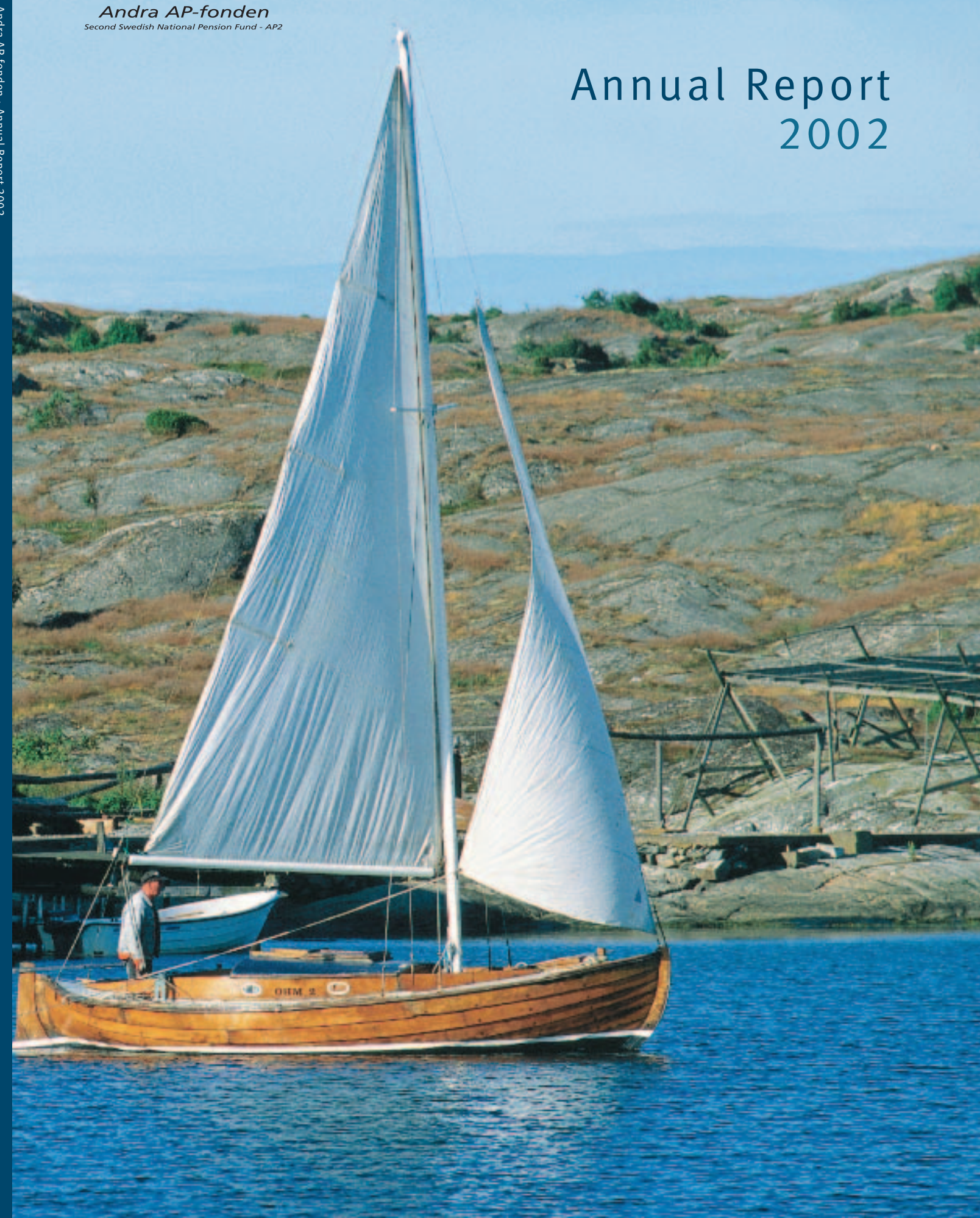




**Andra AP-fonden**  
Second Swedish National Pension Fund - AP2

# Annual Report 2002



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This year's visual theme symbolises longevity – focusing on lasting values that span generations. Qualities that are also intrinsic to pension funds.

## The Second AP Fund in brief

- The capital assets invested in Sweden's publicly financed national pension system are managed by "buffer funds", which invest these assets in the capital markets. The joint regulations governing investment by the First to Fourth AP Funds permit investment in several different asset classes and on different markets.
- The Second Swedish National Pension Fund/AP2, located in Gothenburg, started operations on January 1<sup>st</sup>, 2001. During 2002, the Fund progressively developed and implemented its strategies and infrastructure to become a modern and internationally focused asset management organisation.
- The Board of the Second Swedish National Pension Fund/AP2 consists of nine directors, appointed by the Swedish Government. Each director is appointed on the basis of his/her individual ability to further the Fund's management goals.
- The aim of the Second Swedish National Pension Fund/AP2 is to ensure that the Swedish pension assets for which the Fund is responsible are invested to generate a maximum long-term return at minimum risk, supported by efficient and professional asset management techniques.
- The Second Swedish National Pension Fund/AP2 is determined to be the most successful Swedish pension fund manager, with respect to the long-term return generated on invested assets. This shall be achieved through the successful in-house management of assets and skilled "management of managers".

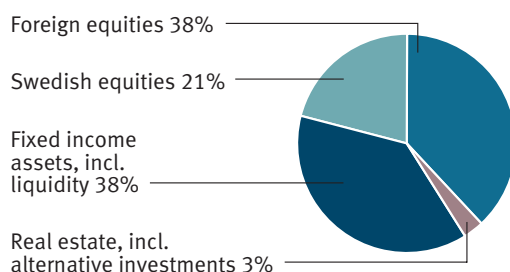
Amounts in Swedish kronor are given as SEK k (thousand), SEK million (million) and SEK billion (thousand million).

Andra AP-fonden is officially translated as the Second Swedish National Pension Fund/AP2. In body text, for convenience, this is shortened to the Second AP Fund.

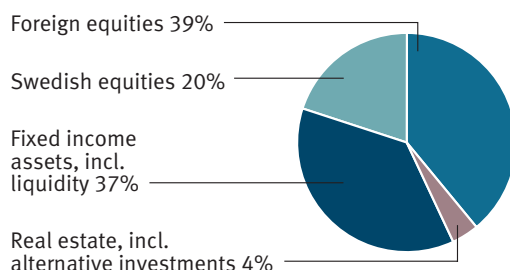


# The year in brief

## Portfolio as per Dec. 31<sup>st</sup> 2001



## Portfolio as per Dec. 31<sup>st</sup> 2002



Unless otherwise stated, the portfolio assets referred to in this report are "allocated exposures". In addition to booked market values, these also refer to allocated (but not yet invested) liquidity for the specific asset class, and the liquid funds held as collateral for positions already taken in derivative instruments. Asset classes, derivative instruments and liquid funds are reported individually in the balance sheet at market values.

- The capital assets of the Second Swedish National Pension Fund/AP2 totalled SEK 117.1 billion on December 31<sup>st</sup> 2002. At the start of 2002, the Fund had a total of SEK 133.5 billion under management. During the year, the Fund reported a net inflow of SEK 5 billion.

- The return on the Fund's invested assets for the full twelve months ending December 31<sup>st</sup> 2002 amounted to -15.3 percent. This was a 0.4 percent improvement against the Fund's benchmark index\*, corresponding to SEK 586 million. Excluding the Fund's operating expenses, this generated a relative return on invested capital of 0.6 percent, corresponding to SEK 783 million. The decline in the Fund's assets may be attributed to the sharp drop in market rates on the world's leading stock markets during 2002.

- Unlike many other institutions, the Fund maintained the composition of its investment portfolio, featuring a surplus allocation of equities, throughout the year. This is partly attributable to the Fund's extremely long-term investment horizon, partly to a code of practice which frees the Fund from a need to sell large blocks of shares, such as for consolidation.

- A significant reallocation of portfolio assets was implemented during the year, both in equities and fixed income investments. This has led to increased geographic differentiation and a greater focus on active management and absolute return.

- The composition of the portfolio at year-end remains within the approved parameters of the benchmark portfolio, as defined by the Fund's board of directors. The benchmark portfolio comprises the following: fixed income assets (37%); real estate (3%); Swedish equities (20%) and foreign equities (40%).

- In line with the Fund's investment strategy and after an extensive process of evaluation, a number of external mandates have been awarded to external fund managers. This policy is designed to secure the services of those best qualified in the management of specific asset classes and geographical markets. The Fund has also procured the services of a new bank to be its global custodian.

\*) During the year, the Second AP Fund has revised its benchmark index in conjunction with the change in the composition of the portfolio (see page 9).

# Chief Executive's review

**Working with something as important as Sweden's new national pension system is both a solemn responsibility and a highly stimulating challenge. Our task as a fund manager is both responsible and stimulating, in that our day-to-day work requires that we, through a combination of professionalism, competence and good judgement, ensure that the assets we manage accrue in value, to ensure the security and wellbeing of tomorrow's pensioners.**



**t**he Second AP Fund's primary task is to adopt an extremely long-term investment perspective. But effective long-term investment assumes the ability to act rapidly in the short term, to secure the best long-term solutions.

The role played by Sweden's AP (National Pension) or "buffer" funds is to be that part of the national pension system that, from an asset management perspective, accepts a higher level of risk. The task assigned to us is to generate maximum return at only limited risk, taking into account the relevance and growing importance of environmental and ethical issues. In concrete terms, this means that a large part of the portfolio, in the form of equities, is exposed to risk.

The ratio between equities and fixed income securities is based on estimates and analyses about how assets can best be allocated to create the optimal portfolio, with a view to fulfilling future demands in terms of pension disbursements. In our case, the real return on investment should amount to about 4.5 percent a year, demanding a relatively high proportion of equities. This portfolio strategy is based on the fundamental principle that, in the long term, equities generate a higher return than liquid deposits or fixed income securities. If this assumption proves to be a false premise in the years ahead, the

global economy is heading for gigantic problems that would far outweigh the importance of issues such as the demands placed on Sweden's AP Funds in terms of yield requirements and asset allocation.

After 2001, which involved a major reallocation of Fund assets, from fixed income securities to a long-term strategic portfolio with a majority of share-related assets, 2002 has provided a whole series of unpleasant economic surprises. Seldom have economic forecasts been so far off target as in 2002. The Stockholm Stock Exchange had not performed so badly for 72 years!

With this in mind, it would of course have been better, at least in the short term, to have been less exposed in equities. However, this only becomes clear in retrospect. Even if we had responded otherwise, it would have meant a radical departure from our long-term investment strategy. The risk involved in abandoning an agreed strategy is that you end up by compounding the negative effect: by the time the market is on the way up again, you may have already "missed the train".

The virtues of pursuing an agreed strategy are well demonstrated by the fact that the Second AP Fund's capital assets amounted to SEK 137.5 billion in March 2002 in absolute terms. This was the highest level noted since the Fund was established in January 2001.

Many qualified analysts believed, as we did, that the economy would gradually recover during the second quarter, and that we should see relatively solid macro-economic growth by the close of 2002. We now know better.

When it comes to long-term economic growth, the Second AP Fund believes in a balanced view. We are now reaping the consequences of a previous decade not only of major political and economic progress, but also of stock market bubbles and uncontrolled speculation.

## **Value-generating asset management – the next challenge**

After a two-year period of build-up and establishment, the Fund's next challenge is to consolidate operations, to

focus on value generating asset management – in the most concrete sense. It sounds self evident, but everyone with practical experience and expertise in fund management is all too aware of how the smooth interplay between each element of the asset management process is crucial to the end result. It is the combination of smooth day-to-day management and a tactically well considered balance between asset classes that determines whether a solid surplus return can be generated, based on the selected investment strategy and benchmark portfolio.

During the autumn, the Fund implemented a major reallocation of the equities portfolio, a process that will be refined and extended during the first half of 2003. The Fund's strategy of managing a portion of the portfolio in-house while simultaneously delegating a substantial portion to external fund managers has considerable potential. At the same time, it is clear that a number of Swedish and international fund managers are finding it difficult to meet their index. Even with respect to passively managed assets, where only minor gains are required to meet the specified index, managers have failed in many instances. There is also good reason to question why the mediocre or directly negative results of asset managers who already receive high salaries should be rewarded with bonus payments and other forms of remuneration. In this context, the international trend is for large pension funds to practise more active asset management, where interest in real estate funds and alternative investments, as well as unquoted companies, hedge funds and a demand for more absolute returns is growing rapidly.

#### **Active governance in a globalised world**

The structural transformation process within industry and society at large is accelerating, to achieve economies of scale and increased productivity. And the globalisation process has continued in parallel. The development of faster communications ensures that economic and political changes, whether negative or positive, have a much more immediate impact than before. In a financial system where "patient capital" in many cases is either totally absent or shrinking in significance, the role of institutional investors as active and responsible owners is becoming all the more important. This is something that became all too clear during 2002. The accounting scandals, business cartels and destructive incentive programmes that hit the headlines have nevertheless had the positive effect of placing corporate governance a good deal higher on companies' agendas. The Second AP Fund has also revised its corporate governance policy. The primary objective in instituting such a governance policy is to safeguard and protect the Fund's investments. It is therefore important that the ethical and moral principles and values espoused by companies in which the Fund invests should be clearly demonstrated in practice. A company may well function quite satisfactorily in the short term, although already morally bankrupt.

The Second AP Fund's corporate governance policy will also change and develop with time. In the short term, attention will focus on issues such as in-house accounting routines and reasonable incentive programmes. Another important issue is the need to increase female representation on corporate boards. The Second AP Fund has therefore introduced an index that uses 2002 as its starting point for stimulating and accelerating a more focused effort, to better utilise this potential to the benefit of corporate boards and executive managements. The goal is to ensure, within the next three years, that Swedish companies shall in general have doubled the number of women on their boards.

#### **The year in figures**

As already noted, 2002 was a wasted year in terms of stock market performance. My colleagues and I are naturally far from satisfied with a return of minus 15.3 percent, even if we performed somewhat better than our benchmark index. Fund pension assets under management totalled SEK 117.1 billion on December 31<sup>st</sup> 2002. Since the Fund was established on January 1<sup>st</sup> 2001, we have noted a surplus return of 1.8 percent against our benchmark index. During this period, the world's major stock markets have seen their estimated worth decline by between 53 and 33 percent. Even though our strategy may have resulted in a decline in value in the short term, our economic objective remains the same – to be 0.5 percent better than our benchmark index based on our agreed strategy.

#### **Looking ahead**

Trying to predict economic trends at the start of the year is always a tricky process, but predicting developments in 2003 poses greater challenges than for a very long time. We are nevertheless cautiously optimistic that, by the latter part of 2003, the economy will have recovered sufficiently to impact favourably on regular financial forecasts and growth ratios.

At the Second AP Fund, the work of improving and developing our asset management skills has the highest priority. In this respect, with sound evaluations and professional staff, 2003 looks as if it could be a very good year. We are determined to continue to be open to innovation and, within reason, to extend the limits on which traditional asset management is based.

There's a saying that only those who know their own strength dare try new ways. In all humility – we'd like to try.

Gothenburg, February 2003



Lars Idermark  
CEO





– My dad's got the world's finest saxophone. He's had it for ages and says it's too precious to play with. I only play the recorder, but dad says that maybe, when I'm ten...

Emma, 6 years old

# Fund strategy

## in the short and long term

**As a consequence of the ALM (Asset Liability Modelling) study, revised in 2002, the Second AP Fund has developed a new benchmark portfolio that offers a still better diversification of risk while simultaneously meeting the Fund's objectives with respect to long-term returns. A guiding principle of this new strategy is to increase the portion of capital assets managed in accordance with the requirements placed on an absolute return.**

**W**hen the new AP funds were formed, the freedom to invest a significantly greater proportion of total pension assets in the stock market signified an important change in policy. These new investment regulations derived from the simple fact that funds, in which fixed income instruments were the pre-dominant form of investment, were thought unlikely to be able to generate the required returns. During the first full twelve months of operations – in 2001 – the Second AP Fund, in common with the three other large AP funds, instituted an extensive re-allocation of the assets in its portfolio, involving the sale of fixed income instruments and the purchase of foreign equities. By the late autumn of 2001, the Fund had achieved parity in terms of the composition of the actual portfolio and that of the benchmark portfolio, as approved by the board of directors. Put simply, by year-end 2001, 60 percent of the Fund's portfolio consisted of equities and 40 percent consisted of fixed income instruments and investments in real estate. This ratio derived from an ALM study of the Fund's long-term asset and liability sides, based on a number of economic and financial assumptions and on demographic data supplied by RFV (The National Social Insurance Board).

With the falling stock market rates of 2002 still fresh in our minds, it is only natural to question this realloca-

tion of the AP funds' assets from fixed income instruments to equities, with respect to timing, tempo and its analytical basis. It is equally important to look forward – how should one build up a portfolio to achieve a more diversified risk, a portfolio with a yield profile that is



**How should one build up a portfolio to achieve a more diversified risk, a portfolio with a yield profile that is expected to be better than the return available from fixed income instruments?**



expected to be better than the return available from fixed income instruments?

### **The role of the AP funds in the new national pension system**

It is worth noting that the role the AP funds play in the national pension system as a whole, although important, is nevertheless limited. At a rough estimate, Sweden's combined "pension liability" amounts to about SEK 5,000 billion. Of this total, approximately 90 percent is financed from contributions in the form of taxes and charges levied according to the "pay-as-you-earn" method, whereby the part of the population that is

currently in gainful employment pays, on an ongoing basis, for the pensions of those who have retired. The remaining part, about 10 percent or approximately SEK 500 billion, is financed from invested capital built up within the AP funds, with the first net payment scheduled for around 2010, when ongoing contributions to the national pension system will be insufficient to cover pension disbursements. This means that only a very small proportion of the Swedish pension system's total assets are invested in equities: at present, about five percent. To ensure that the AP funds can meet their commitments, a real average annual return on investment of from four to five percent may be required in the long term. Historically, evidence suggests that a portfolio featuring a relatively high proportion of equities is the only way to achieve such a high return in the long term.

#### Criticised reallocation process

The AP funds' extensive investment in equities must be seen in this context. As part of the public debate, some have argued that the reallocation of portfolio assets from fixed income instruments to equities was implemented at the wrong time. There is naturally something to be said for this argument, especially with the benefit of hindsight. If reallocation of the funds' portfolio assets had been conducted at a time when the market rates for equities were at their lowest, the assets under management would have had a better chance of achieving rapid growth in value. However, the pension assets managed by the AP funds are not intended to reach their maximum size until some time after the year 2010. For this reason, a decline in stock market rates for one or more years at the start of AP fund activities will not necessarily have a decisive impact on the end result. It is also important to point out that the AP

funds, unlike insurance companies and others, are not required to fulfil specially drafted consolidation requirements when deciding on the composition of an investment portfolio. This means the AP funds are allowed to have a greater percentage of equities in their portfolios than some other institutional investors, such as the life assurance companies. No enforced sales of equities with the realisation of consequent losses have been required during the year. This meant that, during the stock market decline of 2002, the Second AP Fund was able to become a substantial net purchaser of equities. This coincided with the fact that many insurance companies were forced to sell large parts of their stockholdings on a bear market. This has meant that the AP funds are in this respect better positioned to benefit from a normalisation of stock markets over the next few years.

#### Increased focus on absolute return

In conjunction with the 2002 revision of the ALM study, the Second AP Fund has established a new benchmark portfolio that offers a better differentiation of risk while at the same time meeting the Fund's long-term yield requirements. A key element of this new strategy is an increase in the proportion of invested assets that are to be managed to satisfy an absolute yield requirement.

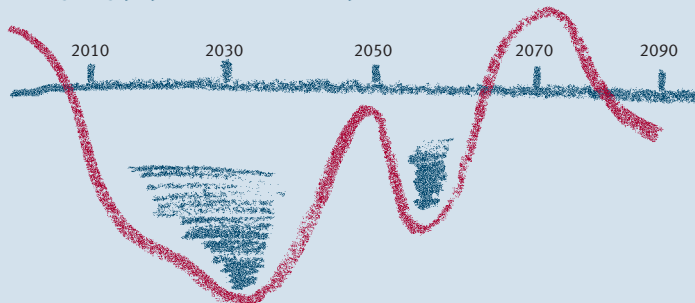
During the year, the Fund has conducted a reallocation of earlier portfolio

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**This means that only a very small proportion of the Swedish pension system's total assets are invested in equities: at present, about five percent.**

”

#### The ageing population creates a pension deficit



The role of the AP funds, financed from invested capital, is to contribute to pension disbursements when ongoing contributions to the national pension system are no longer sufficient to cover pension liabilities. This process is expected to start some time around 2010.



assets to create the new portfolio. Continuing adjustments to the structure of this new portfolio will gradually be introduced over the next few years. The reason for this cautious pace is that the Fund wishes to carefully study the degree to which this new portfolio strategy affects results and risks.

