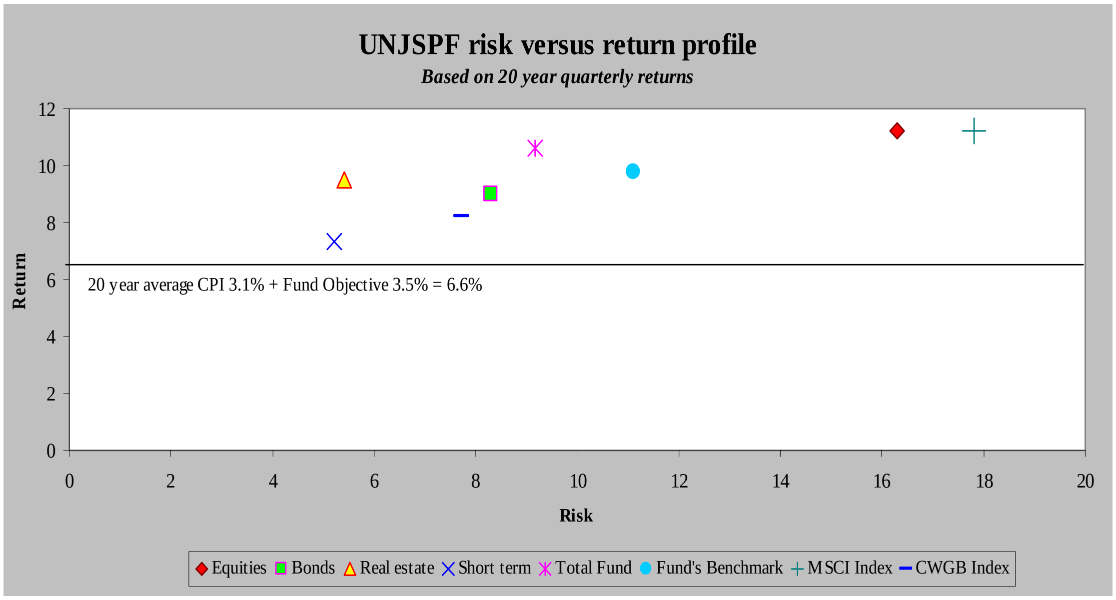
(Percentages for selected periods ending 31 March)

		2006	*2005*	*2004*	*5 years to 2006*	*10 years to 2006*	*15 years to 2006*
	United States equities	13.1	6.3	29.3	4.0	9.4	10.6
	Equities outside United States	28.8	16.9	56.5	11.6	8.5	9.1
Total equities		21.3	11.8	42.5	7.9	8.7	9.6
	United States bonds	2.4	1.2	6.8	6.1	6.8	7.5
	Bonds outside United States	-4.4	10.5	19.4	11.7	6.2	8.3
Total bonds		-2.8	7.8	15.7	9.9	6.5	8.1
Real-estate related		30.5	15.8	23.9	17.1	14.0	9.1
Short-term investments		2.9	2.5	8.1	5.6	6.3	5.9
Total Fund in United States dollars		13.3	10.4	28.7	9.3	8.6	9.2
Inflation-adjusted return (based on United States CPI)		9.6	7.1	26.5	6.5	6.0	6.3

E. Risk/return profile

42. Over the past 20 years, the Fund's average annual return of 10.0 per cent was slightly higher than the benchmark's return of 9.8 per cent, but the Fund's volatility of 9.6 per cent was substantially less than the benchmark's 11.1 per cent. The Fund had a better risk/return profile because it has a well-diversified portfolio that includes all major asset classes and securities.

43. Within asset classes, the Fund's equity portfolio return of 11.2 equalled the MSCI World Index, but the Fund's equity portfolio had a much better risk profile (16.3 per cent) than the MSCI World Index (17.8 per cent). The bond portfolio (with a 20-year average return of 9.0 per cent) outperformed CWGBI (8.2 per cent) but had slightly higher volatility (8.3 per cent) than CWGBI (7.7 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.



VI. Investments in developing countries

44. On 23 December 2004, the General Assembly adopted resolution 59/269 on the United Nations pension system. Section VIII of the resolution, entitled "Diversification of the investments of the United Nations Joint Staff Pension Fund", begins as follows:

> "*Recalling* its resolutions 36/119 A to C of 10 December 1981,
>
> "1. *Takes note* of the increase in investments of the United Nations Joint Staff Pension Fund in developing countries, and requests the Secretary-General to report to the General Assembly at its sixty-first session on the steps and efforts undertaken to increase, to the maximum extent possible, investments in developing countries".

