

FOR ACTION

Finance and Investment Report

Purpose

To inform members of the activities of the FIC and to provide members with information regarding the endowment fund investments.

To consider and approve the annual budget for 2009.

Background

At their recent meeting in September 2008, the FIC discussed recent investment performance and the current investment strategy. It was agreed that the Trust should start moving towards a specialized asset management structure and that the IFA should start the selection process. The Committee will hold their next meeting prior to the Executive Board (EB) meeting where they will consider the UN Principles for Responsible Investment (UNPRI) with a view to recommending to the EB whether the Trust should formally adopt these Principles.

The Secretariat has prepared an annual budget for 2009 in the amount of USD 12.6 million. This includes USD 2.46 million in respect of long-term grants through which the Trust will support international collections for 16 crops; and USD 5.6 million in grants under the global system project and other capacity building grants, which receive support from the Gates Foundation/UN Foundation and GRDC. The Trust does not intend to withdraw the entire 4.5% from the endowment fund as foreseen in our Business plan; approximately 2% will be withdrawn and the remainder will remain invested while still being available for use if absolutely necessary to meet the Trust's contractual agreements with grantees.

Action

That Members consider the activities of the FIC and the current investment fund status and strategy.

That members consider and approve the annual budget for 2009.

<u>Annex A</u>	HSBC Portfolio Update (7 pages)
<u>Annex B</u>	Draft Annual Budget 2009 (2 pages)

HSBC Portfolio Update



HSBC Global Asset Management

The Global Crop Diversity Trust

Portfolio update

October 2008

HSBC 

The Global Crop Diversity Trust

October 2008 portfolio update

Provided by:

HSBC Investments (UK) Limited
78 St James's Street
London
SW1A 1EJ

Authorised and regulated by the Financial Services Authority

Contacts:

Jenine Langrish, Director, Institutional Investment

Tel: 020 7024 0305

Fax: 020 7024 1993

Email: jenine.langrish@hsbc.com

Allison Bell, Client Associate

Tel: 020 7024 0304

Fax: 020 7024 1993

Email: allison.bell@hsbc.com

Performance and strategy overview

Despite recent market weakness, the fund has still produced positive returns since inception, with a return of 19.4%, against an estimated (the hedge fund benchmark index is currently provisional) benchmark return of 17.9% for the period from 1st June 2005 until 30th September 2008. A more detailed breakdown of performance is given in the section on portfolio performance below.

The table below shows how the fund was invested relative to the benchmark as at the 30th September 2008.

Asset class	Value \$	% fund	% benchmark	Relative
US Equities	8,208,149.78	20.50	26.0	(5.50)
Non-US Equities	7,927,170.31	19.80	16.0	3.80
Emerging Market Equities	4,035,823.54	10.08	10.5	(0.42)
US Government Bonds	5,765,986.56	14.40	27.5	(13.10)
US Corporate Bonds	7,670,380.64	19.16	7.5	11.66
Emerging Market Bonds	796,452.35	1.99	2.5	(0.51)
US Real Estate	1,642,187.71	4.10	4	0.10
Hedge Funds	2,490,828.27	6.22	6	0.22
Cash	1,500,585.11	3.75	0	3.75
Total	40,037,564.27	100.0	100.0	

Relative to the benchmark, the fund is underweight in equities and bonds, broadly in line in property and hedge funds and overweight in cash. Within equities, non-US equities are still preferred to US equities on valuation and fundamental grounds, although we may turn more positive on the US market shortly. We are marginally underweight in emerging market equities, which are sensitive to global equity market weakness. Within bonds, we are underweight in US government bonds and overweight in corporate bonds. Within corporate bonds, we remain underweight in high yield bonds. We also remain underweight in emerging market bonds.

Market trends and background

Markets have experienced a significant switchback in the last year. Having risen very strongly from the time your portfolio was established in early May 2005 until mid 2007, they have since given up a large portion of their previous gains. Despite their recent setback, the best returns have still come from emerging market equities, with European equity markets also producing good returns for dollar based investors. More subdued but still positive returns have been achieved by US and Japanese equities over the same period. Although it has seen some recovery in recent months,

dollar weakness over the full period has enhanced dollar denominated returns from overseas markets.