Virtually all the large international fund managers are to some extent engaged in “passive” or index-related asset management. This involves managing all or at least the greater part of a fund’s own equities or fixed income portfolio to mirror a selected index. In practice, this means that the particular fund’s own portfolio consistently mimics the performance of the chosen index. International fund managers often choose the MSCI World Index, that combines several large stock market indexes, while in Sweden it is more common to choose a broad general index that better reflects the Stockholm Stock Exchange. The various indexes are capital weighted, i.e. based on the market worth of all quoted companies in each case.

On a very large equities market, such as the American stock market, the share price of a single company can only marginally effect the performance of the index as a whole. Conversely, however, fluctuations in the share prices of large companies on small stock markets can have a major impact on index performance. For example, Nokia accounted for 71 percent of the Helsinki Stock Exchange’s HEX index at year-end 2000, while Ericsson accounted for 27.5 percent of the OM Stockholm Stock Exchange’s SBX index. When it comes to the Nordic exchanges, therefore, risk is not as differentiated as on the world’s largest stock markets, such as in the USA.

When asset management is so closely related to index, the expressed intention is that the portfolio under man-

agement shall develop in line with the stock market as a whole. Investors seek stock market exposure as such, and the market’s upswings and downturns are directly reflected in the portfolio, depending on how the index has performed. The benefits of index-related asset management are self-evident in a buoyantly bullish market: it enables a fund manager to simultaneously invest at low cost in many different corporate stocks, which would otherwise be impossible to monitor. The downside of passive management against index reveals itself when stock market performance is flat or distinctly bearish, especially on a stock market where the performance of a few large companies has a major impact on index. In 2002, the decline in the value of the Ericsson share alone accounted for 14 percent of the Stockholm Stock Exchange’s total decline of approximately 35 percent.

According to a study conducted by the Second AP Fund in 2002, the decline noted by the Stockholm Stock Exchange during the year derived mainly from the sharp drop in the share prices of a few large and heavily index-weighted companies, often in the same sector. If these few companies had been excluded from the equation, the decline on the Stockholm Stock Exchange would have been much less dramatic, given that the shares of several small and midsize companies have performed fairly well, a fact that the SBX index totally failed to reflect. Generally speaking, the stock market declines of the past two to three years

“Generally speaking, the stock market declines of the past two to three years have been related to a number of specific sectors and, at least to some extent, could have been avoided if a larger percentage of the shares traded had been actively managed.”

### Absolute and relative risk

Absolute risk refers to the financial risk incurred by investment in a portfolio, as compared to the same amount in the form of liquid funds. In this context, the Fund’s total assets are considered to be a portfolio with subsidiary portfolios containing different asset classes, such as portfolios of equities and bonds.

Absolute risk can be measured in several ways. The most common methods are to measure “volatility” and “value at risk”. Most absolute measures of risk, including both the above, are based on variability and correlation of the underlying contents of the portfolio. Essentially, a portfolio’s absolute risk is determined by how Fund capital is strategically allo-

cated among respective asset classes. Major investment in asset classes that feature considerable variations in market value, such as equities, involves high absolute risk, and vice versa.

And the fact that variations in and between asset classes are not consistent over time must also be considered. When variations in and between asset classes increase, this can lead to a substantial rise in the portfolio’s absolute level of risk. This is precisely what has happened on the unstable equities markets of recent years.

Relative risk refers to the risk incurred by deviations from the strategic benchmark portfolio. This relative risk is normally measured

with a “tracking error”. Deviations from the strategic allocation of assets can arise partly due to market movements that change relative distribution between asset classes, and partly due to active departure from the strategic allocation policy. It is important to note that the active adoption of a relative risk can be employed both to reduce and increase a portfolio’s absolute risk. The absolute risk can be reduced by an over-weighting of asset classes that feature a low degree of variation, or by rebalancing the portfolio to correspond to the strategic allocation at a time when higher-risk assets have performed well and have changed the portfolio’s actual composition.

have been related to a number of specific sectors and, at least to some extent, could have been avoided if a larger percentage of the shares traded had been actively managed.

Another effect of this index or index-proximate management is that the managers of large portfolios can find themselves forced to buy into companies in which they have no confidence, since the evaluation is based on how well the share has performed relative to the chosen index. When viewed in this context, any deviation from index is considered to be a definition of risk. It should nevertheless be stressed that fund managers are often justified in acting like this, since this is how the management mandates are formulated. A description of the implications of (and relationship between) absolute and relative risk is given on page 7.

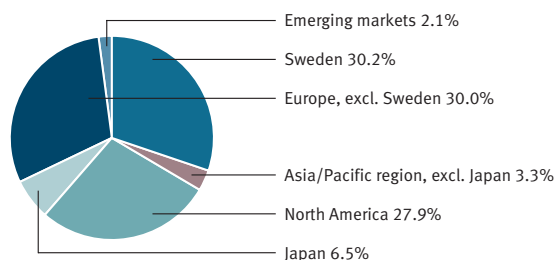
#### **New benchmark portfolio ensures greater diversification**

To differentiate the risks, the major fund managers choose to invest in several asset classes on a number of different geographical markets. In terms of the Second AP Fund's portfolio, this has meant that a greater part of the Fund's equities comprise shares in US and European companies. However, in the context of the Swedish Stock Exchange's relative size in international terms, which accounts for not more than about two percent of the market, Fund investments in the Swedish stock market are clearly over-represented – almost a third of the share portfolio consists of Swedish equities. Seen in terms of the Fund's role in Swedish society, this is both natural and reasonable, given the fact that the Swedish National Pension Funds are an integral part of the Swedish econo-

my as a whole. In strict asset management terms, however, this can cause a number of problems.

To diversify risk without at the same time deserting the Swedish stock market, the Fund has developed a partially new portfolio strategy, based on the findings of the ALM study conducted in the spring of 2002. The Fund's board of directors has subsequently decided on a somewhat modified and more refined benchmark portfolio, compared with the earlier one. The new fixed income portfolio features an internationally diversified bond portfolio, with an increased proportion of corporate bonds. To reduce the Swedish equities portfolio's dependence on the performance of a few large Swedish companies, the asset class known as "Swedish equities" has been revised to increase the relative proportion of investments in small and midsize companies. Furthermore, new asset classes such as "emerging markets" and "real estate" have been partially redefined.

**Second AP Fund's equities-related securities exposure by region, Dec. 31<sup>st</sup> 2002**



#### **The Second AP Fund's new benchmark portfolio**

The Swedish equities portfolio has been divided into three parts to enhance the potential for achieving a better



absolute return and to reduce dependence on the performance of a few large companies' shares in the capital weighted index. In practice, this means that about 70 percent of the Swedish equities portfolio will continue to consist of capital weighted equities, 20 percent equally-weighted equities (where the 50 largest companies are accorded the same weighting, regardless of actual market worth) and 10 percent equities in small and midsize Swedish companies. By reducing the proportion of capital weighted companies from 100 percent to 70 percent, it is hoped that the Fund's portfolio of Swedish equities will generate a better absolute return than before, to prevent a decline in the share prices of single large companies from having such a devastating impact on the portfolio as a whole. On the other hand, should the market stage a strong recovery, the Fund's relative return on this portfolio of assets could be less satisfactory, as the largest listed companies will post the strongest gains.

The portfolio of foreign equities will also gradually be changed in certain respects. Its regional composition is being changed to somewhat reduce the holdings in US companies. This shortfall is being compensated by a corresponding increase in mainly European and Japanese stocks. Another change is that a small part of the foreign equities portfolio will consist of shares in companies in "emerging markets". This will help to ensure that the weighting of the portfolio will be more closely related to the respective economies share of the global economy.

Apart from a small percentage of the whole, the foreign equities portfolio was managed externally during 2002, in accordance with a number of mandates.

The new benchmark portfolio offers the Fund's fixed income investment managers an opportunity to broaden the fixed income portfolio, in geographic terms as well as in real estate and corporate bonds. In the long term, about

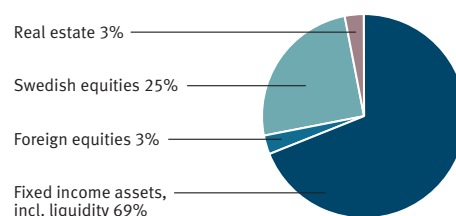
40 percent of the fixed income portfolio will consist of Swedish nominal bonds, 40 percent of foreign nominal government securities and 20 percent of Swedish real fixed income instruments.

The benchmark portfolio now also features holdings in unlisted real estate companies as an approved asset class.

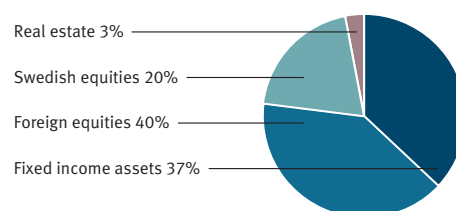
### Gradual implementation

The degree of active asset management and the focus on an absolute return will intensify over the next two to three years. During this period, the composition of the portfolio will be analysed and evaluated continuously, to determine the expected return in relation to absolute and relative risk. Another factor that will affect how fast the portfolio can be implemented will be the availability of specialised external asset managers with the appropriate expertise.

**Initial portfolio Jan. 1<sup>st</sup> 2001**



**Benchmark portfolio Dec. 31<sup>st</sup> 2002**



### The Fund's new benchmark portfolio

	Benchmark portfolio, %	Permitted interval, %
Swedish equities <sup>1)</sup>	20	15–25
Foreign equities, hedged	32	20–40
Foreign equities, non-hedged	6	4–17
Foreign equities, emerging markets	2	0–3
Swedish fixed income instruments, nominal	16	10–25
Swedish fixed income instruments, real	5	2–8
Foreign fixed income instruments, nominal	16	10–25
Real estate	3	0–15
Alternative investments (unlisted)	0	0–5

1) Consists of the following: SBX (70%), OSX equally-weighted (20%) and Carnegie Small Cap Index (10%).





–My car and I are of the same vintage – 1953. It's in fantastic condition: every single component is original. A car like this has a value that lasts. I enjoy lavishing care and attention on cars: it's my favourite hobby, as well as my job.  
Gunnar, 49 years old

# Investment regulations for Swedish National Pension Funds

The four buffer funds, the First to Fourth AP Funds, have joint investment regulations, established in conjunction with Sweden's pension reform in 1999.

The following regulations define the relative proportions for each asset class under management. Compared

to earlier, the new regulations permit greater exposure in equities and increased investment in international stocks. These new investment regulations establish the appropriate conditions for an increased return on long-term investment.

- Investments may be made in all types of listed and negotiable instruments on the capital market.
- No more than 5 percent of the assets in each fund shall be invested in unlisted securities. Such investments shall only be made indirectly, via venture capital companies, mutual funds or by similar means.
- At least 30 percent of each fund's assets shall be invested in fixed income instruments with low credit and liquidity risk.
- Each fund's holding in listed Swedish companies shall not exceed the equivalent of 2 percent of the total Swedish stock market value.
- Each fund may own no more than 10 percent of the votes in a single listed company. The corresponding limit for unlisted venture capital companies is 30 percent.
- The Funds may not invest in warrants, forward contracts or other financial instruments based on commodities as collateral.
- After a gradual increase of five percentage points per year, from 15 percent in 2001, no more than 40 percent of a fund's assets shall be exposed to currency risk.
- No more than 10 percent of a fund's assets shall be exposed to one issuer or one group of issuers.
- At least 10 percent of the assets of each fund shall be managed by outside managers.



# –Net profit on the world’s productive capital will be decisive to future pensions

Every year, the Second AP Fund’s Annual Report features an article written by an independent contributor. This year, our contributor is Kjell-Olof Feldt, who describes how the expectations placed on Sweden’s AP funds have changed and evolved since Sweden’s 1957 national pension reform.

Pontus Lundahl/Presens Bild



Politician and author, Kjell-Olof Feldt served as Sweden’s Minister of Finance in successive Social Democratic governments that were in power from 1982 until 1990. Mr Feldt has held (and holds) a number of positions on the boards of several institutions, including the chairmanship of the Board of Governors of the Bank of Sweden (1967–1970 and 1994–1998) and as founder and chairman of Stiftelsen Pensionsforum (The Pensions Forum Trust), an organisation dedicated to disseminating information and influencing public opinion concerning pensions-related issues. Mr Feldt has also written several books, including an autobiography entitled “Det blev ingen storröst”, published in 2002.

My first public assignment was as Secretary to the 1957 Pensions Committee, when I was required to justify the fact that the introduction of a national pension scheme required the establishment of a substantial state pension fund. Its justification was simply a question of national economics, founded on the assumption that the private and voluntary savings of Swedish households would fail to provide a capital base sufficient to fuel the economic growth on which the Swedish State’s pension commitments were based. This assumption naturally included the recognition that such commitments radically reduced the Swedish population’s incentive to save for its old age. The National Pension Fund would thereby contribute to financing old age pensions through a form of saving which offered room for investment, which in its turn fuelled growth.

When one considers the role the AP funds are to play in the new pension system, one realises just how far government has distanced itself from those earlier concerns about capital accumulation, investment and growth. Today’s funds are expected to finance future pension disbursements for the current active generation, a generation

whose pension contributions are insufficient to cover its eventual pension requirement. The funds must finance future pension disbursements either from returns generated on invested pension assets or, if this is not enough, through disinvestment. And since the fundamental contention is that, not long after 2010, the pension system will be suffering from a substantial financial deficit, there is very little doubt that the AP funds will play an almost crucial role in determining the system’s ability to provide pensions that go some way to satisfying political ambitions and people’s expectations.

## Long-term role

Originally, the designers of Sweden’s pension reform described the role of the AP funds in somewhat different terms. They were expected to act as a financial buffer, should the system find itself in temporary imbalance, due perhaps to a sharp increase in the level of unemployment and/or a slowdown in the economy. However, because the level of pension contributions was set lower than the actual level of demographic growth essential to generate sufficient revenue to cover the eventual disbursement of income pensions – and having banked on a stable Swedish



economy with a reasonable level of growth – the AP funds had to be assigned a different and more long-term role. The actual crisis-management process was delegated to the balancing or “braking” mechanism. Even so, the name “buffer funds” was retained, although no longer a truly accurate description of their function.

Of course, no-one can at present say to what extent these buffer funds will be able to fulfil their intended role. Clearly, it will be easier the bigger they manage to grow over the next few years, since contributions still exceed pension disbursements. Estimates published at various times by the National Social Insurance Board (no less than 72) predict that, at their current size, the funds should generate a real annual return of at least two percent throughout the entire forecast period, assuming favourable national economic conditions. Less favourable conditions would require a return of close to four percent. These are the assumptions that must be made to avoid having to apply the “brake” more often than the estimates actually suggest.

#### **Are the financial markets up to the task?**

In the Second AP Fund annual report, Nigel O’Sullivan, of Goldman Sachs, writes: “Efficient fund management is decisive in securing a maximum return from pension assets”. He is here referring to the combined assets of the world’s pension funds, which he estimates to be about USD 13,000 billion or SEK 117,000 billion. It is reasonable to assume that these combined assets will grow even bigger, given the fact that a number of countries introduced national pension systems in the 1990s – systems that were more or less based on the idea that invested assets would be used to fund future pensions. To put it another way: the welfare of a rapidly increasing percentage of the Western world’s ageing population will be dependent on the performance of the international financial market, its yield ratio and value growth.

It is not unjustified to question whether the financial markets will be up to this. “Efficient fund management” will not be enough in itself. The deciding factor is likely to be growth in net profit on the world’s actively employed productive capital. In extreme cases, this net profit must be sufficient not only to fund the necessary renewal of production resources, but also to generate enough income to support as much as a third of a country’s entire popu-

lation. Of course, at this point in time, it is impossible to judge how large the net profit on income generated from production must be, and how this will affect the living standards of those in active employment. It is particularly difficult to imagine what might happen if, after some time, pension fund growth was transformed into the opposite, the result of having to realise invested assets in



**The AP funds will play an almost crucial role in determining the system’s ability to provide pensions that go some way to satisfying political ambitions and people’s expectations.**



order to fund pension disbursements. What would then happen to share prices on global stock markets – and to the return on productive capital? One possible hypothesis is the need for a much greater increase in savings and accumulation of capital outside national pension systems than is currently the case, if the financial markets are to be able to deliver the requisite return on investment.

#### **“Pay-as-you-earn” creates stability**

When confronted by a possible future scenario like this – whose relevance is of course open to dispute – it is nevertheless comforting to know that the Swedish pension system is based largely on taxation of the generation currently in active employment, even though these taxes/contributions may prove insufficient to fund the hoped-for level of pension entitlement. Thankfully, Sweden will therefore not be transformed into a country where a third of the population will be forced to survive on the return generated from invested capital.

However, when it comes to the AP funds’ ability to fulfil their joint role as a long-term financial buffer, the performance of the world’s pension assets on financial markets will be fairly decisive. The first annual reports published by the new AP funds indicate that a large proportion of the funds within the parameters defined by the Swedish Parliament have been invested in foreign equities and bonds. Clearly, fund managers are convinced that investment in international pension assets will yield a profit. Only time will tell how successful this strategy will be.

# Economic and financial trends in 2002

The Second AP Fund operates in a global financial environment and, in common with other financial institutions in the past year, has been radically affected by market movements that have been difficult to predict. The financial markets have reacted erratically and dramatically to the flow of news items, and there has been considerable uncertainty about forecasting long-term economic development.

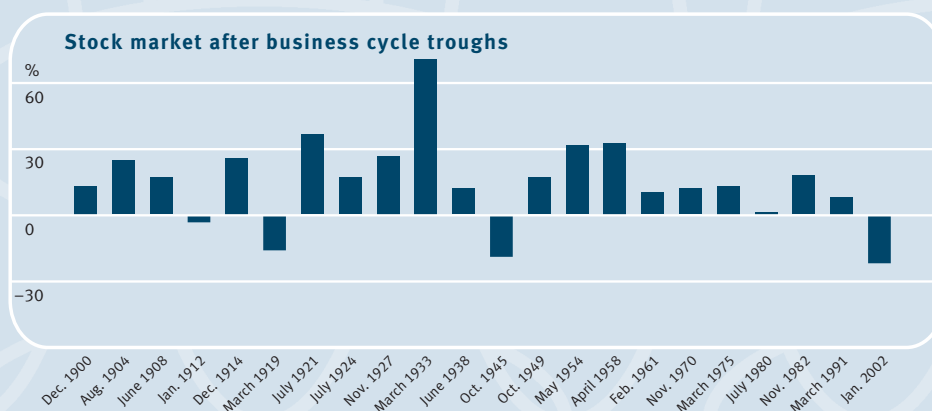
The prevailing uncertainty about the geopolitical climate was a contributing factor, the main focus being on the situation in Iraq, the accounting scandals affecting several large US companies and economic data that appeared to point in different directions. This has had a clearly negative effect on the willingness of international investors to incur risk, a fact mirrored by the reduced interest in equities and fixed income instruments noted on most of the world's stock markets.

Growth in the US economy was significantly better than had been anticipated at the beginning of last year, while the EMU area performed somewhat worse than expected. Expectations of a more stringent monetary policy remained unfulfilled and, despite additional monetary stimulus, anxiety about a global slowdown continued. This uncertainty revolved around questions such as:

- when and how the US economy would adjust to a lower rate of growth,
  - to what extent the risk of deflation could lead to a substantial and extended decline in consumer and asset prices,
  - how the economic policies of the major economies should be formulated to combat economic stagnation.
- In the light of this situation, and based on a widespread view that many shares were overvalued, many of the world's stock markets suffered from extreme volatility, with extended and substantial declines in market rates, punctuated by sharp but fleeting recoveries. The enforced sale of stocks by a number of institutional investors further contributed to this decline. The sheer size of the collapse in share values challenges comparison with the most dramatic market fluctuations of the 20<sup>th</sup> century, as well as the equally dramatic recoveries that followed these

The bars indicate the percentage change in the S&P 500 (fixed prices), 12 months after business cycle troughs in the US economy. The dates for these economic lows are taken from statistics issued by the NBER (National Bureau of Economic Research), apart from January 2002, selected by the Second AP Fund.

Source: Shiller and NBER



market lows (see bar chart). At the start of the year, the rates determined on bond markets were based on expectations of the introduction of more stringent monetary policies in 2002. Serious worries about the threat of deflation affected the market later in the year.

### Different conditions in the USA and EU

The USA and the EU adopted different approaches in dealing with downturns in their economies. In the USA, monetary policy approached its lower limit and there was a radical turnaround in fiscal policy. At the same time, the tensions inherent in the economic policy regulations applied within the EMU were laid bare.

Until year-end 2002, the US policy rate was maintained at its lowest level for the past 40 years, in the hope that the significant relaxations in monetary policy implemented in 2001 would achieve their full impact by the end of the following year. At the same time, the prospects for US fiscal policy were favourable and the Bush administration chose to promote an expansive fiscal policy, leading to a deficit in government finances.