45. The investments are made wherever this serves the interests of participants and beneficiaries. The Fund continued to make efforts to invest in developing countries during the last biennium. Direct and indirect investments in developing countries amounted to $1.8 billion on 31 March 2006, an increase of 8 per cent from $1.7 billion at cost on 31 March 2004. The increases were in the African region (13 per cent), Asia and the Pacific (27 per cent) and emerging European markets (101 per cent). There was a decrease in Latin America due to the maturity of some bond investments and the sale of equities in some countries. New investments were initiated in Egypt and Turkey, and there were substantial increases in investments in India and Singapore. Development-related investments accounted for approximately 7.6 per cent of the Fund's assets at book value. Table 7 shows the Fund's investments in developing countries by book value in 2006 and 2004.

46. The Investment Management Service continued 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. It also continues to explore opportunities in sovereign debt where credit quality has improved.

47. At the Investments Committee meeting in May 2005, the Fund's benchmark was changed to reflect its long-term strategic exposures to emerging and developing countries, i.e., through the MSCI All Country Index.

48. At the recently concluded fifty-third session of the United Nations Joint Staff Pension Board, the Board decided to endorse to the General Assembly at its sixty-first session the approval of two Professional posts devoted to global emerging markets. This will bolster the Fund's efforts to seek potential investment opportunities in these markets.

Table 7
Development-related investments: book value as at 31 March 2006 and 31 March 2004

	Investments made in United States dollars	*Dollar value of investments made in other currencies*	*Total 2006*	*Total 2004*
Africa				
Egypt	23 435 000	0	23 435 000	0
Ghana	0	0	0	1 830 000
South Africa	40 102 000	134 023 000	174 125 000	145 851 000
Zimbabwe	0	0	0	22 000
Regional funds	20 570 000	0	20 570 000	12 753 000
Subtotal	**84 107 000**	**134 023 000**	**218 130 000**	**160 456 000**
Development institutions	69 926 000	0	69 926 000	95 097 000
Total Africa	**154 033 000**	**134 023 000**	**288 056 000**	**255 553 000**
Asia				
China	130 746 000	71 599 000	202 345 000	110 437 000
Hong Kong SAR	0	79 901 000	79 901 000	104 029 000
India	4 432 000	55 978 000	60 410 000	21 604 000
Jordan	7 000	0	7 000	845 000
Malaysia	0	32 069 000	32 069 000	23 371 000
Qatar	14 144 000	0	14 144 000	29 490 000
Republic of Korea	144 438 000	174 962 000	319 400 000	323 024 000
Saudi Arabia	0	0	0	5 125 000
Singapore	0	102 594 000	102 594 000	48 157 000

	Investments made in United States dollars	*Dollar value of investments made in other currencies*	*Total 2006*	*Total 2004*
Regional funds	66 254 000	0	66 254 000	42 200 000
Subtotal	**360 021 000**	**517 103 000**	**877 124 000**	**708 282 000**
Development institutions	52 929 000	0	52 929 000	23 008 000
Total Asia	**412 950 000**	**517 103 000**	**930 053 000**	**731 290 000**
Europe				
Cyprus	43 817 000	0	43 817 000	43 817 000
Turkey	0	44 065 000	44 065 000	0
Subtotal	**43 817 000**	**44 065 000**	**87 882 000**	**43 817 000**
Total Europe	**43 817 000**	**44 065 000**	**87 882 000**	**43 817 000**
Latin America				
Argentina	0	2 046 000	2 046 000	0
Brazil	39 040 000	30 691 000	69 731 000	95 741 000
Chile	37 846 000	0	37 846 000	40 292 000
Mexico	47 951 000	202 736 000	250 687 000	246 627 000
Regional funds	30 564 000	0	30 564 000	30 564 000
Subtotal	**155 401 000**	**235 473 000**	**390 874 000**	**413 224 000**
Development institutions	0	0	0	39 647 000
Total Latin America	**155 401 000**	**235 473 000**	**390 874 000**	**452 871 000**
Other development funds				
International Bank for Reconstruction and Development	78 595 000	0	78 595 000	152 208 000
Fiduciary Emerging Market Bond Fund	21 599 000	0	21 599 000	19 660 000
Emerging Market Middle East Fund	15 000 000	0	15 000 000	0
Emerging Market Investors Fund	30 501 000	0	30 501 000	45 059 000
Total other development funds	**145 695 000**	**0**	**145 695 000**	**216 927 000**
Grand total	**911 896 000**	**930 664 000**	**1 842 560 000**	**1 700 458 000**

VII. Conclusion

49. The biennium ended 31 March 2006 brought to fruition economic trends only hinted at in the last report (A/C.5/59/11): the emergence of China as an economic powerhouse and surging oil prices due to upheaval in the Middle East. Indeed, skyrocketing commodity and oil prices have been affected not only by China, but also by Brazil, the Russian Federation and India, and the influence of those countries on the global economy of the current biennium will likely have a dramatic impact on the Fund. Low inflation does appear to be departing the economic scene, and low interest rates are following or are likely to. Thus, uncertainty continues to prevail at the beginning of the current biennium. Today, the outlook remains tipped to the positive. The Investment Management Service continues to monitor both perils and opportunities for the Fund's assets, always bearing in mind the long-term objectives and well-being of the Fund.