Returns from bond markets have been more mixed. US government bonds have performed strongly, benefiting from fears of recession and from a flight to quality. Corporate and high yield bonds have lagged significantly as credit quality fears have resulted in widening spreads. Emerging market bonds have achieved impressive returns as investors have re-evaluated the credit quality of many countries. US real estate and hedge funds have done what they were designed to do, providing a degree of diversification within the portfolio. Hedge funds lagged equity returns during the bull market, but have proved more defensive (although not completely immune) as equity markets have fallen.

The table below shows the performance of each of the markets in which you are invested, both during the 3rd quarter of 2008, and since your initial investment in early May 2005 until end September 2008.

Asset class	Performance in Q3 2008	Performance since 30/4/05
US Equities	-9.0	8.6
European Equities	-20.7	20.2
Japanese Equities	-26.9	4.8
Emerging Market Equities	15.1	62.4
US Government Bonds	2.4	19.3
US Corporate Bonds	-7.5	1.7
US High Yield Bonds	-9.5	7.6
Emerging Market Bonds	-5.1	22.2
US Real Estate	4.5	22.0
Hedge Funds	-8.8*	17.5*

Source: HSBC. * The number for hedge funds is provisional, based on estimated benchmark returns up to 30/9/08, which may be subject to slight change.

Performance analysis

The fund has outperformed its benchmark since inception, with a return of 19.4%, against an estimated benchmark return of 17.9% for the period from 1st June 2005 until 30th September 2008.

The table below breaks down the performance attribution of the fund, showing which areas have added to, or detracted from, performance since June 2005 (the first full month during which the fund was invested). The difference between the attribution total of 0.56% and the relative performance of 1.5% is due to timing differences.

Asset class	Asset allocation	Stock selection
Global Equities	0.25	1.06
Emerging Market Equities	0.77	0.04
US Bonds	0.32	-1.97
Emerging Market Bonds	-0.04	0.06
US Real Estate	0.06	0.23
Hedge Funds *	-0.02	-0.16
Cash	-0.75	0.71
Total	0.59	-0.03

Source: HSBC. * Numbers for hedge funds are provisional, based on estimated benchmark returns up to 30/9/08, which may be subject to slight change.

As can be seen from the table, asset allocation has added value to the portfolio, whereas stock selection has been broadly neutral. Within asset allocation, the biggest positive contribution has come from the overweight position in emerging market equities. This has been in part offset by the drag from holding cash (which is not in the benchmark but essential for portfolio management purposes) at a time of rising markets. Stock selection has seen positive contributions from all areas apart from US bonds and hedge funds. The largest contributions have come from global equities, real estate and cash.

Comments on the benchmark

Your benchmark was recommended on the understanding that you were seeking a return, over the long term, of 6.5% pre fees and 6% post fees, comprising long term market returns (beta) of 5.5% and value added by us (alpha) of 1% per annum. We also understood that you were seeking a US dollar based fund, and that you were happy to have a significant exposure to emerging markets as a number of your operations were based in these markets. The benchmark we proposed was forecast to produce this over the long term and was intended to be a long term strategic position from which we would take shorter term tactical positions (within agreed bands) according to our short term views on markets. We remain comfortable with the benchmark and would not recommend any significant changes at this stage UNLESS your objectives have changed. I understand that there has been some debate as to whether the US dollar is the appropriate base currency. If it is decided that this is not the case, then we would need to revisit the benchmark. For example a Euro based benchmark would inevitably result in less US, and more European, based assets.

From a purely practical point of view, it would be easier for us to run the global equity portion of the fund against the MSCI World index, rather than separating it into US, European, Japanese and other equities, since this is how the global equity team operate in practice. This would not involve a significant change.

Outlook and risks

The global economic outlook has deteriorated significantly since our last report to you. The “credit crunch”, which started with concerns about the quality of US mortgage assets, has escalated alarmingly rapidly into a global crisis of confidence in the banking system. A functional banking system is crucial to any free market based economy, and the recent reluctance (and in some cases inability) of banks to lend threatens the very fabric of our economic systems. Recent actions by governments should help to stabilise the situation, but it will take some time for confidence to recover.

Valuations of equities look exceptionally cheap on most measures, both absolute and relative to bonds. However, in the short term, further nervousness in equity markets is likely. With risk aversion likely to persist in credit markets in the near future, corporate and high yield bond markets are also likely to remain volatile for some time.