Within the EU however, the relevance of the “Stability and Growth Pact”, conceived to establish joint controls for enforcing fiscal discipline on Member States, was questioned, even by key decision makers. At the same time, monetary policy, which is based on a predetermined ceiling for inflation, had varied consequences for the different EMU countries, which have very different rates of growth and inflation. The problems confronting the German economy were not only compounded by the fact that the real exchange rate was probably overvalued, but by the fact that the room for manoeuvre in the national budget, built up in previous years, gave insufficient latitude to enable the automatic stabilisers to take full effect.

### Positive deviation in Swedish economy

Given this climate of international, economic and structural uncertainty, Sweden’s economic development was relatively satisfactory. The slow-down in the economy

was modest and unemployment remained at a fairly low level. This situation was supported by a controlled rate of inflation, partially attributable to tighter monetary measures introduced in the spring. In the autumn, the Swedish Central Bank deemed that the risk of inflation was so low, it cut the interest rate on two separate occasions. Public debate concerning Sweden’s possible participation in the EMU helped strengthen the krona.

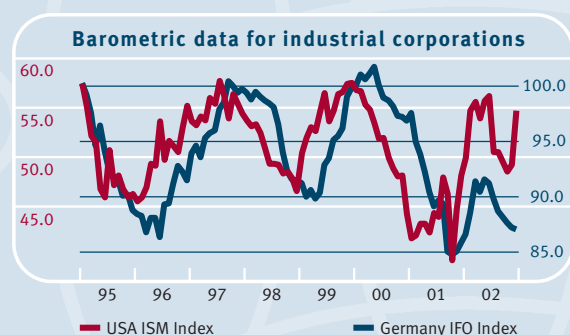
### Prospects for 2003

Looking ahead to the coming year, the genuine uncertainty concerning the global economic situation and the geopolitical prospects continues. As regards inflation, the indicators are still favourable.

The proposal the USA presented at the start of the year, concerning its long-term fiscal policy, was more comprehensive than had been anticipated. The resulting cyclical support that may strengthen the economy in 2003 is welcome. It will also require the consolidation and improvement of investments to support a subsequent upswing of the economy. Development of the financial markets will also depend on how successful companies are in generating profits, despite a low rate of inflation and growing international competition. Against this background, low nominal growth will be a fundamental starting point when acting on the world’s financial markets.

Although the prospects for predicting short-term movements on the financial markets are limited, a number of key trends may be discerned from the relative values assigned to different asset classes.

- The anticipated profits and P/E ratios for a number of large share indexes appear reasonable, when seen in relationship to their historical development and compared with the bond markets.
- The long bond interest rates seem low, even after taking low real growth and the risk of weaker state finances into account.
- Equities markets that offer a solid direct return seem particularly attractive, given these conditions.



Source: Ecwin



Source: Ecwin





–The watch dates from 1956.  
My mother was given it by her  
Uncle Gottfrid, who was a farmer  
and lived way out in the country.  
The watch is really beautiful – not  
a scratch. It was probably the  
most valuable thing he owned.  
My, 26 years of age

# Review of operations

## Tactical asset allocation

**The Second AP Fund's long-term investment focus is defined by its benchmark portfolio. It is this that determines the strategic allocation of assets.**

**Tactical Asset Allocation (TAA) refers to short-term deviations from the strategic allocation policy. The idea of tactical allocation is to benefit from temporary fluctuations in the performance of a specific asset class.**

**t**actical asset allocation can involve changes between different asset classes (Swedish equities, foreign equities and fixed income investments) or changes within different asset classes (equities or fixed income). Within the Second AP Fund, tactical allocation between asset classes counts as a separate "asset class", with its own mandate and risk budget. The success of the mandate is matched against the Fund's strategic benchmark index.

TAA differs from the management of individual asset classes in that it takes as its starting point the extent to which one should invest in a market or asset class, as opposed to where one should invest in a particular market. This makes it possible to add more value to the assets under management, in conjunction with the portfolio's long-term strategic focus and security selection.

In the broader context of the fund management process, the tactical allocation of assets lies somewhere between the strategic allocation of assets and choosing individual securities. The tactical exposure sought at every opportunity comes mainly from a portfolio of derivative instruments, which serves as a complement to the underlying portfolios. This approach makes it easier and less expensive to adjust exposure in accordance with shifts in market conditions. The short-term reallocation of assets need lead neither to the sale nor purchase of individual securities.

### **Few active decisions**

TAA is based on relatively few active decisions compared with the number of choices to be made concerning investments in the equities and fixed income portfolios. The

pace of change affecting an asset class is also driven by fewer factors than those influencing most securities.

TAA is driven mainly by macroeconomic factors. This "top-down" characteristic gives a valuable diversification of risk in contrast to the management of individual asset classes, which have a greater "bottom-up" element, where the relative assessment of individual securities are in focus. This applies particularly with respect to the portfolio of equities. This means that the investment decisions made within the sphere of TAA can result in a relatively low correlation with the actively chosen securities, and thereby contribute to diversification of risk in the portfolio.

TAA works better in cyclical markets than in markets characterised by strong trends over extended periods. The application of TAA produced excellent results during the 1970s, good results in the 1980s and unsatisfactory results in the latter part of the 1990s. Expectations of significantly lower returns on financial markets in coming years, and a more distinct interplay between the different asset classes, should ensure a far more favourable financial climate for TAA, compared with the past five or six years.

### **Re-balancing**

If an entirely passive approach is adopted with respect to asset allocation, market movements will gradually take over the actual allocation of assets. Rising relative prices in a specific asset class increase this class of asset's share of the portfolio and vice versa. The "least ambitious" form of tactical allocation is therefore to re-balance the portfolio with a view to keeping the strategic distribution of assets intact, or at least to ensure that the process is not

allowed to drift too far. Re-balancing can be conducted at predetermined intervals or when deviations from the normal portfolio have reached a certain level.

Re-balancing reduces the fluctuations in the portfolio through the sale of those assets that have risen in price, thereby becoming less attractive, and vice versa. Re-balancing allows the fund manager to “recoup” and secure a portion of the profit that market movements have generated in the portfolio.

A more active TAA approach permits the controlled over or under-weighting of asset classes, to exploit changes in the market situation.

The Fund plans to award mandates to external managers in 2003, based on the implementation of global tactical asset allocation.

### Tactical asset allocation in 2002

In 2002, the positions adopted in the tactical allocation of assets were significantly fewer than in 2001. The equities allocation swung between an over-weighting of about 3 percent, and an under-weighting of about 3 percent, compared with the benchmark portfolio. During the greater part of the year, the reallocations implemented were a form of re-balancing. All in all, the Fund’s basic view of the equities markets was far too optimistic during the year. Consequently, it failed to reap full benefit (in terms of a tactical allocation of assets) from the opportunities presented by the stock market’s decline. During 2002, the Fund has maintained a lower level of foreign currency exposure than that defined by the benchmark portfolio, so as to benefit from the strengthening of the Swedish krona during the year. This under-weighting has contributed to an active return. Taken as whole, the tactical allocation of assets made a positive contribution, compared with the Fund’s benchmark index.

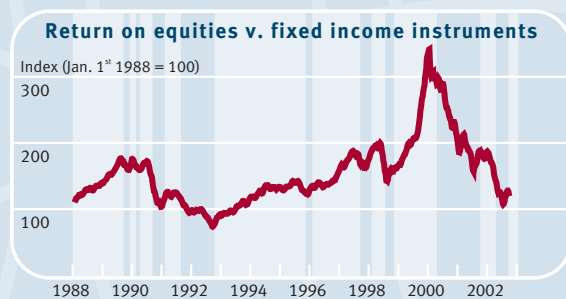
The Fund gradually built up a 1.5 percent over-weighting in equities at the start of 2002. Some inflows to the

Fund were invested in the equities market, raising the over-weighting in equities to approximately 2.5 percent.

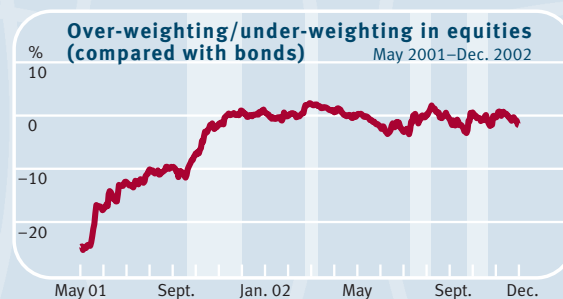
In the second quarter, the stock markets plummeted sharply and unexpectedly. Consequently, during April and May, the Fund’s over-weighting in equities was allowed to drift to a neutral allocation by the start of June. No active allocations were implemented during this period. The continuing decline of the world’s stock markets, not least in Sweden, led to a growing under-weighting of equities in the month of June. Limited re-balancing through the purchase of Swedish securities was conducted in the latter part of June, at which time the under-weighting in Swedish equities peaked at 3 percent of the Fund’s total assets.

The third quarter opened with yet another decline in share prices. Once again, the Fund implemented limited re-balancing, purchasing Swedish equities during the first half of July. During the latter part of July, the Fund increased its investment in equities to attain a neutral allocation in its portfolio. This enabled the Fund to benefit from the strong recovery staged by the stock market towards the end of July. The over-weighting in equities was steadily increased to almost 3 percent during the latter part of August. At this point, the Fund judged that the upswing would continue. Consequently, the September market correction was only to a limited extent utilised to realise profits.

The fourth quarter heralded a new upswing of the markets, which gradually increased the Fund’s over-weighting in equities. During this upswing, profit takings were realised when the over-weighting in equities rose to 2 percent on several occasions. A new downturn and falling interest rates in December led to a limited purchase of equities and corresponding divestment of bonds. All in all, the tactical allocation of assets has resulted in an over-weighting during the fourth quarter, compared with the Fund’s benchmark portfolio.



The graph matches total return generated by investment in the Stockholm Stock Exchange against that from Swedish bonds. Equities during the periods marked in light blue have outperformed fixed income investments (blue).  
Source: Ecwin and Second AP Fund



The graph shows the Second AP Fund’s equities, as a percentage of total assets, compared with the benchmark allocation. (+) indicates over-weighting, (–) indicates under-weighting. The light blue bands indicate periods during which the stock market rose by 10% or more.



# Equities management

**The negative trend noted by the world's stock markets in 2001 continued through 2002. With only a few exceptions, the trend was the same on all major stock markets. Limited stabilisation of market rates during the first four months of the year was followed by an extended decline which bottomed out in early October.**

2002 was the third full year in succession with declining market values. During the final quarter of the year, however, the market staged a modest recovery, thereby somewhat limiting the overall decline for the full twelve months. During the year, the world's stock markets\* have generated a total return on investment of -24 percent, while in the same period, bonds\*\* globally generated a return of +2.3 percent.

## The international market

In spite of implementing a range of measures to stimulate the economy, the global stock markets revealed growing uncertainty during 2002 in conjunction with economic developments in several important markets. This general uncertainty, combined with the doubts surrounding the reliability of corporate reports after several accounting scandals in the USA, resulted in a highly sceptical attitude to the stock market as such. An additional factor that contributed to undermining hopes of rapid economic growth was the tense geopolitical situation in several parts of the Middle East.

The decline noted by the stock markets in the USA (Dow Jones), Great Britain (FTSE 100) and Japan (NIKKEI 225) amounted to between -15 and -25 percent for the full year 2002 compared with the start of the year. However, on the Nasdaq, America's technology dominated exchange, and in Germany (DAX 30), the markets noted a decline of almost 50 percent at the end of September. Over the full twelve months, these indexes posted declines of -31.5 and -44 percent respectively.

## The Swedish equities market

One of the specific factors that has had a significant impact on the Swedish stock market is uncertainty affecting developments within the telecom market in general and Ericsson in particular. The company's plans concerning a major new share issue and the potential impact on the capital market have dominated the financial media for the several months.

Cutbacks and postponed investment plans in the telecom sector have been major contributors to the extremely negative trend noted by the IT sector. At its lowest point,

in September, the Stockholm Stock Exchange's IT index posted a decline of more than 80 percent since year-end 2001, ending the year on -79 percent. The relatively better performance of other sectors, such as the engineering industry, was unable to compensate for the dramatic slump in the IT and telecom sectors. Consequently, despite a brief levelling out during the latter part of the summer, the Swedish Stock Exchange's general index continued to fall still further, until the start of October. At its lowest point, by early October, the Stockholm Stock Exchange's SBX index had fallen almost 50 percent since year-end 2001. During the full twelve months, the SBX index fell by 38.6 percent. The fact that many investors were soon forced to withdraw from the equities market, preferring the security of fixed income investments, further exacerbated this situation. Subject to current consolidation regulations, the enforced sale of equities by Swedish life assurance companies led to a dramatic surplus on the Swedish equities market.

Market uncertainty has also made it more difficult when seeking a stock exchange listing for new companies. Several stock exchange introductions had to be postponed, and the few companies which did gain a listing quickly saw their shares decline in value to a level below that of the original asking price at the time of the introduction.

## Equities management: focus and organisation

In strategic and organisational terms, the Second AP Fund's equities management activities involve a combination of in-house management in selected sectors, and external management in cooperation with a number of partners, acting under specific mandates.

In-house asset management activities are conducted in the following sectors: consumer products, IT/telecoms, finance/real estate, the pharmaceuticals industry and, in 2003, the engineering and raw materials sectors. These sectors, both at the Swedish and European level, are handled both by the Fund's own in-house portfolio managers as well as external asset managers. Other industries and regions are managed to closely reflect the index or by external managers. This specialisation in particular sectors is based on the growing importance of individual

\*) MSCI World index

\*\*) Lehman Global Aggregated, excl. Japan Government Index

asset managers' special competence in specific industries and in the internal logic of such industries, regardless of geographical borders, when assessing the long-term prospects for the creation of added financial value.

Equities management will thus in the long term be based on the fact that a significant proportion of the Fund's assets will be handled by external asset managers. An important task for the in-house asset management team, apart from handling the Fund's own portfolios, is therefore to sustain a continual and informed evaluation of the performance of external asset managers. During 2002, the Fund has negotiated a number of additional external mandates. The intention is that capital shall be supplied for these mandates in gradual stages, starting in 2003. External managers will consequently contribute resources in sectors and regions where the Fund lacks in-house competence, and will also help to complement the Fund's in-house asset management activities. The intention is to diversify risk in the Fund's active asset management and to build a network which can promote the development of the Fund's own asset management skills. The majority of the external mandates awarded by the Second AP Fund for the management of portions of its portfolio are shown in the table below.

### Swedish equities

The benchmark index previously used for Swedish equities was the SIXRX index, a share index that measures the performance of all shares traded on the Stockholm Stock Exchange, weighted according to a company's market value. The dividends issued by companies are also factored into index performance. Since the index is weighted according to the companies' market valuation on the stock exchange, a very limited number of companies have a decisive impact on index performance. To reduce dependence on the market performance of just a few companies, and to avoid the risk posed by the negative performance of these same companies, the Fund chose in the autumn to change to three different benchmark indexes for the equities portfolio.

- A significant part (70 percent) is still matched against a "capital weighted" index (SBX), comprising more than 80 companies and corresponding to 90 percent of the SIXRX. This involves more traditional asset manage-

ment and the portfolio is managed in-house, and by Carlson and SEB. This part of the portfolio incurs extremely low risk compared with index. The objective is a surplus return of 1–2 percent, compared with index.

- A completely new index has been created (OSX), which accounts for 20 percent of the Swedish equities portfolio and comprises the 50 largest companies on the Stockholm Stock Exchange. All companies have the same weighting in the index, which reduces dependence on the large companies. In addition to index performance, a target of a 10-percent-per-year absolute return on investment has been established. Fund managers will thus be evaluated against both the OSX and the ROI target. With this type of evaluation, the performance of assets under management is expected to deviate quite substantially from index. To further underline the importance of a positive absolute return, two limited investments have been made in hedge funds in this part of the portfolio. The external fund managers are SEB, Carlson, Carnegie, Enter kapitalförvaltning, RAM and Lundén kapitalförvaltning (Eikos).
- The last part (10 percent) of the Swedish equities portfolio involves the management of holdings in small Swedish businesses, where the Second AP Fund investments are in the form of shares in unit trusts. The performance of this part of the portfolio is matched against Carnegie's small business index (CSX). The objective here is to exceed index by 2–4 percent in the long term. The external fund managers handling this assignment are SEB, Carlson, SHB, Lannebo Fonder and Robur.

In 2003, the difference between the various parts of the Swedish portfolio will become more distinct. On the one hand, the portfolios will be matched against different indexes. On the other, the asset management styles adopted will differ clearly in approach. The objective is to secure a higher and more stable return on investment.

### Foreign equities

During 2002, the portfolio of foreign equities, apart from three mandates involving active management, have been indexed against MSCI World. During the autumn, a number of changes have been made to this part of the portfolio. To reduce dependence on the US stock market, the



### Global equities mandate

	Mgmt. style	ROI, %	Negative/surplus-return compared with index, %
MFS Institutional Advisors	(active)	– 25.7	8.0
Merrill Lynch Investment Managers	(passive)	– 33.9	– 0.3
Pictet Asset Management	(active)	– 33.9	– 0.3
State Street Global Advisors	(passive)	– 33.1	0.5

portfolio's indexed weighting has been reduced in favour of European, Japanese and Pacific Basin stocks. Investments have also been made in emerging markets. During 2003, current passive mandates will be transformed into "enhanced indexing" mandates. This refers to a form of asset management where the objective is to secure a return that exceeds index by 0.5–1 percent, but with an extremely low risk compared with index. These mandates can be global or regional. Of the Fund's external managers, Merrill Lynch, Barclays and State Street utilise this "enhanced indexing" approach.

At present, the Fund's external fund managers entrusted with active mandates focused on global stocks are MFS and Pictet. Active regional and sector mandates were negotiated in the autumn and the fund managers selected for new mandates starting in 2003 are Alliance Bernstein, Bankinvest, Citigroup, Credit Agricole, Deutsche Asset Management, Dresdner RCM, Franklin Templeton Institutional, Goldman Sachs, Govett Investment, Martin Currie, Scottish Widows, Singer & Friedlander and UBS. These fund managers aim to generate a surplus return of 2–4 percent compared with index.

The portfolio of equities in emerging markets will initially be managed by Foreign & Colonial, Deutsche Bank, Pictet, State Street Global Advisors and Genesis Investment Management. All of these are active fund managers in the sense that they strive to exceed index. The target is a surplus return of 1–4 percent, depending on mandate and fund manager. Management of the mandate for equities in emerging markets was implemented in December and is therefore not shown in the tables below.

#### Regional equities mandate

	Mgmt. style	ROI, %	Negative/surplus-return compared with index, %
Europe:			
› In-house portfolio mgmt.	(active)	– 30.0	0.9
› Barclays Global Investors	(passive)	– 29.6	1.3
North America:			
› Barclays Global Investors	(passive)	– 35.6	0.3
Japan:			
› Barclays Global Investors	(passive)	– 29.7	– 0.1
Asia/Pacific region (excl. Japan):			
› Barclays Global Investors	(passive)	– 20.6	2.0

#### Swedish OSX mandate

	Mgmt. style	ROI, %	Negative/surplus-return compared with index, %
In-house portfolio mgmt.	(active) *	14.8	– 4.7
Carnegie Kapitalförvaltning	(active) *	2.1	– 18.4
Carlson Investment Management	(active) *	4.0	– 16.6
SEB Asset Management	(active) *	0.8	– 6.8
Fund portfolio:			
› Enter Sverige Focus	(active) *	0.1	– 3.0
› RAM One	(active) <sup>2)</sup>	– 0.5	1.0
› Eikos	(active) <sup>2)</sup>	2.2	16.9

\*) ROI refers to part of the year.

1) The mandate has been deactivated during the year.

2) RAM One and Eikos are hedge funds, and are also being evaluated in line with an absolute ROI target.

#### Second AP Fund equities management in 2002

In the past year, the Fund's equities management activities entered the operational stage, with increased market exposure, after a build-up phase in which the focus had been on the recruitment of personnel and systems development. The Fund's in-house portfolio management organisation has gradually taken over responsibility for its own sector portfolios and for both its actively and passively managed portfolios of Swedish equities. In line with the Fund's long-term investment strategy, involving an allocation amounting to approximately 60 percent of the Fund's total assets, the Fund was a significant net purchaser of equities in 2002. This was achieved by a gradual re-balancing of the Fund's assets. New investment in equities during the year amounted to approximately SEK 14 billion, about 50 percent of which pertained to the Swedish market.

In all essential respects, the foreign equities portfolio has been indexed against MSCI World, with minimal opportunities for deviation from the agreed index. The only exceptions have been the three active management mandates for MFS and Pictet, and the Fund's in-house management of European equities.

At year-end 2002, the foreign equities portfolio had an estimated market value of SEK 46.1 billion, of which 85 percent was hedged. During the year, the foreign equities portfolio declined in value by –24.9 percent, while the benchmark index declined by –27.0 percent.

The Swedish equities portfolio declined in value by –36.7 percent in 2002. SIXRX noted a decline of –35.9 percent for the same period. At year-end 2002, the portfolio had a total value of SEK 22.8 billion.

#### Swedish SIXRX/SBX mandate

	Mgmt. style	ROI, %	Negative/surplus-return compared with index, %
In-house portfolio mgmt:			
› Portfolio 1	(passive)*	– 36.3	0.0
› Portfolio 2	(active)	– 32.9	2.8
SEB Asset Management	(active)	– 37.5	– 0.8
Carlson Investment Management	(active)	– 37.8	– 1.1
Carnegie Kapitalförvaltning	(active) <sup>*)</sup>	– 15.6	– 6.4
Alfred Berg Kapitalförvaltning	(active) <sup>*)</sup>	– 3.2	– 2.7

#### Swedish small business funds

	Mgmt. style	ROI, %	Negative/surplus-return compared with index, %
SEB Sverige small business fund	(active) *	11.9	– 3.2
Carlson Sverige small business fund	(active) *	15.7	0.5
Lannebo small business fund	(active) *	8.9	– 0.5
Handelsbanken small business fund	(active) *	4.4	– 0.8
SEB Sverige small business fund Opportunity/Risk	(active) *	– 7.6	1.7
Robur small business fund	(active) *	– 3.3	– 0.1





–The sound of metal against newly frozen winter ice – it doesn't get any better! I've had these ice skates for years, and they're still great to skate on. Look after them, and they'll last forever. Now I'm looking forward to teaching my grandchildren to skate.  
Agneta, 62 years of age

# Fixed income management

**Like the year that preceded it, 2002 was an eventful and volatile year on the world's fixed income and bond markets. Unlike 2001, however, the world's central banks have pursued a relatively stable monetary policy, waiting until later in the year before dropping interest rates in an attempt to stimulate an economic recovery.**

Bond interest rates have fallen during the year as a consequence of the continuing decline of stock markets and weak growth in the economies of the major industrialised nations.

## **Market trends in Sweden**

The Swedish economy has enjoyed more stable growth than the USA and Germany, for example, and the Riksbank (Sweden's Central Bank) has therefore acted differently to counterparts such as the Federal Reserve and the ECB.

What the Riksbank saw as worrying pressure from domestic inflation resulted in a more restrictive monetary policy, causing a rise in the repo interest rate of 25 percentage points on two separate occasions during the spring. During the same period, the world's stock markets remained fairly stable, arousing hopes of a rapid recovery – which were reflected in a gradual, if slight, increase in interest rates. During the late spring, however, this trend was broken. Weak economic indicators and a number of accounting scandals persuaded investors to flee the world's stock markets and seek safety in fixed income securities. The true value of the assets of life assurance companies and pension funds were questioned, as was their ability to guarantee future commitments. Towards the close of the year, the Riksbank reduced its key interest rate twice, by 25 percentage points, justifying the move by citing its own economic forecasts, which suggested that the inflation target would not be reached.

The reallocation of assets from equities to fixed income instruments, conducted during a period of increasingly deteriorating economic data, produced a sharp drop in bond yields. However, this drop was less dramatic in Sweden than in other countries, leading to a slight increase in yield spread during the year.

Swedish inflation-linked bonds have performed extremely well during 2002. The combination of a relative-

ly high level of inflation and falling nominal interest rates have generated a return that has surpassed other forms of investment in the Swedish market for fixed income securities. During the first nine months of the year, the Fund has maintained an over-weighting in inflation-linked bonds compared with the benchmark portfolio, which has had a positive impact on the overall return.

## **Global market performance**

Even in the international arena, bond market performance during the year has been affected by fluctuating hopes of economic recovery and growth that would fuel rising stock prices. Fears of economic developments similar to those being experienced by Japan, with the risk of deflation and low bond interest rates, have alternated with periods of optimism about an imminent recovery, complete with rising stock prices and bond interest rates. Nevertheless, the

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**Swedish inflation-linked bonds have performed extremely well during 2002.**

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negative data has predominated and, during the year, the market noted interest rates on long-term US bonds that fell to levels not seen since 1958. Fears of continuing weak growth and the absence of inflationary pressure led the Federal Reserve to reduce its key interest rate by 1.25 percent. The ECB (European Central Bank) which, unlike the Federal Reserve, pursues a monetary policy based on an agreed maximum level of inflation, acted more cautiously. Even so, in December, the ECB decided to drop its key rate by 50 percentage points. European interest rates also fell earlier in the year, but not to the same extent as in the USA.

In the US economy as well as in several countries within the EMU, the shortfall in state budgets led to increas-

ing problems. The fears expressed a couple of years ago, over the risk that the government bond market would shrink drastically as a consequence of large budget surpluses, have dissolved. Instead, we can expect to see an increased borrowing requirement over the next few years.

### The corporate bond market

Accounting scandals accompanied by the downgrading of borrowers' credit ratings, and even a number of bankruptcies, have created major problems for investors in the corporate bond market. The yield spread between government securities and the rates at which companies can borrow on the corporate bond market has expanded sharply.

As a result of the problems confronted by some large borrowers (such as Worldcom), investors have incurred substantial losses on their bond portfolios. On the Swedish domestic market, major problems affecting the finances of ABB and Ericsson have grabbed the headlines, resulting in sharply increased interest rates on these companies' bonds, and reduced credit ratings, which have fallen below investment grade. The consequence of such a low credit rating is that the bond loan is considered too high a risk for inclusion in the majority of investors' portfolios. What has happened on the corporate bond market has demonstrated the crucial importance of diversification when investing in high-risk assets. Consequently, the market for credit derivatives, which offer investors the option to adopt risk or secure guarantees against unpleasant surprises, has grown sharply.

### The foreign exchange market

After a somewhat vacillating start, the Swedish krona has strengthened steadily during the year. Speculation about Sweden's possible forthcoming membership of the EMU, an interest spread that favours the krona and more advan-

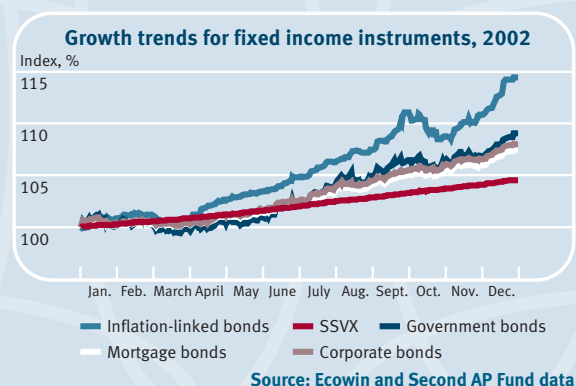
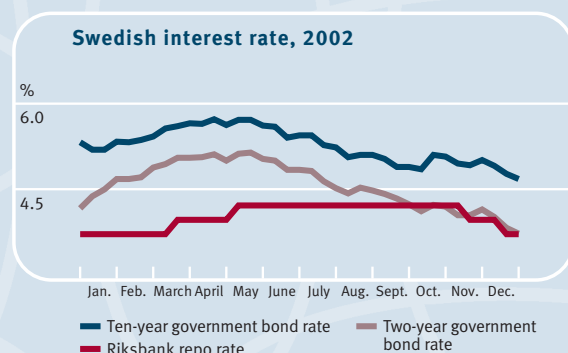
tageous financial flows have counteracted the normally negative effect of a bear market on the krona's exchange rate. 2001 saw a substantial net outflow of Swedish kronor, something for which the Second AP Fund and others were blamed in the public forum. Many analysts predicted that this outflow would continue in 2002, as a result of the phased increase in permitted currency exposure for the AP funds. However, the trend was rather the reverse and, by year-end 2002, the Second AP Fund's currency exposure had been reduced to approximately 7 percent, compared with 10 percent at the start of the year.

Otherwise, the foreign exchange market has largely been characterised by the general decline in the dollar rate. Security policy headaches, low US interest rates and financing of the USA's growing balance of payments deficit have all contributed to weakening the dollar, which is again below par value against the euro.

### In-house portfolio management

The year has been marked by the ongoing build-up of the Fund's in-house portfolio management team, with respect to both fixed income securities and FX (foreign exchange) management. Routines, manning, working methods and systems structure have been developed to satisfy the demands made by modern and efficient fund management. The Second AP Fund's fixed income management team currently comprises five asset managers with specialist competence in the fixed income and FX management sectors.

At the beginning of 2002, management of the fixed income portfolio was mostly delegated to external fund managers. Gradually, however, the portfolio has been transferred from external managers to the Fund's in-house asset management team, in parallel with a comprehensive revision of the fixed income portfolio's composition. At the beginning of the year, the Second AP Fund had a portfolio





that consisted exclusively of Swedish fixed income securities. To create a more effective and diversified portfolio, a greater number of parameters were included in the new ALM study conducted during the year. This has resulted in a fixed income portfolio that now consists of Swedish and global government securities, corporate bonds and other fixed income securities that carry a credit risk.

In the new benchmark portfolio, a distinction is made between nominal and inflation-linked bonds, which was not the case in the earlier portfolio. The portfolio's duration is extended as what was previously a significant portion of treasury bills is reduced. All foreign investments are hedged. The degree of currency exposure approved for the Fund is taken in positions on the equities market.

The agreed changes implemented during the autumn have involved a reallocation of assets from the Swedish portfolio (mainly from the portfolio of treasury bills) to global government and credit bonds. Assets were reallocated on three occasions, and considerable effort has been invested in ensuring that the Fund attains the required level of exposure and that the transactions are conducted in the most cost-efficient manner.

In future, management of the Fund's fixed income portfolio will be handled by a combination of external and in-house asset managers. The Fund has a high level of in-house asset management competence, but at the same time wishes to utilise the expertise of the best external fund managers, to ensure that the portfolio is optimally managed. Negotiations concerning the award of external mandates will be initiated in 2003.

During the year, management of the fixed income portfolio has generated a return of 8.9 percent, which is in line with the benchmark index. The Swedish portfolio, which has been managed in-house, generated a return of 9.7 percent, compared with the benchmark portfolio's 9.6 percent. The greatest deviations from the benchmark port-

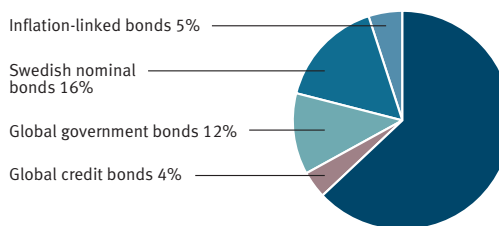
folio during the year consisted of an over-weighting in inflation-linked bonds up until the beginning of October, and a cautious degree of credit risk in corporate bonds.

Management of foreign fixed income securities generated a return of 2.7 percent, which was in line with the benchmark index. The active risk level in managing these assets has been low during the year, a result of the work put into ensuring smooth and cost-efficient reallocation.

Earlier, the Fund's hedging activities were delegated to external managers, but have now reverted to the Fund's in-house team. The task of the Fund's FX management function is to conduct all FX transactions arising in connection with the Fund's business activities, as well as to handle the hedging of the Fund's foreign assets. At present, the FX management function has no active risk mandate.

Developments on the equities and FX markets have placed considerable demands on effective and professional hedging activities. Both the market value of the assets to be hedged and the exchange rates of the currencies in which they are quoted have been highly volatile during the year. This has placed extremely high demands on the FX function, requiring it to have total control over the actual exposure involved, on every occasion, while also knowing how to re-balance the Fund's hedging activities on a continuous basis. These hedging efforts have functioned very well, and made a positive contribution to the Fund's overall return on invested assets.

#### Fixed income portfolio as percentage of total portfolio



#### Value of Swedish krona against TCW index, 2002

Index Nov. 18<sup>th</sup> 1992 = 100



The Riksbank (Swedish Central Bank) TCW index consists of a carefully balanced mix of the currencies of Sweden's most important competitors. The diagram shows that the exchange rate for the Swedish krona, compared with the TCW index, strengthened during the year. The lower the index, the stronger the krona.  
Source: Ecwin and Second AP Fund data

# Alternative investments

**As an asset class, alternative investments are intended to provide a substantial absolute return and contribute to a strategic diversification of risk in the Fund's overall portfolio of investments.**

Investments made by the Second AP Fund in the asset class "Alternative Investments" are mainly in funds for unlisted equities that offer an absolute return. In line with the AP funds' investment regulations, no more than five per cent of the Fund's total assets may be invested in unlisted securities. Investments in unlisted equities must be indirect, via venture capital companies/funds or mutual funds.

## **The Fund is developing an investment strategy**

During the year, the Second AP Fund has continued work on the development and implementation of an investment strategy for alternative investments. In respect of investment in funds for unlisted and listed equities, this strategy will involve the step-by-step build up of a well diversified portfolio over a period of three years, with the initial emphasis on northern Europe as a geographic base. The prospects for a greater geographical spread of Fund investments will be evaluated on an ongoing basis. Analyses of the many investment proposals submitted to the Second AP Fund will be conducted in line with the selection process described below.

The Second AP Fund aims to create long-term strategic relationships with a handful of carefully selected market players, to secure access to the best investment opportunities and, at the same time, to establish a well-developed network that can contribute to a build-up of the in-house

asset management organisation. During 2002, in connection with this assessment of investment opportunities and the build-up of a network, the Fund conducted meetings with representatives of some 50 venture capital companies. These contacts have led to concrete discussions with about 40 companies concerning investment opportunities, a number of which resulted in actual investments during the past year. A number of other companies are currently engaged in a phase of evaluation and negotiation.

## **Investments during 2002**

During 2002, new investments totalling SEK 507 million were made in Nordic Capital V and Carnegie Biotech Bridge. During 2001, investments totalling SEK 233 million were made in the venture-capital fund EQT Northern Europe and in the Swedestart Tech and Swedestart Life Science funds. By year-end 2002, the Second AP Fund's total investments in these funds amounted to approximately SEK 740 million, of which SEK 169 million in actual investments.

### *EQT Northern Europe*

EQT's strategy is to acquire large business units with substantial development and growth potential, in the Nordic area and German-speaking countries. EQT is focused on building up and developing its acquisitions



### **The Second AP Fund's evaluation process**

The Second AP Fund conducts ongoing evaluation of the different investment opportunities that arise, within the parameters defined for the asset class "Alternative Investments". Less than half of the more than one hundred external proposals and in-house investment ideas submitted are subjected to more systematic analysis. Of these, fewer than five lead to an actual investment decision.

Once an investment has been made, regular contact with the venture capital company and an ongoing assessment of the investments it makes are essential to long-term success.

over the long term and turning them into sound and dynamic companies.

EQT Northern Europe has made a number of large scale acquisitions, mainly industrial in nature, including Electrolux Leisure Appliances, VTI Technologies and Haarmann & Reimer. In only a short time, the newly acquired companies have already developed strongly, through further acquisitions, revised strategies and improvements in operational efficiency and control.

#### *Swedestart Life Science and Swedestart Tech*

The Swedestart investment concept focuses on participation as an active long-term minority shareholder in small businesses (often new start-ups), which are grounded in basic research or advanced product development. The companies shall be based on the life sciences and focused primarily on medical technology, IT, telecom or some other form of advanced technology. Operations shall be founded on a unique technology or competence that possesses global commercial potential. Both Swedestart funds have invested in areas that are considered promising and that offer real development potential.

#### *Nordic Capital V*

Nordic Capital's investment strategy is to acquire majority interests in midsize companies that possess development and growth potential and that have, or can attain, a commanding market position, with a predictable cash flow. Nordic Capital is devoted to creating added-value in its companies by concentrating on improving their market worth – new industrial combinations, strategic re-positioning, internationalisation of business activities and ongoing operational improvements.

Nordic Capital V will start operations in the first quarter of 2003.

#### *Carnegie Biotech Bridge*

The strategy here is to invest in unlisted companies in the life science sector, apart from health care and similar activities. The companies selected shall have products or pharmaceuticals under clinical trials and shall demonstrate sufficient breadth and depth in their R&D programme to avoid dependency on a single product.

The fund, which started business operations in October 2002, has yet to make any investments.

#### **Market trend**

In 2002, the market within the venture capital sector has adopted a wait-and-see attitude. Investors have generally been sceptical about investing in “companies in the early stages of development”, and it has been easier to find prospective investors for business with a more distinct exit horizon. A number of market players also find themselves in a situation where they are forced to focus all their attention on dealing with a range of problems affecting the companies in their portfolios.

The level of acquisitions, disposals and stock exchange introductions remains low. The performance of shares in companies recently introduced on the stock exchange has been mixed, but mostly negative. Consequently, it is thought likely that the number of new listings will continue to be limited over the next few years.

In the USA and many parts of Europe, there has been a sharp reduction in the number of venture capital companies on the market. On the Nordic market, however, a large number of players are now at the stage where they are looking for investors. The Fund believes that funds for unlisted equities operating in the Nordic area in 2002 and 2003 are out to attract as much as SEK 70 billion in venture capital. The conclusion is that only a few of these will succeed, and that several players will probably have to merge or establish various types of alliance, if they are to stay on the market.







–This bike is my passion. I designed the frame myself and bought the shock-absorbing front fork in Hong Kong. I won't say how much it cost, but if I ever have children, they're definitely going to inherit this bike.  
Niklas, 30 years of age

# Real estate

**The Second AP Fund's real-estate-related holdings consist of shares in both listed and unlisted property companies.**

**The decline of the real estate market continued and intensified during 2002. A report published at the end of November 2002 noted that the level of vacant office space in Stockholm was at its highest in almost ten years. The growing amount of vacant office space has been matched by a decline in property rents.**

Elsewhere in Sweden, however, the picture is more varied. In the Gothenburg and Öresund regions, the real estate market has been fairly stable, both with respect to vacancy and rental levels.

This is equally true of many smaller and midsize communities in different parts of the country, which have had low vacancy levels and stable rents throughout the year, partially attributable to the fact that they have been less seriously affected by the downturn in the IT and Telecom sectors than the major urban regions.

During the year, the real estate market has noted a fairly high level of activity, with a substantial number of property transactions. Two trends have been particularly distinct. The first is the great interest international financial investors have expressed in the Swedish property market. This interest may be explained in part by the fact that Sweden's administrative and legal system, unlike those of many other markets, is highly transparent, and – according to many analysts – that the Swedish property market is nearing the bottom of a cycle.

The second trend derives from the fact that many of Sweden's major institutions (in particular the life assurance companies), due to a general decline in the market worth of their equities portfolios, have found themselves with an over-weighting of real estate. Many analysts are therefore convinced that there is a latent surplus of real estate that, in conjunction with increased vacancy levels and falling rents, could reduce the market value of many properties. By year-end 2002, however, this scenario had not been realised to any great extent.

Shares in property companies listed on the Stockholm Stock Exchange have performed significantly better than the stock market as a whole. The Stockholm Stock Exchange's SX Real Estate Index rose by 2.6 percent.

## **Second AP Fund real-estate holdings**

The Second AP Fund invests in real estate to generate a solid direct return and to diversify risk in its overall portfolio.

The Fund's unlisted shareholdings in real estate consist of a 25-percent participation in AP-fastigheter AB, which is jointly owned by the four first AP funds, as well as a third of NS-Holding AB (Fastighetsbolaget Norrporten AB). The Fund's holding, including debenture loans, is valued at SEK 4.6 billion.

Both companies have developed favourably in 2002, even though AP-fastigheter was negatively affected by the harsher market conditions that prevailed during the latter part of the year, especially in the Stockholm area.

AP-fastigheter has a concentrated and ideally located portfolio of real-estate holdings in the Stockholm, Gothenburg, Uppsala and Umeå areas. The company owns and manages some 370 properties offering 2.7 million square metres of floor space, at a combined market worth of SEK 35.7 billion. Most of these holdings consist of office space, with a smaller number of residential properties and retail premises. During the first half of 2002, the property and rental market remained virtually unchanged, with no obviously negative market signals. During the second half, however, vacancy levels noted a slight increase, although still at a low level. The slowdown may be attributed to the negative trend in and around Stockholm, while AP-fastigheter's other subsidiary markets have been stable throughout the year.

In contrast to many other real-estate companies, Norrporten has not been negatively affected by the decline in the market, as the company is not particularly sensitive to economic fluctuations. Norrporten's strategy, which is to concentrate on office and administrative premises located in regionally important urban centres, has proved successful. One of the areas in which the company has expanded is the Helsingborg region, where it has acquired seven large properties. Norrporten owns and manages some 200 properties, adding up to more than a million square metres of floor space. These properties have a combined total worth of approximately SEK 9 billion.