The key risks to financial markets are deemed to be:

- Failure of government action to restore confidence in the global banking system. This could lead to a prolonged period of severe economic disruption, and a further pick up in bankruptcies and corporate failures.
- Global recession – recent falls in financial markets have been due to fears of global recession. We feel that all but an Armageddon scenario such as that described in the previous point is now already being discounted by equity markets.
- Global imbalances – recent government moves to bail out the banking system, together with the automatic pick up in spending and reduction in tax revenues that occurs at times of economic downturns, will further increase government deficits in countries such as the US, the UK and parts of Europe. These are not sustainable on a long term view and will result in an increase in government bond issuance in the near term.
- Geopolitical risks have moved away from the centre of investor attention at present, but remain nonetheless. Most notably: the ongoing threat of terrorist attacks; conflicts in the Middle East and Pakistan; and the unpredictable nature of North Korea remain. Barring a major escalation markets are likely to shrug off most incidents, provided there is no marked upwards pressure on the oil price as a result.

On the plus side, it should be said that many risks that appeared worrying six months ago have now receded. Concerns about rising inflation, particularly in commodity, oil and food prices, have eased significantly as the likelihood of global economic slowdown has risen.

Draft Annual Budget for the year ending December 31, 2009

**GLOBAL CROP DIVERSITY TRUST
ANNUAL BUDGET 2009**

INCOME:	Note	USD
Endowment Fund Income Released	1	1,792,500
Restricted Funding:	2	
Bill & Melinda Gates Foundation/UN Foundation		7,276,000
Grains Research & Development Corporation		1,105,000
Lillian Goldman Charitable Trust		300,000
Sweden		135,600
Swiss Agency for Development & Cooperation		60,000
USAID		1,000,000
Unrestricted Funding:	3	
Canada		940,000
TOTAL INCOME		<u><u>12,609,100</u></u>
 EXPENDITURE		
Program Expenditure		11,175,450
Operational Expenditure		1,328,150
Contingency	4	105,500
TOTAL EXPENDITURE		<u><u>12,609,100</u></u>

Notes to the Annual Budget 2009

1. In accordance with the current Investment Objectives and Policies of the Trust, the Trust may withdraw an amount equivalent to 4.5% of the average portfolio value over the previous six quarters as annual income from the endowment investment fund. However as with previous years, the Trust does not intend to withdraw the entire amount during 2009. It is projected that the Trust will require an amount of c. USD 1.8 million to fulfill expenditure requirements. The remainder will be retained in the investment fund.
2. The Trust will receive restricted funding from the following sources during the year:
 - Bill & Melinda Gates Foundation/UN Foundation*
This is a four-year project, April 2007 – March 2011, which aims to secure the biological basis of agriculture and promote new and fuller use of crop genetic resources. The Trust has secured a further USD 15 million for the Endowment Fund through this project.
 - Grains Research & Development Corporation (GRDC)*
Through this agreement GRDC has provided funding for crop and regional conservation strategies and related capacity building grants. During 2009 funding will be provided for long-term conservation grants, grant schemes for collection and evaluation and crop regeneration.
 - Lillian Goldman Charitable Foundation*
The Trust is in the process of finalizing an agreement with the LGCF to provide funding for the long-term conservation of bean, rice and vegetables for a three-year period (2008-2010).
 - Sweden*
Sweden has provided an Associate Professional Officer to the Trust for three years (2007-2009).
 - Swiss Agency for Development & Cooperation (SDC)*
SDC have entered into an agreement with the Trust to provide funding for an Independent Financial Advisor for a period of three years (2007-2009).
 - United States Agency for International Development (USAID)*
USAID have confirmed that they will provide the Trust with program and operational funding for the year.
3. Canada will provide unrestricted funding in the amount of CAD 1 million as part of a ten-year CAD 10 million Agreement, 2003-2012.
4. The Trust has provided for a contingency of 5% on non-project program and operational expenditure for the year. It is not necessary to include a contingency in respect of long-term grants in the budget as (a.) the level of commitment is set by contract and not variable, and (b.) the Trust will not withdraw the entire 4.5% authorized under the investment objectives and policies as annual income from the endowment fund, thereby creating the possibility and option of tapping this “reserve” should there be a dramatic fall in markets. These funds therefore remain invested while still remaining available for use if absolutely necessary to meet the Trust’s contractual agreements with grantees.