# Effective risk management – several functions that interact

The Second AP Fund's risk management activities are conducted by three mutually independent but interacting units: Risk Budgeting, Compliance and Risk Management.

## RISK BUDGETING

The task of Risk Budgeting, which is an integral part of the asset management organisation, is to analyse and spread the Fund's total risk, as well as its risk exposure in connection with single asset classes and specific asset management mandates. Using mathematical models, the optimal risk profiles are determined for absolute and relative risk (see page 7), which determine both the Fund's overall strategic and tactical allocations as well as the mandated risk limit for individual portfolios of equities and fixed income securities.

## COMPLIANCE

Compliance is responsible for ensuring that the legal and administrative aspects of risk are handled correctly, in "compliance" with external and internal regulations. Responsibilities include the establishment of guidelines as to how various tasks are to be conducted, such as monitoring compliance. External regulations involve laws and regulations pertaining to the AP funds, as well as other rules that apply to the capital market, such as those on disclosure of substantial acquisitions of shares. Internal regulations apply to areas such as employees' private transactions in securities and ensuring that external fund managers comply with the terms agreed in contracts.

## RISK MANAGEMENT

Risk Management is responsible for follow-up and analysis of overall risk, by asset class and by asset management

mandate. Risk Management is part of the Business Support organisation and acts independently from the Asset Management organisation, to ensure duality.

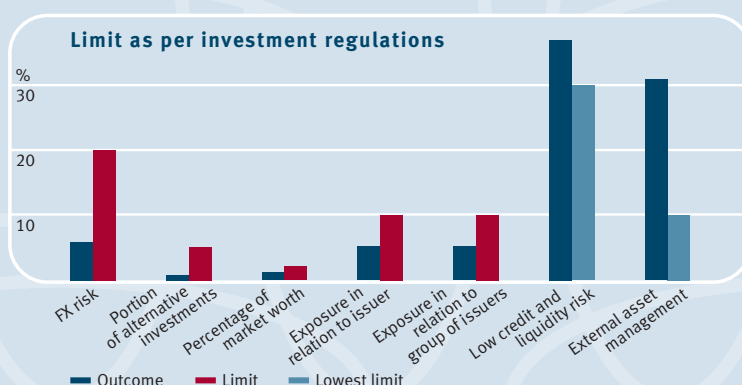
In some cases, the active and preventive risk analyses comprise a stress test, back-testing of risk models and validation of price models as well as the evaluation and review of limit structures. "Risk attribution" refers to the clarification of risk and means that utilisation of the mandated risk limit is followed up and analysed in detail. This is an important aspect of the evaluation of external fund managers.

The overall parameters defining the adoption of risk by the four large AP funds are determined by the Swedish Parliament. The guidelines have subsequently been developed and adapted for the Second AP Fund in the business plan approved by the board of directors. Risk limits have been defined for the Fund as a whole, and for each asset class.

Risk Management strives to support the Fund's asset management activities by providing tools for the computation of risk when optimising portfolio composition (risk budgeting), and by subsequently following up and analysing incurred risks.

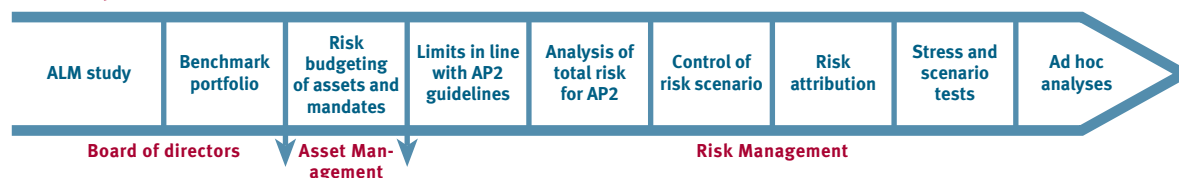
## Special focus in 2002

In 2002, the work of Risk Management, in common with that of the Fund as a whole, entered a more operational phase. Parallel with the day-to-day analysis and follow-up of the Fund's risk utilisation strategies, operations have also focused on further development and implementation of some of the projects originally initiated in conjunction with the inauguration of the Second AP Fund.





## The risk process within the Second AP Fund



### Quality assurance of external asset managers

During the year, a qualitative analysis was conducted that focused on external fund managers' organisations, asset management teams, investment approaches and process and risk-management routines. Its purpose was to ensure that the mandates awarded to external fund managers had been correctly interpreted and implemented, and that the assets had been managed in compliance with the Second AP Fund's quality standards. At the same time, the idea was to build up the experience and professional competence of the Fund's in-house risk function, based on lessons learned from the way external fund managers handle yield and risk.

### Implementation of risk limits

To ensure that data used in the asset management process is of the highest quality, the Second AP Fund uses its TMS 2000 integrated asset management system as a database for computing risk. Subsequent to securing the quality of the base data and completing the necessary calculations, all the Fund's risk limits have been implemented in the system.

### Implementation of risk system

During the autumn, work started on the implementation of a system for managing market and credit risks, where risk assessment is based on Value at Risk (VaR). The system permits advanced simulation for the computation of alternative risk scenarios. The increased focus on stress

tests and scenario management will promote consistent development with respect to follow-up and analysis of the Fund's total risk.

### Financial risks

Since the purpose of asset management is to outperform the benchmark portfolio, risk is defined relative to the Fund's benchmark index. In asset management terms, a position that deviates from the benchmark portfolio leads to an uncertain future return as per index. The relative risk that derives from such a position must be measured and restricted to predetermined risk intervals. The gauge in follow-up is active risk (Tracking Error), which measures the standard deviation for relative return. In absolute terms, the portfolio under management can of itself generate either a positive or negative return, whether relative return is better or worse than the Fund's benchmark index.

In operational terms, asset management activities shall ensure that the anticipated active risk borne by the entire portfolio of listed securities does not exceed three percent. This risk limit is complemented by establishing a goal for the Second AP Fund's preferred level of risk utilisation. The goal for active risk in respect of the Fund's total portfolio is two percent.

For the Second AP Fund, the crucial financial risks are market risk, credit risk, liquidity risk and operational risk (see risk definitions on page 64). The Compliance Officer is responsible for monitoring the legal risk.

### Market risk: Duration

No. of yrs.	Swedish fixed income portfolio				Global fixed income portfolio			
	Nominal, %	Index, %	Real rate, %	Index, %	Government, %	Index, %	Credit, %	Index, %
0-1	5.0	1.4			3.3		4.7	
1-3	34.9	39.1	3.7	3.8	25.0	33.8	20.6	29.7
3-5	25.7	27.2			22.4	21.3	34.0	25.2
5-7	17.4	15.0	26.7	26.1	11.2	16.2	12.7	26.1
7-10	10.0	10.9			18.1	11.7	14.5	9.6
10-15	7.1	6.4	35.3	34.9	8.3	16.2	8.9	9.0
15+			34.3	35.2	11.6	0.7	4.6	0.3



–When you acquire a wooden boat, you acquire a responsibility. Somebody has put their heart and soul into her construction, now it's my duty to take care of her. The best boats are made of wood that has been allowed to grow slowly, over a long time. That's what produces the finest timber.  
Carold, 70 years of age

# Principles of corporate governance

**Each year, the Board of Directors of the Second AP Fund approves an updated and revised version of the Fund's corporate governance policy. This policy is published in its entirety on the Fund's website. The Fund's general objective in exercising active ownership is to contribute to the long-term incremental value of companies in which it has invested.**

**I**n exercising its ownership, the Fund shall also actively promote good business ethics and environmental awareness, while contributing to the development of sound business principles in the capital market.

The Fund's position on ownership issues is that a listed company, by seeking a listing on the Stockholm Stock Exchange (or corresponding institution), accepts that its overall objective must be solid growth in the incremental value of the funds invested by shareholders, and that the company's board of directors shall act accordingly. In its perception of (and response to) a number of concrete governance-related issues, the Fund adopts a pragmatic approach, based on an ongoing discussion of principles by the board. Governance-related issues, that have been the subject of a discussion of principle by the board in 2002, comprise the following areas.

## **Nomination committees**

The Second AP Fund believes every listed company should have a nomination committee that submits proposals to the Annual General Meeting (AGM). The committee should be appointed in good time prior to the AGM and should be made known to the shareholders in an appropriate manner.

## **Composition of the board**

Each board of directors shall contain directors who are not in a position of dependency with respect to major shareholders or the company's executive management. Each member of the board shall represent the interests of all shareholders.

In line with Swedish business tradition, the CEO of a company is often elected to a seat on the board by the AGM. The Fund sees no reason to oppose this, but no other officers of the company should hold a seat on the board.

In its corporate governance policy, the Second AP Fund has stressed the importance of increasing the proportion of women on the boards of exchange listed companies. In cases where the Fund participates in the nomination process, therefore, special attention will be paid to this issue. The Fund also feels that the various nomination committees that have already been formed should finalise a concrete proposal, to determine how best to increase the proportion of women elected to positions on a company's board.

## **CEO as chairman of the board**

The Second AP Fund is in principle opposed to the appointment of a previous CEO to act as chairman of the same company. In exceptional cases, however, as when such an approach may offer the best means to secure continuity, this principle may have to be waived.

## **Limits on duration of board service**

The Second AP Fund is of the opinion that active commitment as a member of the board is more important than the establishment of formal limits to the duration of the mandate. For this reason, the Fund is opposed to placing a time limit on the duration of the mandate.

The Second AP Fund also feels that effective assessment of the contribution made by each member is a better way of improving efficiency and promoting renewal in the



work of the board, than instituting mandates of limited duration.

#### **Number of seats held by a single director**

The Second AP Fund is of the opinion that one and the same person, for reasons of time, should hold no more than a limited number of positions on the boards of exchange listed companies. The number of board responsibilities appropriate in individual cases depends on whether the position is as chairman or as a member of the particular board, the nature and scope of his/her “civil” responsibilities, the size of the company and the situation in which it finds itself.

#### **The size of director’ remuneration**

In principle, the Second AP Fund considers that there shall be a clear link between expected performance, the size and complexity of the company and the remuneration paid.

The level of remuneration paid to the chairman of the board should normally be at least double that received by any other member of the board.

Directors should be paid fixed fees, that should be openly declared.

#### **Accounting and accounting committees**

The Fund is of the opinion that the board of directors, either in the person of the chairman of the board, or in the form of a specially appointed accounting committee, shall play an active role in the procurement of auditors for the company. The chairman should submit a report on the selection and procurement process to the Annual General Meeting. At the AGM, the chairman or auditor should also present a comprehensive report on the company’s auditing procedures and on the deliberations conducted during the year.

Normally speaking, no single auditor (individual or company) shall perform the company’s audit for longer than two periods of four years each.

The board should establish a limit concerning the purchase of other services (non-audit related) from the company’s normal firm of accountants and, perhaps at the AGM, should also submit a report detailing the extent of such additional services.

The Fund feels that each board should explore the arguments for and against appointing an internal advisory committee, or establishing a formal accounting committee, to report on accounting issues.

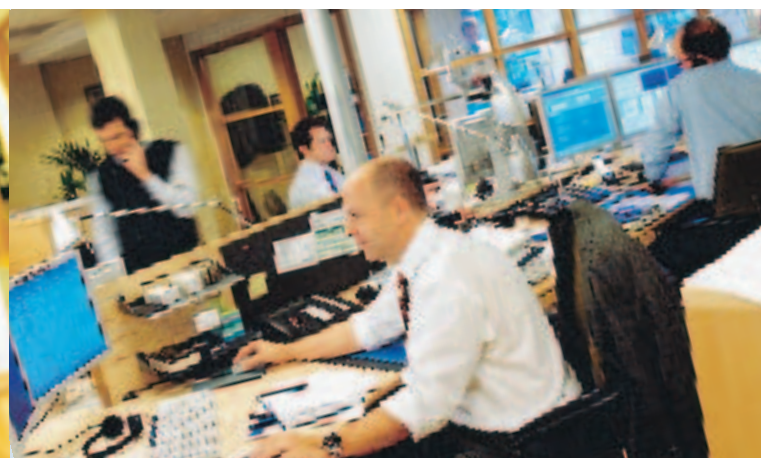
#### **Incentive programmes**

On the issue of how incentive programmes should be formulated, the Second AP Fund generally supports the recommendations developed by the Swedish Securities Council. The Second AP Fund favours the type of programme that clearly links performance with results. In certain cases, the Fund matches such programmes against three principles: appropriateness, clarity and measurability – and evaluates them individually on this basis.

Another issue that must be addressed, in terms of the position to be adopted by the Fund, is how the evaluation of incentive programmes should be conducted (and how earlier programmes have been evaluated). The Fund believes that options programmes should be disclosed as an expense in the income statement. Furthermore, an appropriate balance should be struck in the composition of the incentive package offered to individual officers of the company, in terms of options and equities.

#### **Pension benefits for the CEO**

In the case of pension benefits, the Fund believes that all retirement benefit agreements shall have a fixed “ceiling”, even if part of the basis for the calculated benefit features a variable salary element. Pension rights shall normally be calculated on the basis of average salary (fixed and variable) during the past three to five years, and provision for the CEO’s pension benefits shall be made during his/her employment by the company.



### Transparency of remuneration programmes and pension benefits

The chairman of the board and the CEO shall conduct a joint annual review of current and applied incentive and benefit programmes. The details of these programmes should subsequently be presented to the board in their entirety. All benefits shall be fully transparent and shall be presented in the annual report.

### Directed new share issues

The Second AP Fund is in principle opposed to directed new share issues without preferential rights for current shareholders. This practice is only acceptable in exceptional cases, such as when it offers a rapid solution to an acute economic crisis.

### Differentiated voting rights

The Second AP Fund is in principle opposed to differentiated voting rights. Nevertheless, the Fund believes that, if changes in the voting rights of different shares are implemented too rapidly and radically, this could have an unwelcome impact on the Swedish business community.

The Fund will vote against the introduction of preferential voting rights where such do not already exist.

The Fund favours a reduction of the differences in voting rights between different asset classes, assuming that this is conducted in an orderly manner, and will vote in favour of proposals to review the situation. Changes in a share's voting rights shall be implemented in accordance with the principles normally pertaining to shareholder rights.

Where voting rights are already differentiated, this shall not lead to the distribution of differentiated information in connection with important issues. In the case of a possible bid situation, no difference shall normally be made in the premium bid for class A or class B shares.

### Buy-back of shares

The Second AP Fund believes that buy-backs of shares can be an effective way of managing a company's capital struc-

ture. Buy-backs of shares can also serve as a way of preparing for a planned restructure of the company. Nevertheless, the Fund does not consider the buy-back of shares to be an appropriate way to sustain the company's share price. In its proposal to the AGM, the board of directors should state and justify the situations in which it intends to exercise the authority awarded to it by the AGM.

### Loans against shares and short-selling

The Fund considers loans against shares and short-selling a natural tool in a developed capital market. Nevertheless, there may be cause to review and harmonise the code of conduct with current international regulations.

### Ethical values and the environment

The Second AP Fund's general stance is that the companies in which it invests shall comply in an acceptable manner with the various conventions signed by Sweden. Companies domiciled in Sweden shall also comply with Swedish legislation. In the same way, companies officially domiciled in other countries shall comply with the laws of those countries. The Fund's routines for handling issues concerning companies that fail to comply with these requirements are described in its corporate governance policy.

Ethical and/or moral positions adopted in addition to those stated above can easily be based on subjective criteria, which makes them difficult to interpret and to comply with in a consistent manner. The Second AP Fund manages assets that are the common property of the Swedish people and considers that the establishment of specific rules defining ethical limits (relating to areas such as alcohol, tobacco and weapons), over and above existing legislation, is not feasible at the present time.

The Second AP Fund plans to instigate and support a variety of initiatives to promote a general debate concerning ethical and environmental issues in trade and industry.

### The highest and lowest rated corporate incentive programmes of companies listed on the Stockholm Stock Exchange as of Dec. 31<sup>st</sup> 2002

#### Highest market value

SEK million

Pharmacia	15,155
Handelsbanken	9,385
Nokia	2,792
AstraZeneca	1,840
Nordea	796

#### Lowest market value

SEK million

WM-data	- 81
Proffice	- 66
Cell Network	- 50
Teleca	- 26
Enea Data	- 26

The above tables present the corporate incentive programmes which noted the highest and lowest market values respectively at year-end 2002. The negative values derive from the fact that premiums have been paid for the options.

The Black & Scholes model for option assessment has been employed in evaluating all option programmes. Volatility has been set at 25 percent. Dividends paid out by the companies are not included. In the case of profit-sharing funds, fund holdings in all securities have been valued at the current rate. The last day of the redemption period has been used as the redemption date for options, since in theory it is most beneficial to wait.

Source: Nordic Investor Services

# Second AP Fund as owner

**To a great extent, 2002 was the year when the spotlight turned on the role of the institutional investor. This was demonstrated in part by media coverage of (and impact on) the market performance of specific companies, and by the way general corporate governance issues were handled. The Fund's exercise of a more active ownership role derives to some extent from the significant decline in public confidence for a number of corporate managements.**

**m**any factors have played a role. One was general scepticism about the size of the pensions and options programmes enjoyed by the heads of numerous Swedish companies. Internationally, and especially in the USA, the collapse of major corporate players such as Enron, Worldcom, Tyco International and others has led to radical changes in the rules applied to auditing and accounting practice. The legal responsibilities of corporate managements have also increased, and the authorities have been invested with new and tougher powers to bring negligent managements to justice.

In public debate about these issues, the role and responsibilities of majority owners have also been questioned. In pace with the increase in institutional ownership in the past few decades, in Sweden as well as internationally, there is growing demand that institutions such as pension funds must play a more active role as owners.

Unlike earlier, many institutions now see an immediate business advantage in adopting a more active approach in their role as majority owners. Companies with clearly defined and demanding owners tend to be valued more highly than companies that are perceived as “ownerless” and dominated by its executives.

According to British pension fund Hermes, a survey conducted by McKinsey, an international firm of consultants, has revealed that investors are prepared to pay an 18 percent premium for companies known to have active owners, as opposed to “ownerless” companies.

Given these conditions, corporate governance issues have gained an increasingly important role within the Second AP Fund. Over the past year, representatives from the Fund have participated in a number of conferences and meetings where ownership issues have been on the agenda. As part of its build-up of routines, systems and in-house expertise, the Fund has also been studying how



several large international pension funds, such as Hermes (UK) and CalPers and Calsters (USA), deal with corporate governance issues.

#### AGMs during 2002

During 2002, the Second AP Fund participated in 46 Swedish AGMs. The Fund has also been actively engaged in the preparatory work prior to many of these AGMs, cooperating with other institutional shareholders and board representatives in analysing and discussing the various proposals which the boards have planned for submission to their respective AGMs. During the year, the two most frequently asked questions at these AGMs concerned the Fund's attitude to numerous incentive programmes and the issue of board nominations.

On the few occasions when a specific issue raised at one of these AGMs had to be put to the vote, the Fund voted in support of the board's proposal, with very few exceptions. Starting in 2003, the Second AP Fund will in future report on how it votes at each AGM. Further details are available on the Fund's website.

During the year, the Fund has participated in one foreign AGM (ABB Ltd) and has also voted for companies with a Swedish connection at some other foreign AGMs. In the latter instances, voting was conducted by proxy, a form of absentee voting.

#### Owner-related contacts in 2002

In its contacts with companies in which it has an interest, the Fund normally adopts one of two approaches. This may be in the form of annual visits to a large number of companies, conducted by the Fund's portfolio managers and analysts, where attention is focused strictly on the company's investment potential. Or it may be in the form of a visit by the Fund's CEO and the head of corporate governance to a number of companies to discuss ownership issues. In the latter case, the CEO or chairman of the company being visited acts as host.

A total of 16 such corporate visits were made in 2002, focused specifically on ownership issues. The companies

visited represent a selection of the Fund's largest Swedish holdings, in terms of capital investment or voting rights, as well as a number of smaller companies which the Fund was interested in visiting, for a number of different reasons. The purpose of these visits has been to present the newly started Second AP Fund's background and investment focus, to clarify the Fund's ownership policy and to listen to companies' expectations of the Fund in its role as owner. And the visits have contributed to an expansion of the Fund's network of contacts.

#### Owner focus in 2003 – a glimpse of the future

Even though ownership issues may to some extent be said to be "event determined", the Second AP Fund is also committed to influencing the long-term development of companies in which it has interests, in line with its corporate governance policy. The areas to which the Fund will pay special attention in 2003 are audit and accounting issues, incentive programmes and a range of measures to improve the quality of the work carried out by corporate boards. A specific issue to be addressed is the composition of boards and how the relative proportion of women on these boards can best be increased.

The Fund's efforts in this latter area will focus on two aspects. Where possible, the Fund will determine the extent to which individual companies have striven to promote women when nominating new representatives for seats on their boards. In 2003, the Second AP Fund also plans to instigate a long-term programme to monitor how different companies and industries change over an extended period of time in terms of the number of women with seats on the board. The results of this monitoring process will be presented as an index, to be updated annually and published on the Fund's website.

In 2003, the Second AP Fund will be one of the first Swedish institutional investors to vote regularly at foreign AGMs, held by companies in which the Fund has interests with a market value in excess of SEK 200 million. This voting will be by proxy, a particularly common practice in the USA and Great Britain.

#### Female representation on corporate boards by industrial sector, re. AP2 index



In 2002, the Second AP Fund commissioned an analytical survey of the proportion of women who held seats on the boards of Swedish companies listed on the stock market. The survey, conducted by Nordic Investor Services, covered all 297 Swedish companies found on the "A", "Attract 40" and "O" lists. The average proportion of female representation on these boards was 7.3 percent, which in the diagram corresponds to 100 on the index. The Second AP Fund plans to follow developments closely and will present an updated index on an annual basis. For further details, check out the Fund's website at: [www.ap2.se](http://www.ap2.se)  
Source: The Second AP Fund/Nordic Investor Services



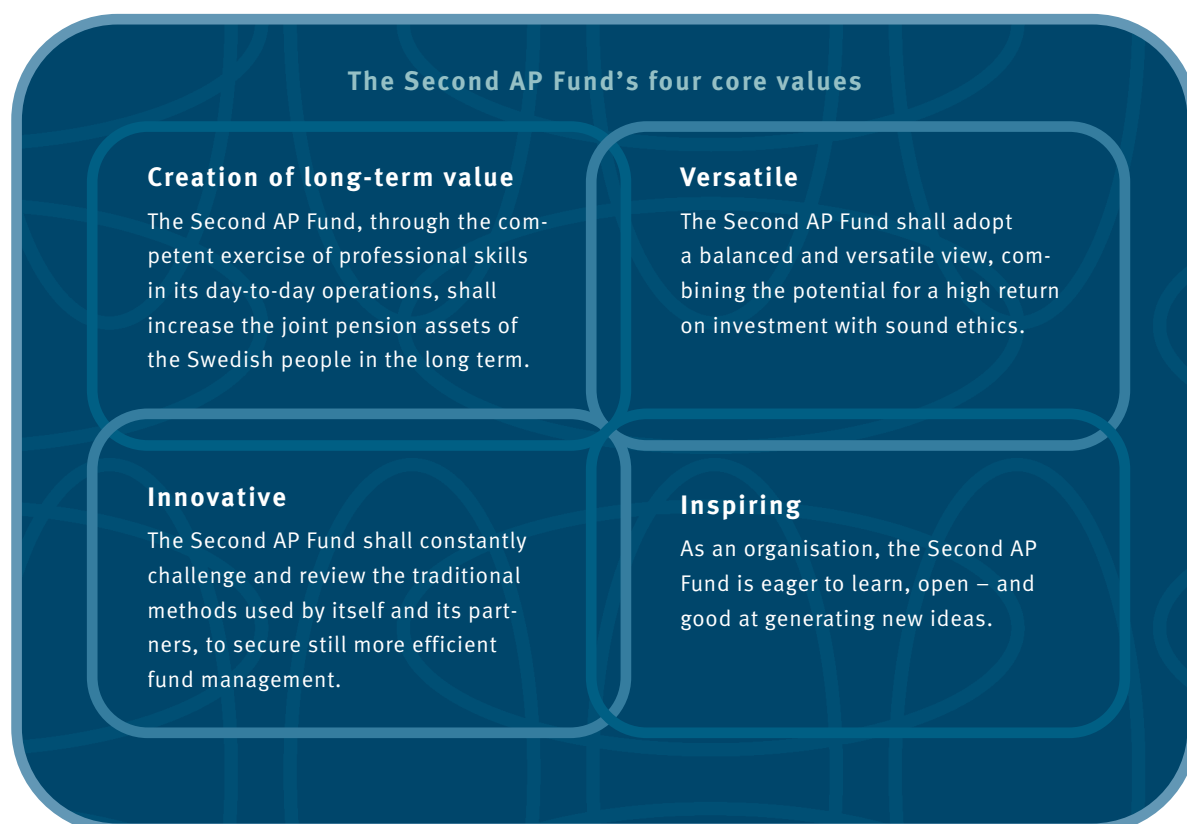
# Trademark and core values

During 2002, the Second AP Fund has initiated work on the long-term project of building up and establishing the Fund's professional image or trademark. One of the starting points for this process, which has involved interviews with staff and external interested parties, has been to determine the factors that can have a long-term impact on the reputation of an organisation such as the Second AP Fund, and also which target groups are the most important when it comes to refining and promoting the Fund's professional identity.

The many different qualities that can contribute to establishing a positive perception of a pension fund have been summarised and defined in terms of four core values, on which the task of establishing the long-term identity of the Second AP Fund shall be based.

From very early on, it was apparent that the Second AP Fund had the capacity to attract considerable interest. The expectations placed on the Fund are many and varied, and differ from group to group. Although the Fund's reputation naturally depends on the perceptions of many different players, an analysis determined that the following three target groups are critical to establishing the Second AP Fund's credibility: its staff (current and prospective), the Swedish capital market and the daily and business press.

The Fund's four core values and the concrete implications have been finalised following a comprehensive in-house development project, to which the majority of staff have contributed in one way or another.



# Structure and staff

**In only just over two years, the Second AP Fund has been built from scratch, and recruited almost 40 staff. This recruitment process, now completed, has been dedicated to creating a professional team, jointly committed to developing the Fund's focus and working methods as a modern, international asset management organisation.**

As a result, the Fund is now staffed by five different nationalities, with ages ranging from 25 to 58, and representing an extremely broad range of professional experience – even beyond the traditional sphere of fund management.

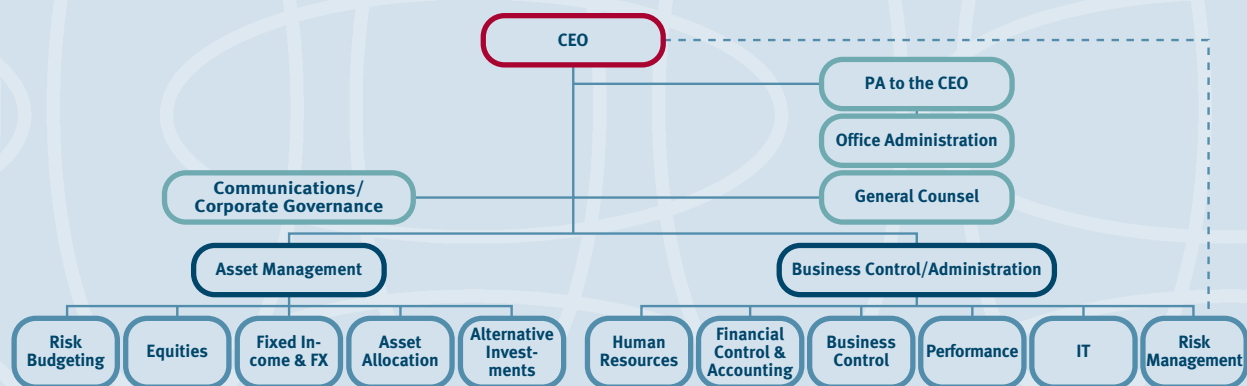
Within the HR sphere, the Fund has focused on creating a functional internal work structure and common values for the evaluation of individual employees during 2002. The work has also focused on giving each employee the opportunity to develop within his/her own field and to take individual responsibility for his/her personal development.

The annual career development appraisal, on a one-to-one basis, offers the individual employee an opportunity to discuss his/her current life situation and career

plans, and to determine how far these are consistent with the actual career opportunities offered by the Fund. These appraisals are a way to attain the targets established for individual and organisation, and contribute to the ongoing development of both.

In addition to the career development appraisal, each employee undergoes a salary review during the year, where performance is assessed in line with the specific demands placed on him/her. This review may be seen as an evaluation and review of the goals and career development plans discussed during the career development appraisal.

Unlike the other AP funds, the Second AP Fund operates no bonus system: remuneration is in the form of a fixed salary only.



### Long-term recruitment planning

The Second AP Fund's long-term recruitment planning is based on three strategies.

The first is that, as far as possible, the Fund shall strive to satisfy the wishes of individual employees concerning changes in job assignment and function. In a small workplace with limited opportunities for internal career planning, it is important to give staff the opportunity for continual skills enhancement and specialisation in their field of responsibility. One way to achieve this is to delegate more routine assignments to external suppliers, retaining the type of stimulating assignments and functions that can promote personal development for in-house staff. Eventually, wherever possible, it is hoped that management and specialist positions can be filled from internal recruitment.

The second is to utilise the fact that the Second AP Fund, thanks to informal cooperation with the Gothenburg School of Economics, is able to offer undergraduates practical topics for their degree theses, including the chance of temporary secondment and vacation jobs. This creates a potential source of recruitment, while simultaneously offering students a practical insight into how a modern asset management organisation functions.

The third strategy, of course, concerns the need to maintain open and continual contact with established specialists in the asset management field, should an acute recruitment requirement arise. This may involve cooperating with recruitment consultants, or utilising a number of different individual networks.

### Training and personal development

During the build-up phase, the Fund's employees have made countless study visits to other pension funds, exter-

nal fund managers, analysts and other partners and associates, mostly in Sweden, Great Britain and the USA. Conversely, the Second AP Fund has hosted a large number of visits from financial industry experts and other interested parties during the year. This ongoing exchange of know-how and experience is a crucial aspect of individual and collective "on-the-job-training".

Employees of the Second AP Fund have a high general level of education. Nevertheless, the rapid pace of change in modern fund management makes the ongoing development of new skills essential, to be able to carry out many of the assignments. In-house training, such as participation in seminars and trade conferences, planned and conducted by employees themselves, therefore form an important part of the competence enhancement process. In future, the Fund's own specialists will also conduct extension courses in their own fields, for fellow members of staff.

As well as participating in specialist extension courses, Fund employees have also participated in training that has addressed more general themes such as international politics, economics, ethics and the environment, understanding the media, emergency management and fire prevention.

“  
In only just over two years, the Second AP Fund has been built from scratch, and recruited almost 40 staff.

”

Average age: 37.8 years  
Median age: 37 years

Gender distribution:  
23 men and  
15 women

Average work  
experience:  
13 years

No. of nationalities: 5

Personnel T/O:  
9 staff accepted full  
time positions during  
the year, 3 left.





# The Second AP Fund

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# Förvaltningsberättelse

## Andra AP-fonden under 2002

Formellt startade Andra AP-fonden sin operativa verksamhet den 1 januari 2001.

Under 2002 har verksamheten successivt utvecklats och strategier samt infrastruktur har implementerats. Fondens rekrytering av medarbetare har slutförts och organisationen är på plats. Systemstöd för förvaltning samt verktyg för daglig avkastnings- och riskanalys har tagits i drift. Förvaltningen bedrivs ur ett sektorperspektiv och är uppbyggd för en betydande andel extern förvaltning. Fondens tillgångar har under året delvis anpassats till en ny strategisk referensportfölj. Den nya portföljens sammansättning karaktäriseras i högre grad än tidigare av en inriktning mot mer aktiv förvaltning med större inslag av absolut avkastning i syfte att öka riskspridning samt långsiktigt uppnå högre avkastning.

## Styrelsens arbete

Andra AP-fondens styrelse består av nio ledamöter, vilka har utsetts av regeringen. Vid styrelsens sammanträden deltar även fondens verkställande direktör och de övriga anställda som erfordras för ett ärendes behandling. Därutöver kan vid behov ytterligare personer närvara, såsom fondens revisorer eller externa samarbetspartners.

Styrelsen har sammanträtt vid åtta tillfällen under 2002. Vid samtliga styrelsemöten har fondens ekonomiska utveckling och resultat föredragits och diskuterats. Utöver denna redovisning av den löpande förvaltningsverksamheten, ägnade styrelsen betydande tid åt frågor av strategisk betydelse för fonden. Detta inkluderar särskilt fastställandet av fondens strategiska tillgångsallokering, det vill säga den fördelning mellan olika tillgångsslag – räntebärande instrument, aktier,

alternativa investeringar, fastigheter – som styrelsen anser ha bäst förutsättningar att generera en långsiktigt god avkastning till låg risk. Detta sker efter det att en ALM-studie har genomförts (se sidan 8) av fondens medarbetare tillsammans med externa experter och där efter förelagts styrelsen.

Styrelsen har under året fastställt en reviderad verksamhetsplan, vilken bland annat inkluderar en uppdaterad ägar- och riskpolicy. Dessutom har styrelsen fastställt halvårs- och årsbokslut samt en budget för fondens verksamhet. I samband med fastställandet av årsbokslutet redogjorde fondens revisorer för sin syn på verksamhetens bedrivande.

Utöver ovanstående frågor har styrelsen diskuterat och behandlat en rad principfrågor med ursprung i fondens operativa verksamhet. Det avser till exempel olika ställningstaganden i ägarfrågor liksom frågeställningar och beslut kopplade till investeringsförslag inom tillgångsslaget Alternativa investeringar.

## Principer för ägarstyrning

Fondens policy för ägarstyrning fastställs årligen av styrelsen. Det övergripande målet är att som aktiv ägare bidra till en långsiktigt god värdetillväxt för de bolag där fonden är ägare. Policyn anger fondens syn på bland annat styrelsesammansättning, incitamentsprogram samt revision och revisionskommittéer. Vidare fastställer policyn att ägande endast skall innehas i företag vilka inte bryter mot de konventioner som Sverige undertecknat.

## Referensportfölj och referensindex

Den under 2002 reviderade ALM-studien har resulterat i en delvis diversifierad referensportfölj vilken ligger till grund för fondens strategiska tillgångsfördelning.

## Fondkapitalets utveckling

Belopp i mdkr	2001-01-01	2001-12-31	2002-12-31
Tillgångar, netto		129	112,1
Inflöde		4,5	5,0
<b>Fondkapital</b>	<b>134</b>	<b>133,5</b>	<b>117,1</b>

## Övriga nyckeltal

	2001-12-31	2002-12-31
Genomsnittligt fondkapital, mnkr	133 282	124 949
Förvaltningskostnadsandel*, %	– 0,14	– 0,16

\*) Avser fondens totala rörelsekostnader.

Den svenska aktieportföljen har delats upp i tre delar i syfte att generera en högre absolut avkastning och minska beroendet av utvecklingen i enskilda stora bolag ingående i kapitalviktade index. Den utländska aktieportföljen kommer successivt att förändras, både vad avser regional fördelning och specifika marknader. Fondens räntebärande portfölj breddas såväl geografiskt som i valet av instrument.

Referensportföljen anger i absoluta tal vikten för de olika tillgångsslagen samt vilka intervall som är acceptabla över tid. Fondens referensportfölj är uppbyggd med valda referensindex enligt nedan, vilka har modifierats för att ge ett bättre jämförelseunderlag till den nya portföljen. Portföljens utveckling jämförs löpande mot fastställda referensindex. Målet är att långsiktigt, med en horisont på 10–15 år, skapa en överavkastning relativt referensindex på 0,5 procent per år.

#### Omviktningsarbetet under 2002

Omviktningen av fondens portfölj har under året inneburit en förflyttning i flera dimensioner, dels en omviktning till en portfölj med inriktning mot en högre andel absolut avkastning, dels en omviktning till en större andel aktiv förvaltning, såväl intern som extern. Portföljen har även givits en bredare global spridning. Transitionen till den nya referensportföljen inleddes under sensommaren och intensifierades under perioden oktober till december.

Graden av aktiv förvaltning och fokuseringen mot absolut avkastning kommer att ökas under de närmaste två till tre åren. Under perioden kommer en kontinuerlig analys och utvärdering att ske av avkastning och riskutnyttjande. Andelen externa förvaltningsmandat ökas successivt i takt med tillgången på specialiserade externa förvaltare.

#### Årets resultat

Fonden redovisar en fondförmögenhet på 117,1 mdkr inklusive nettoinflöden. Fondens avkastning för 2002 uppgick till –15,3 procent, vilket innebär att fonden överträffat sitt referensindex\* vars avkastning uppgick till –15,7 procent. Inflödet av externa likvida medel under året uppgick till 5,0 mdkr där 2,0 mdkr motsvaras av nettoinbetalningar från RFV. Resterande inflöden avser överföringar från Avvecklingsfonden vilken administreras av Första AP-fonden.

Redovisade värden avser "exponerade värden" där inte annat anges. Dessa omfattar utöver bokförda marknadsvärden även allokerad (men ej investerad) likviditet till det aktuella tillgångslaget samt övriga tillgångar som utgör säkerhet för ingångna derivatpositioner. I balansräkningen särredovisas marknadsvärderade tillgångslag, derivat och likvida medel.

#### Sammanställning av referensportfölj, referensindex och avkastning

Tillgångsslag	Referensportfölj, %	Referensindex	2001-12-31 marknadsvärde, mdkr	2002-12-31 marknadsvärde, mdkr	2002-12-31 exponerat värde, mdkr	2002-12-31 avkastning AP2, %	2002-12-31 avkastning referensindex, %
Svenska aktier	20	<sup>1)</sup>	27,7	22,4	22,8	– 36,7	– 35,8
Utländska aktier	40	<sup>2)</sup>	50,0	34,5	46,1	– 24,9	– 27,0
Räntebärande tillgångar, inklusive likviditet och upplupna räntor	37	<sup>3)</sup>	51,3	54,9	43,4	8,9	8,9
Fastigheter	3	<sup>4)</sup>	4,1	4,0	4,6	5,5	
Alternativa investeringar			0,1	0,2	0,2	– 8,1	
<b>Totalt</b>	<b>100</b>		<b>133,2</b>	<b>116,0<sup>5)</sup></b>	<b>117,1</b>	<b>– 15,3</b>	<b>– 15,7</b>

1) Består av 70% SBX, 20% OSX och 10% CSX.

2) Globalindex exklusive valutasäkring består av 44,1% MSCI Developed Markets North America Net USD, 39,2% MSCI Developed Markets Europe Net USD, 9,8% MSCI Developed Markets Japan Net USD, 4,9% MSCI Developed Markets Pacific (ex Japan) Net USD och 2,0% MSCI Emerging Markets Free Net USD omräknat till SEK.

3) Ränteindex består av 43,2% SHB Swedish All Bond, 13,5% SHB Swedish Index Linked, 32,4% Lehman GA Govt 1000xAsia 100% Hedged och 10,8% Lehman GA Cred 1000xAsia 100% Hedged omräknat till SEK.

4) Index för fastigheter är Svenskt Fastighetsindex, SFIX. Fram till och med 2002-09-02 jämfördes utvecklingen av fondens onoterade fastighetsinnehav med ränteindex. SFIX 2002 avser preliminärt uppskattat värde.

5) Differensen mellan totalt marknadsvärde och exponering består i huvudsak av derivat.

\*) Består av 20% Sverigeindex, 40% Globalindex, 37% Ränteindex och 3% Svenskt Fastighetsindex.



Erhållna utdelningar uppgick till 1,6 mdkr och realiserat resultat för aktierelaterade tillgångar uppgick till –12,6 mdkr. Redovisat räntenetto uppgick till 3,2 mdkr och realiserat resultat för ränterelaterade tillgångar till 29 mnkr. Årets resultat uppgick till –21,4 mdkr. Resultatet utgörs av utdelningar, räntenetto, valutakursresultat, realiserade och orealiserade värdeförändringar samt rörelsens kostnader.

De kraftiga kursfallen på de internationella aktiemarknaderna under året har inneburit att portföljens värde i absoluta tal har minskat. På sidan 42 redovisas värdeförändringen sedan start.

### Fondförmögenhetens fördelning och utveckling

Fondens tillgångar per 2002-12-31 är fördelade på 68,9 mdkr i noterade aktier, varav 22,8 mdkr i svenska aktier och 46,1 mdkr i utländska aktier. De räntebärande tillgångarna, inklusive likviditet uppgick till 43,4 mdkr. Innehav i onoterade fastighetsaktier samt alternativa investeringar uppgick till 4,6 mdkr inklusive förlagslån, respektive 168 mnkr. Fondens tillgångar förvaltas, såväl aktivt som passivt, till 38 procent av externa förvaltare. De externa förvaltare har valts efter noggrann analys och utvärdering. Uppdragen fördelas på ett antal svenska och utländska förvaltare; Alfred Berg, Carlson Investment Management, Carnegie, SEB, State Street Global Investors, Merrill Lynch, Barclays Global Investors, MFS och Pictet samt ett antal fondförvaltare. Se vidare not 4.

### Extern förvaltning per tillgångsslag, mdkr

Tillgångsslag	2001-12-31	2002-12-31
Svenska aktier	27,6	11,3
Utländska aktier	53,9	29,3
Räntebärande	28,6	3,8
Fastigheter och Alternativa investeringar	0	0
<b>Summa externt förvaltad kapital</b>	<b>110,1</b>	<b>44,4</b>

### Svenska aktier

Värdet av den svenska aktieportföljen uppgick till 22,8 mdkr. Innehaven var väl spridda bland de större noterade bolagen. Omkring 80 procent av portföljen har under året förvaltats aktivt med begränsad relativ risk, medan resterande del har förvaltats passivt mot index. Per 2002-12-31 förvaltades 50 procent av tillgångarna i svenska aktier externt. Avkastningen på den svenska aktieportföljen uppgick till –36,7 procent mot referensindex, ett viktat index, –35,8. SIXRX har under samma period genererat –35,9 procent i avkastning. Fondens värdemässigt fem enskilt största svenska innehav i den totala aktieportföljen utgjordes av AstraZeneca (2,7 procent), H&M (2,0 procent), SHB (1,9 procent), Ericsson (1,8 procent) och Nordea (1,7 procent).

### Utländska aktier

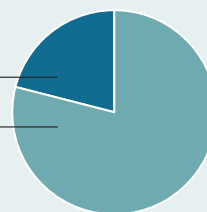
Värdet av den utländska aktieportföljen uppgick vid årsskiftet till 46,1 mdkr. Under året har exponeringen mot USA minskat till förmån för Europa, Japan och Pacific. Därutöver har investeringar gjorts i tillväxtmarknader. Den utländska portföljen har givit en avkastning på –24,9 procent jämfört med ett regionjusterat MSCI World index som genererat –27,0 procent för motsvarande period. Per 2002-12-31 förvaltades 64 procent av tillgångarna i utländska aktier externt. Vid årsskiftet var de fem enskilt största utländska innehaven i Andra AP-fondens totala aktieportfölj Nokia (1,0 procent), General Electric (0,8 procent), Microsoft (0,8 procent), Exxon-Mobil (0,8 procent) och Pfizer Inc. (0,7 procent).

### Extern förvaltning, placeringsstil

#### Per 31 december 2001

Aktiv 21%

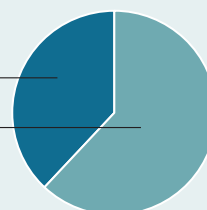
Passiv 79%



#### Per 31 december 2002

Aktiv 38%

Passiv 62%



### Räntebärande tillgångar

Värdet av fondens räntebärande innehav exklusive likviditet per 2001-12-31 var 46,3 mdkr. Hela den räntebärande portföljen har under större delen av 2002 förvaltats internt. Vid utgången av 2002 uppgick värdet till 42,2 mdkr. Under året har räntebärande tillgångar allokerats till aktier i syfte att rebalansera fondens portfölj. I huvudsak består ränteportföljen av svenska nominella och reala obligationer samt globala statsobligationer. Andelen utländska innehav uppgick till 17 mdkr. Omviktningen till en högre andel aktiv förvaltning samt en global spridning kommer att genomföras under 2003. Avkastningen för ränteportföljen uppgick till 8,9 procent, i nivå med referensindex. Utöver de räntebärande innehaven uppgick vid utgången av 2002 fondens likvida medel till 1,2 mdkr.

### Alternativa investeringar

Under 2002 har investeringsåtaganden gjorts i Nordic Capital V med 457 mnkr och Carnegie Biotech Bridge med 50 mnkr. Tidigare genomförda investeringsåtaganden inom segmentet buy-outs har skett i riskkapitalfonden EQT Northern Europe. Inom segmentet ventures har investeringar gjorts i fonderna Swedestart Tech och Swedestart Life Science. Vid utgången av 2002 uppgick Andra AP-fondens sammanlagda investeringsåtaganden till 740 mnkr fördelade på fem fonder. Av dessa åtaganden utgör 169 mnkr faktiska investeringar varav 113 mnkr genomförts under 2002.

### Fastigheter

Fondens fastighetsexponering utgörs dels av innehav i den noterade aktieportföljen, dels av innehav i onoterade fastighetsbolag.

Andra AP-fondens onoterade fastighetsinnehav består av en 25-procentig ägarandel i AP-fastigheter AB samt 33,3 procent av NS-Holding AB (Fastighetsbolaget Norrporten AB). Innehavet i AP-fastigheter har under året haft en stabil utveckling trots en kärvare marknadsutveckling. Värdet av innehavet i NS-Holding AB har utvecklats positivt och genererat en värdeökning på 116 mnkr. Det redovisade marknadsvärdet uppgick till 3 554 mnkr för AP-fastigheter och 1 040 mnkr för Norrporten, inklusive förlagslån.

### Valutaexponering

Fondens tillgångar är exponerade mot utländsk valuta med cirka 7 procent. Resterande tillgångar exponerade mot utländsk valuta har valutasäkrats med hjälp av valutaterminer. Exponeringen återfinns i huvudsak i den utländska aktieportföljen och fördelar sig enligt nedanstående tabell.

### Derivat

Transitionen till den nya referensportföljen har genomförts med hjälp av aktiederivat i syfte att öka effektiviteten och minska transaktionskostnaderna. Under omviktningsarbetet har derivatpositionerna aldrig givit en högre exponering gentemot aktiemarknaderna än

### Valutaexponering

2002-12-31, motvärde i mnkr	USD	GBP	EUR	JPY	Övr	Total
Aktier och andelar	18 537	4 085	5 947	2 881	3 216	34 666
Obligationer och andra räntebärande värdepapper	8 873	1 040	11 517	—	375	21 805
Övriga tillgångar	359	380	809	145	231	1 924
Derivat	- 24 174	- 4 781	- 15 712	- 2 553	- 3 116	- 50 336
Övriga skulder	- 40	—	- 27	—	- 7	- 74
<b>Valutaexponering, netto</b>	<b>3 555</b>	<b>724</b>	<b>2 534</b>	<b>473</b>	<b>699</b>	<b>7 985</b>

2001-12-31, motvärde i mnkr	USD	GBP	EUR	JPY	Övr	Total
Aktier och andelar	29 468	5 607	7 124	3 913	3 885	49 997
Obligationer och andra räntebärande värdepapper	—	—	2 528	—	—	2 528
Övriga tillgångar	88	5	10	12	1	116
Derivat	- 21 955	- 4 213	- 7 625	- 2 859	- 2 730	- 39 382
Övriga skulder	—	—	—	—	—	—
<b>Valutaexponering, netto</b>	<b>7 601</b>	<b>1 399</b>	<b>2 037</b>	<b>1 066</b>	<b>1 156</b>	<b>13 259</b>

det förvaltade kapitalet. Derivat har även använts i den taktiska allokeringen samt vid rebalansering av fondens portfölj.

### Analys, uppföljning och kontroll

Andra AP-fonden är en stor och internationellt verksam fondförvaltare med ett flertal förvaltningsuppdrag utlagda på externa aktörer. Det ställer höga krav på analys och uppföljning samt kontroll av portföljen, såväl av enskilda mandat som av helheten. För att uppfylla dessa krav har fonden investerat i en avancerad IT-plattform med hög driftsäkerhet och flexibilitet.

Fondens integrerade förvaltningssystem, TMS 2000, implementerades fullt ut under året i enlighet med plan. Fonden kontrollerar, värderar och analyserar innehav på daglig basis, likaså mäts avkastning samt riskutnyttjande dagligen. Fonden sammanställer månatliga bokslut innehållande balans- och resultaträkning.

### Risikfunktioner

All typ av kapitalförvaltning är förenad med olika finansiella risker. Fondens riskhantering ryms inom tre, sins emellan fristående men samverkande, enheter; Riskbudgetering, Compliance och Risk Management. Det mått som används för uppföljning är aktiv risk, vilken maximalt får uppgå till tre procent, målsättningen för den aktiva risken är två procent. Fondens riskexponering analyseras och följs upp på daglig basis. Nedanstående tabeller visar fondens riskexponering och riskjusterade avkastning och fördelning av kreditrisker.

### Risk och riskjusterad avkastning

Utvärderingsmått på årsbasis

2002-12-31

Standardavvikelse	AP2	13,0%
	Totalindex	13,1%
Tracking Error	AP2	1,0%
Sharpekvot	AP2	Neg
Informationskvot	AP2	0,5

### Ratingprofil – fördelning kreditrisk, %

	Lång rating AAA till AA–	A+ till A–	BBB+ till BBB–	Kort rating A1	A2	Total
Stater: Sverige samt G5 länder	58,8	0,0	0,0	0,0	0,0	58,8
Övriga stater	6,5	0,8	0,0	0,4	0,0	7,7
Supranationals	3,2	0,0	0,0	0,2	0,0	3,4
Övriga svenska emittenter	5,8	9,1	0,0	1,8	0,0	16,7
Övriga utländska emittenter	8,0	4,9	0,0	0,5	0,0	13,4
<b>Total</b>	<b>82,3</b>	<b>14,8</b>	<b>0,0</b>	<b>2,9</b>	<b>0,0</b>	<b>100</b>

### Rörelsens kostnader

Under året har arbetet med fondens uppbyggnad avslutats och förvaltning i egen regi inletts. Ett antal externa affärsrelationer för ekonomisk uppföljning och avkastnings- samt riskrapportering har avslutats. Dessa analyser genomförs nu internt.

Fondens kostnader summerade till 197 mnkr där personalkostnader uppgick till 61 mnkr och kostnaden för extern förvaltning, inklusive fondförvaltning till 46 mnkr. Kostnaderna för den externa förvaltningen motsvarar 0,04 procent av fondförmögenhetens genomsnittliga marknadsvärde under året. Rörelsekostnader i förhållande till det genomsnittliga marknadsvärdet under året, den så kallade förvaltningskostnadsandelen, motsvarar 0,16 procent.

I fondens rörelsekostnader ingår etableringskostnader om cirka 17 mnkr, varav 16 mnkr avser inköp och slutlig implementering av kapitalförvaltningssystemet TMS2000. Fondens samtliga investeringar har kostnadsförts.

### Skatt

Andra AP-fonden utgör, som statlig myndighet, i de flesta fall inte skattesubjekt. Fonden är inte heller momsredovisningsskyldig.

### Värderingsprinciper

De principer som använts vid värdering av fondens tillgångar är gemensamma för Första till Fjärde AP-fonderna. På sidan 50 finns en sammanställning över de värderingsprinciper som tillämpats.



# Resultaträkning

Belopp i mnkr	Not	jan–dec 2002	jan–dec 2001*
<b>Rörelsens intäkter</b>			
Erhållna utdelningar		1 578	823
Räntenetto	1	3 193	3 570
Realisationsresultat, netto	2	– 12 602	– 3 918
Valutakursresultat, netto		– 835	899
Orealiserade värdeförändringar	3	– 12 542	– 6 192
<b>Summa rörelsens intäkter</b>		<b>– 21 208</b>	<b>– 4 818</b>
<b>Rörelsens kostnader</b>			
Externa förvaltningskostnader	4	– 46	– 39
Personalkostnader	5	– 61	– 23
Övriga förvaltningskostnader	6	– 90	– 125
<b>Summa rörelsens kostnader</b>		<b>– 197</b>	<b>– 187</b>
<b>Årets resultat</b>		<b>– 21 405</b>	<b>– 5 005</b>

\*) Smärre omklassificeringar mellan resultatposter har gjorts avseende 2001.

## Kommentarer till resultaträkningen

### Årets resultat

Andra AP-fondens resultat uppgick år 2002 till –21 405 mnkr (–5 005) och utgjordes av ett förvaltningsresultat om –21 208 mnkr (–4 818) minskat med rörelsens kostnader om –197 mnkr (–187).

### Förvaltningsresultat

Räntenettot, totalt 3 193 mnkr (3 570), består huvudsakligen av ränteintäkter från obligationer och andra räntebärande värdepapper om netto 2 130 mnkr och ränteintäkter hänförliga till valutaterminer om netto 813.

Redovisat realisationsresultat, netto, var vid årets utgång –12 602 mnkr (–3 918), varav merparten uppstod i samband med höstens transition till en ny strategisk referensportfölj. Av de realiserade värdeförändringarna avsåg netto –12 631 mnkr noterade aktier inklusive aktiederivat och netto 29 mnkr räntebärande placeringar inklusive räntederivat.

Valutakursresultatet utgjordes av såväl orealiserat som realiserat valutakursresultat på fondens exponering i utländsk valuta. Resultatet uppgick netto till –835 mnkr (899). Merparten av Andra AP-fondens valutaexponering fanns vid årsskiftet i USD, 3 555 mnkr, samt i EUR, 2 534 mnkr. Totalt uppgick valutaexponeringen till 7 985 mnkr, vilket motsvarar cirka 7 procent av fondförmögenheten, en reduktion jämfört med exponeringen per 31 december 2001 med 3 procentenheter. Enligt fondens riktlinjer får, för år 2002, maximalt 20 procent av den totala portföljens marknadsvärde placeras i utländska aktier och värdepapper utan kurssäkring.

Orealiserade värdeförändringar uppgick till netto –12 542 mnkr (–6 192). Förlusten är i allt väsentligt hänförlig till aktier och aktiederivat, netto –14 210 mnkr, och förklaras av den kursnedgång som skett under året på världens aktiemarknader.

Räntebärande värdepapper och räntederivat redovisade en orealiserad vinst om 1 787 mnkr.

För Alternativa investeringar och Fastigheter uppgick den orealiserade förlusten till netto –119 mnkr, hänförlig till innehaven i fastighetsbolagen AP-fastigheter och Norrporten. Från AP-fastigheter har under året erhållits en utdelning om 200 mnkr.

### Rörelsens kostnader

Fondens rörelsekostnader uppgick till 197 mnkr (187), vilket motsvarar en förvaltningskostnadsandel om 0,16 procent av genomsnittlig fondförmögenhet under året. Av dessa utgjorde personalkostnader 61 mnkr. Under 2002 har fonden slutfört sin rekryteringsprocess och är i princip fullt bemannad.

Kostnader för extern förvaltning, inklusive förvaltningsavgifter i noterade fonder, uppgick till 46 mnkr. Kostnadsnivån för den externa förvaltningen är framför allt avhängig av dess omfattning och inriktning (aktiv eller passiv). Andra AP-fonden hade per 31 december 2002 såväl aktiva som passiva externa förvaltningsmandat och totalt 44,4 mdkr av total fondförmögenhet var vid årsskiftet externt förvaltat, 38 procent av dessa förvaltades aktivt. Se vidare not 4.

# Balance sheet

Amounts in SEK million	Note	Dec. 31 <sup>st</sup> 2002	Dec. 31 <sup>st</sup> 2001
<b>ASSETS</b>	<b>16</b>		
<b>Investment assets</b>			
Equities and participations			
Listed	7	56,906	77,743
Unlisted	8	4,131	4,139
Bonds and other fixed income assets	9	51,361	48,172
Derivatives	10	1,750	585
<b>Total investment assets</b>		<b>114,148</b>	<b>130,639</b>
<b>Receivables and other assets</b>			
Cash and bank balances	11	2,253	1,916
Other assets		240	43
Prepaid expenses and accrued income	12	1,534	1,193
<b>Total receivables and other assets</b>		<b>4,027</b>	<b>3,152</b>
<b>TOTAL ASSETS</b>		<b>118,175</b>	<b>133,791</b>
<b>FUND CAPITAL AND LIABILITIES</b>	<b>16</b>		
<b>Fund capital</b>	<b>13</b>		
Fund capital at beginning of year		133,493	133,975
Net contributions within the national pension system		1,985	3,062
Transferred from special funds and liquidation fund		3,017	1,461
Net profit for the year		– 21,405	– 5,005
<b>Total fund capital</b>		<b>117,090</b>	<b>133,493</b>
<b>Liabilities</b>			
Derivatives	10	928	217
Other liabilities		28	48
Accrued expenses and deferred income	14	129	33
<b>Total liabilities</b>		<b>1,085</b>	<b>298</b>
<b>TOTAL FUND CAPITAL AND LIABILITIES</b>		<b>118,175</b>	<b>133,791</b>
<b>Memorandum items</b>			
Assets pledged for forward transactions	11	1,094	657
Obligations	15	563	180

# Comments to the balance sheet

## Investment assets

At year-end 2002, the market value of "Listed equities" amounted to SEK 56.9 billion (77.7). The Fund's equities portfolio comprised Swedish equities with a market value of SEK 19.6 billion and foreign equities with a market value of SEK 33.0 billion. In the latter part of the autumn, the Second AP Fund invested in a number of external actively managed Swedish and foreign unit trusts, focused on specific sectors of the equities market, such as small Swedish businesses and emerging markets. These funds have performed relatively well and their market value totalled SEK 4.3 billion by year-end.

At year-end 2002, the Fund's unlisted real estate holdings consisted of its two associated companies, AP-fastigheter and Norrporten, which reported market values of SEK 3.6 billion (3.8) and SEK 0.4 billion (0.3) respectively. The Fund also owns a convertible debenture in Norrporten, which at year-end commanded a market value of SEK 631 million.

In addition to this, investment in funds for unlisted equities have continued during the year, with a new investment of SEK 50 million in Carnegie Biotech Bridge Fund and supplementary investments in EQT Northern Europe, and in Swedestart Tech and Swedestart Life Science. Further commitments totalling SEK 563 million have been pledged to this type of investment.

The total market value of unlisted equities amounted to SEK 4,131 million (4,139).

## Derivative instruments

In the balance sheet, the market values of all outstanding derivatives are declared gross, regardless of type. Derivatives with a positive market value amounted to SEK 1,750 million (585), while those with a negative value amounted to SEK 928 million (217).

To achieve the required level of currency exposure, the Second AP Fund has a considerable trading volume in currency derivatives. These derivatives are traded with some ten or more counterparties and, at year-end 2002,

the volume of currency forwards purchased amounted to SEK 8.0 billion (66.5), while currency forwards sold amounted to SEK 60.5 billion (68.2).

In the case of the equities and fixed income portfolios, share-index and interest-rate futures are mainly used as an effective means of achieving the required exposure at relatively low cost, assuming that the investment decision concerning underlying instruments has already been made. These transactions are cleared through one and the same clearing institute, Goldman Sachs, and outstanding volume at year-end amounted to SEK 3.8 billion (interest-rate futures) and SEK 21.4 billion (share-index futures). Derivative positions have never resulted in higher exposure to the equities and fixed income market than the pension assets under management, i.e. they exert no leverage on the balance sheet.

Trading in stock options has been limited in 2002. At year-end 2002, the net market worth of options held and issued was reported as SEK 1 million.

## Fund capital

Fund capital totalled SEK 117.1 billion (133.5). The change is attributable to the return on investments (performance result), external capital flows and operating expenses for the year.

The performance result was a deficit of SEK -21,208 million, with operating expenses of SEK -197 million.

External capital flows consist mainly of the current pension contributions paid into the Fund and the current pension disbursements made by the Fund. The net of these capital flows amounted to SEK 1,985 million in 2002. In addition to these capital flows, transfers were made to the Fund from the Special Funds and Liquidation Fund, that are managed by the First and Fourth AP Funds. These transfers represent part payments from the assets of the former national pension system, which is being liquidated. During the year, transfers – which have been received from the Liquidation Fund alone – amounted to SEK 3,017 million.

# Accounting and valuation principles

The annual report shall be prepared in accordance with the “Act concerning National Pension Funds (2000:192)” and implemented in line with generally accepted accounting principles. In conformity with the current regulations applying to comparable financial companies and institutions, the buffer funds have drafted and implemented joint accounting and valuation principles.

## Transaction-date accounting

Transactions on the money and bond-market, equities market and currency market are reported in the balance sheet on the transaction date, which is to say the date on which the significant rights and thereby risks are transferred between parties. The claim on or debt to the other party, between transaction date and settlement day, is reported gross under “Other assets” or “Other liabilities”.

## Foreign exchange

Assets and liabilities in foreign currency are reported at the closing day rate. Changes in the value of assets and liabilities in foreign currency are separated into that part attributable to the change in value of the asset or liability, and that part attributable to the change in the exchange rate. Both realised and unrealised changes in value arising from changes in exchange rates are reported under “Exchange gain/loss, net”.

## Equities and participations

Equities and participations are calculated at their true value. In the case of equities listed on an authorised exchange, this normally means the latest price paid in local currency on the final trading day of the year: otherwise, the latest bid rate. Equities are reported under the market where they were acquired. Unlisted holdings, apart from unlisted Swedish shares in property companies, are valued in accordance with EVCA principles. These principles state that holdings shall normally be

valued at acquisition cost during the first twelve months, after which they shall be valued at a conservatively estimated true market value. This true value shall first and foremost be based on transactions with a third party, although in certain instances other methods of valuation may be employed. The valuation of holdings in unlisted Swedish shares in property companies is based on a market valuation of the company’s real-estate portfolio at year-end.

In calculating capital gains and losses, the average exchange rate method has been applied.

## Bonds and other fixed income securities

Bonds and other fixed income assets are calculated at their true value. The market worth of fixed income securities is normally determined by the latest bid rate on the final trading day of the year: otherwise, the bid rate for the preceding day.

Net capital gains/losses and unrealised changes in value derive from the difference between the average accrued acquisition value and the market value/true value. The accrued acquisition value is the net present value of future payments, where the discount rate is the compound interest at the time of acquisition. This means that acquired premiums or discounts are accrual accounted over the security’s remaining term, or until the next adjustment in the interest rate. Changes in the accrued acquisition value are reported as interest income.

## Buy-backs

In a true buy-back transaction, also known as a repurchase agreement, the asset is still reported in the balance sheet and the payment received is reported as a liability. The sold security is reported as a pledged asset among memorandum items in the balance sheet. The difference between spot payment and forward rate is accrual accounted over the term and reported as interest.



**Derivative instruments**

Derivative instruments are calculated at their true value. Derivative transactions with a positive market value on the balance sheet date are reported as investment assets, while transactions with a negative market value are reported as liabilities.

**Equity lending**

Equity lent is reported in the balance sheet, and is disclosed as assets pledged under “Memorandum items”. Premiums received and accrued are reported as interest income.

**Equipment**

Investments in equipment, with in-house developed and externally-purchased software, are booked on current account.

**Items entered directly against Fund capital**

Contributions to and disbursements from the pension system, as well as transfers from the Special Funds and Liquidation Fund, owned jointly by the four buffer funds, are entered directly against Fund capital.

**Income tax**

The AP Funds are exempt from all income tax on investments in Sweden. Tax liability on investments outside Sweden varies from country to country.

# Notes to the income statement and balance sheet

## Note 1 >> Net interest income/expense

Amounts in SEK million	Jan-Dec 2002	Jan-Dec 2001
<b>Interest income</b>		
Bonds and other fixed income securities	2,130	3,574
Other interest income	1,699	221
<b>Total interest income</b>	<b>3,829</b>	<b>3,795</b>
<b>Interest expenses</b>		
Bonds and other fixed income securities	—	– 205*
Other interest expenses	– 636	– 20
<b>Total interest expenses</b>	<b>– 636</b>	<b>– 225</b>
<b>Net interest income/expense</b>	<b>3,193</b>	<b>3,570</b>

\*) Effect of change in method of calculation.

## Note 2 >> Capital gains/losses, net

Amounts in SEK million	Jan-Dec 2002	Jan-Dec 2001
<b>Equities and participations</b>		
Listed	– 9,565	– 1,771
Unlisted	—	—
Bonds and other fixed income securities	10	– 334
Derivatives	– 3,047	– 1,813
<b>Total capital gains/losses, net</b>	<b>– 12,602</b>	<b>– 3,918</b>

## Note 3 >> Unrealised changes in value

Amounts in SEK million	Jan-Dec 2002	Jan-Dec 2001
<b>Equities and participations</b>		
Listed	– 13,992	– 5,957
Unlisted	– 119	129
Bonds and other fixed income securities	1,795	– 365
Derivatives	– 226	1
<b>Unrealised changes in value, net</b>	<b>– 12,542</b>	<b>– 6,192</b>

## Not 4 » External asset management expenses

“External asset management expenses” refers to fees paid to external asset managers entrusted with confidential assignments pertaining to the management of listed and unlisted assets, and to management fees pertaining to listed unit trusts. External asset management expenses, distributed by active and passive mandate, and management fees to funds, are presented in the following table.

### Distribution of Fund assets between external mandates and in-house asset management as at Dec. 31<sup>st</sup> 2002 (SEK m):

	Benchmark index	Market value, Dec. 31 <sup>st</sup> 2002*	Share of Fund capital, %	Asset manage- ment expense
<b>External management mandate</b>				
Equities mandate				
<i>Active management</i>				
SEB	SBX	2,438		
SEB	OSX	1,096		
Carlson	SBX	3,622		
Carlson	OSX	948		
Carnegie	OSX	408		
MFS	MSCI World	3,445		
Pictet	MSCI World	692		
<b>Total</b>		<b>12,649</b>	<b>11</b>	<b>22</b>
<i>Passive management</i>				
Merill Lynch	MSCI World	1,431		
State Street Global Advisors	MSCI World	2,299		
Barclays Global Investors	MSCI regional mandate	19,910		
<b>Total</b>		<b>23,640</b>	<b>20</b>	<b>17</b>
Fixed income mandate		—	—	—
<b>Total external management mandate</b>		<b>36,289</b>	<b>31</b>	<b>39</b>
<b>Investments in listed external funds</b>				
Unit trusts	as per respective fund	4,291		
Fixed income funds	as per respective fund	3,832		
<b>Total investments in listed external funds</b>		<b>8,123</b>	<b>7</b>	<b>3</b>
<b>Total external management mandate</b>		<b>44,412</b>	<b>38</b>	<b>42</b>
<b>In-house asset management</b>				
Unlisted equities and participations incl. convertible debenture loan	SFIX	4,762		
		<b>4,762</b>	<b>4</b>	<b>4</b>
<b>Total asset management expenses</b>				<b>46</b>
Listed equities and participations	SBX, OSX, MSCI World	17,308		
Fixed income mandate	SHB	26,643		
	Lehman	16,876		
Cash and bank balances, incl. deposits and accrued interest		6,756		
<b>Total in-house asset management</b>		<b>67,583</b>	<b>58</b>	
<b>Other assets and liabilities</b>		<b>333</b>	<b>0</b>	
<b>Total Fund capital</b>		<b>117,090</b>	<b>100</b>	

\*) Market value including liquidity allocated for external mandates, and market value including derivative instruments and interest accrued for in-house asset management.

## Note 5 >> Personnel costs

Amounts in SEK k	Jan–Dec 2002		Jan–Dec 2001	
	Men	Women	Men	Women
<b>Average no. of employees</b>	<b>23</b>	<b>15</b>	<b>6</b>	<b>9</b>
<b>No. of employees, Dec. 31<sup>st</sup></b>	<b>23</b>	<b>15</b>	<b>15</b>	<b>13</b>
<b>No. of persons in Executive Management Group, Dec. 31<sup>st</sup></b>	<b>4</b>	<b>2</b>	<b>4</b>	<b>2</b>
<b>Salaries and remuneration</b>				
Chairman of the Board		100		100
CEO		2,620		2,287
Board of Directors, excl. Chairman		425		425
Executive Management Group, excl. CEO		7,052		2,715
Other employees		24,216		8,255
<b>Salaries and remuneration, total</b>		<b>34,413</b>		<b>13,782</b>
<b>Variable remuneration</b>				
CEO		—		—
Executive Management Group, excl. CEO		—		—
Other employees		—		—
<b>Variable remuneration, total</b>		<b>—</b>		<b>—</b>
<b>Remuneration to Members of the Board, in addition to directors' fees</b>		<b>—</b>		<b>—</b>
<b>Pension costs (incl. special employer's contribution)</b>				
CEO		4,384		—
Executive Management Group, excl. CEO		1,522		539
Other employees		5,590		1,871
<b>Pension costs, total</b>		<b>11,496</b>		<b>2,410</b>
<b>Payroll overhead</b>				
Chairman		33		33
CEO		878		768
Board of Directors, excl. Chairman		139		139
Executive Management Group, excl. CEO		2,373		899
Other employees		7,981		2,727
<b>Total payroll overhead</b>		<b>11,404</b>		<b>4,566</b>
<b>Other personnel costs</b>		<b>3,897</b>		<b>1,925</b>
<b>Total personnel costs</b>		<b>61,210</b>		<b>22,683</b>

### Pensions

The CEO is guaranteed retirement pension benefits in line with the retirement benefit agreement between BAO (The Employers' Organisation of the Swedish Banking Institutions) and Finansförbundet (The Union of Financial Sector Employees), known as the bank plan – but with the following supplementary clauses. The Fund and the CEO may both exercise the right to give notice with a retirement pension, as of the start of the month in which the CEO reaches the age of 60 years. The pension benefit shall in this instance correspond to 70 percent of the salary received at the time of retirement, and shall be paid until age 65. The above reported pension cost for 2002 includes pension premiums for the CEO pertaining to the years 2000, 2001 and 2002, including special employer's contribution, when the original agreement concerning pension entitlement was implemented in 2002. The pension cost for 2002 amounts to SEK 2,114 k, including special employer's contribution. The retirement benefit agreement between BAO (The Employers' Organisation of the Swedish Banking Institutions) and Finansförbundet (The Union of Financial Sector Employees) also applies to other senior executives.

### Severance-pay agreement

Where the contract of employment is terminated by the Fund, the CEO is entitled to a severance payment equivalent to two years' salary, less income from a new appointment. Other senior executives are not entitled to any severance pay.

### Drafting and decision process

Directors' fees are determined by the Swedish Government and the CEO's salary is determined by the Chairman and the Vice Chairman of the Board. The Second AP Fund has not appointed a remunerations committee.

### Absence due to illness

In 2002, absence due to illness at the Second AP Fund amounted to 1.1 percent, calculated as a percentage of total hours lost to illness against total normal working hours for all employees. No Fund employee has been absent due to illness for more than 60 days. Absence due to illness for employees up to 29 years of age is 0.8 percent, for the age group 30–49 years the figure is 1.2 percent, and for the age group 50 and above, 0.8 percent.



## Note 6 » Other administrative expenses

Amounts in SEK million	Jan–Dec 2002	Jan–Dec 2001
Rental expenses	3	6
Custodial expenses	11	8
IT and computer expenses	37	55
Other expenses	39	56
<b>Total other administrative expenses</b>	<b>90</b>	<b>125</b>
“Other expenses” includes fees to auditors amounting to SEK 8 million (SEK 6 million).		
Audit assignments		
KPMG	1.76	1.25
PricewaterhouseCoopers	0.38	0.05
Other assignments		
KPMG	5.19	4.58
PricewaterhouseCoopers	1.15	0.20
<b>Total</b>	<b>8.48</b>	<b>6.08</b>

## Note 7 » Listed equities and participations<sup>1)</sup>

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002		Dec. 31 <sup>st</sup> 2001	
	Market value	Acquisition value	Market value	Acquisition value
Swedish equities	19,575	29,515	27,746	32,786
Foreign equities	33,040	47,187	49,997	50,760
Participations in Swedish funds	2,765	2,673	—	—
Participations in foreign funds	1,526	1,602	—	—
<b>Total listed equities and participations</b>	<b>56,906</b>	<b>80,977</b>	<b>77,743</b>	<b>83,546</b>

1) The 20 largest Swedish and foreign shareholdings, by value, are listed on page 60. A complete list of Swedish holdings may be found on the Fund's website at [www.ap2.se](http://www.ap2.se)

## Note 8 » Unlisted equities and participations

Amounts in SEK million	No. of equities	Dec. 31 <sup>st</sup> 2002		Acquisition value
		Participation right Capital	Votes	
<b>Associated companies</b>	Corp. reg.			
AP-fastigheter AB	556061-4603	10,000,000	25%	3,660
NS-Holding AB	556594-3999	1,000,799	33%	293
<b>Total associated companies</b>				<b>3,953</b>
<b>Other unlisted holdings</b>				
Swedish equities and participations	Corp. reg.			
Swedestart Life Science KB	969675-2337	5%		4
Swedestart Tech KB	969674-7725	3%		4
EQT Northern Europe KB	969670-3405	1%		111
Foreign equities and participations				
Carnegie Biotech Bridge Fund				50
<b>Total other unlisted holdings</b>				<b>169</b>
<b>Total unlisted equities and participations</b>				<b>4,122</b>
<b>Total market value</b>				<b>4,131</b>

## Note 9 » Bonds and other fixed income securities

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002		Dec. 31 <sup>st</sup> 2001	
	Market value	Acquisition value	Market value	Acquisition value
<b>Distribution by category of issuer</b>				
Swedish State	16,434	15,789	35,422	35,769
Swedish municipalities	2	2	12	12
Swedish housing finance institutes	5,664	5,572	6,369	6,428
Other Swedish issuers				
Finance companies	343	333	413	411
Non-finance companies <sup>1)</sup>	1,669	1,652	2,414	2,433
Foreign states	11,743	11,757	151	149
Other foreign issuers	10,837	10,887	3,391	3,335
Demand loans	4,669	4,672	—	—
<b>Total</b>	<b>51,361</b>	<b>50,664</b>	<b>48,172</b>	<b>48,537</b>
<b>Distribution by category of instrument</b>				
Index-linked bonds	5,909	5,432	10,012	9,906
Other bonds	34,747	34,512	29,278	29,956
Treasury bills	—	—	5,264	5,113
Certificates	—	—	150	150
Participations in Swedish index-linked funds	—	—	—	—
Participations in foreign index-linked funds	5,405	5,417	2,528	2,466
Other instruments <sup>1)</sup>	631	631	940	946
Demand loans	4,669	4,672	—	—
<b>Total</b>	<b>51,361</b>	<b>50,664</b>	<b>48,172</b>	<b>48,537</b>

1) Including convertible debenture loans to associated companies totalling SEK 631 million (585).

## Note 10 » Derivative instruments

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002		
	Face value <sup>1)</sup>	Derivative instruments with Positive true value	Negative true value
<b>Currency-related instruments</b>			
Forward contracts	68,486	1,747	– 727
<b>Total</b>	<b>68,486</b>	<b>1,747</b>	<b>– 727</b>
of which cleared	0		
<b>Equities-related instruments</b>			
Options			
Held	46	3	—
Issued	18	—	– 2
Forward contracts	21,434	—	– 182
<b>Total</b>	<b>21,498</b>	<b>3</b>	<b>– 184</b>
of which cleared	21,498		
<b>Fixed income instruments</b>			
Forward contracts	3,824	—	– 17
<b>Total</b>	<b>3,824</b>	<b>0</b>	<b>– 17</b>
of which cleared	3,824		
<b>Total derivative instruments</b>		<b>1,750</b>	<b>– 928</b>

1) Face value refers to the number of contracts multiplied by the contract amount for the derivative instruments' absolute amount. The amount thereby includes both forward contracts purchased and sold, gross. Refer to page 49 for a description of the types of derivative instrument employed and the risks that can be managed with such instruments.

### Note 11 » Cash and bank balances

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002	Dec. 31 <sup>st</sup> 2001
Cash and bank balances	1,159	1,259
Guarantees provided for forward trading	1,094	657
<b>Total</b>	<b>2,253</b>	<b>1,916</b>

### Note 12 » Prepaid expenses and accrued income

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002	Dec. 31 <sup>st</sup> 2001
Income accrued	1,396	1,188
Refunds	87	4
Dividends accrued	44	—
Other prepaid expenses and accrued income	7	1
<b>Total</b>	<b>1,534</b>	<b>1,193</b>

### Note 13 » Fund capital

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002	Dec. 31 <sup>st</sup> 2001
Opening fund capital as per approved balance sheet	133,493	133,975
Net payments to the national pension system		
Payments from RFV of pension contributions received	40,187	39,203
Payments to RFV for disbursement of supplementary pension benefits <sup>1)</sup>	– 38,202	– 36,141
<b>Surplus</b>	<b>1,985</b>	<b>3,062</b>
Transferred from Special Funds		
From First AP Fund's liquidation fund	3,017	1,408
From Fourth AP Fund's liquidation fund	—	53
<b>Total</b>	<b>3,017</b>	<b>1,461</b>
Net result for the year	– 21,405	– 5,005
<b>Total</b>	<b>117,090</b>	<b>133,493</b>

1) Including remuneration for administration expenses amounting to SEK 263 million (250).

On Dec. 31<sup>st</sup> 2002, the capital carried forward in the accounts of the First AP Fund's Liquidation Fund and the Fourth AP Fund's Special Fund amounted, respectively, to SEK 6,511 million and SEK 1,377 million. For information about these Special Funds, please refer to the First AP Fund's website at [www.ap1.se](http://www.ap1.se), or contact the Fourth AP Fund, to order a copy of the annual report.

### Note 14 » Accrued expenses and deferred income

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002	Dec. 31 <sup>st</sup> 2001
Accrued external asset management expenses	15	13
Accrued interest expenses on currency forwards	98	—
Other accrued expenses	16	20
<b>Total</b>	<b>129</b>	<b>33</b>

**Note 15 » Obligations**

Amounts in SEK million	Dec. 31 <sup>st</sup> 2002	Dec. 31 <sup>st</sup> 2001
<b>Obligations concerning future payments</b>		
Investment obligations, unlisted holdings	563	180
<b>Total</b>	<b>563</b>	<b>180</b>

**Note 16 » Currency exposure**

See table on page 45.



Gothenburg, February 6<sup>th</sup>, 2003

Kurth Augustson

Gunnar Larsson  
*Chairman*

Bo Dockered

Cecilia Kragsterman

Clas Nykvist

Anne-Marie Pålsson

Lilian Ringsand

Roland Svensson

Ylva Thörn

Lars Idermark  
*CEO*

## Auditors' report

Auditors' report for the Second AP Fund  
(Corp. reg.: 857209-0606)

We have examined the annual report, the accounting records and the administration of the Second AP Fund by the Board of Directors for the financial year 2002. The Board is responsible for the accounting records and administration. Our duty is to state our opinion with respect to the annual report and the administration, based on the results of our audit.

Our examination has been conducted in accordance with generally accepted auditing standards in Sweden. This means that we have planned and conducted the audit in such a manner as to satisfy ourselves, beyond reasonable doubt, that the annual report contains no significant errors. An audit comprises the examination of selected supporting documentation for the figures and other information presented in the accounting records. An audit further comprises an evaluation of the accounting principles and of the application of these same principles by the Board, as well as evaluating the data accumulated in the annual report.

The annual report has been prepared in accordance with the Swedish Act on National Pension Funds, and therefore provides a true and fair picture of the Second AP Fund's net result and financial position in accordance with generally accepted auditing standards in Sweden.

Our audit has given no reason to qualify our approval of the annual report, of the enclosed income statements and balance sheets, of the accounting or inventory of the Fund's assets or any other aspect of its administration.

We recommend that the income statement and balance sheet be adopted.

Gothenburg, February 6<sup>th</sup> 2003

Anders Bäckström  
*Authorised Public Accountant  
Appointed by  
the Swedish Government*

Göran Jacobsson  
*Authorised Public Accountant  
Appointed by  
the Swedish Government*

# Shares, participations and fixed income securities

## Second AP Fund's 20 largest Swedish shareholdings\*

Name of company	No. of equities	Share of capital, %	Share of voting rights, %	Market value, SEK	Sector
AstraZeneca	6,033,547	0.28	0.28	1,848,919,018	Healthcare
Hennes & Mauritz B	8,168,385	0.99	0.48	1,372,288,680	Consumer Discretionary
Svenska Handelsbanken A	10,690,402	1.57	1.64	1,240,086,632	Finance
Svenska Handelsbanken B	500,580			55,564,380	Finance
Ericsson B	206,630,750	1.29	0.03	1,260,447,575	Telecommunications
Ericsson A	14,400			124,560	Telecommunications
Nordea	30,713,636	1.03	1.03	1,179,403,622	Finance
SCA B	2,121,971	1.29	1.77	623,859,474	Raw Materials
SCA A	866,275			254,251,713	Raw Materials
Volvo A	3,963,174	1.32	2.46	538,991,664	Industry
Volvo B	1,872,480			265,892,160	Industry
Skandinaviska Enskilda Banken A	9,893,059	1.44	1.47	717,246,778	Finance
Skandinaviska Enskilda Banken C	250,520			16,283,800	Finance
FöreningsSparbanken A	6,893,809	1.31	1.31	710,062,327	Finance
Electrolux B	4,959,411	1.46	1.16	681,919,013	Consumer Discretionary
Sandvik	2,912,171	1.13	1.13	566,417,260	Industry
SKF B	1,997,272	2.00	1.17	451,383,472	Industry
SKF A	279,557			63,040,104	Industry
Investor B	7,563,680	1.25	0.77	393,311,360	Finance
Investor A	2,010,284			105,539,910	Finance
TeliaSonera	13,894,423	0.46	0.46	455,737,068	Telecommunication
Securitas B	3,824,913	1.06	0.74	397,790,952	Industry
Tele2 B	1,704,290	1.16	0.50	392,838,845	Telecommunication
Assa Abloy B	3,723,367	1.02	0.69	370,475,017	Industry
Atlas Copco A	1,357,364			230,751,880	Industry
Atlas Copco B	888,995	1.07	0.98	137,349,728	Industry
Skandia	13,653,386	1.33	1.33	316,758,551	Finance
Stora Enso OY R	3,231,574	0.36	0.36	292,457,447	Raw Materials
Stora Enso OY A	5,400			491,400	Raw Materials

## Second AP Fund's 20 largest foreign shareholdings\*

Name of company	No. of equities	Market value, SEK	Sector
Nokia	5,119,722	707,323,410	Information Technology
General Electric Co	2,570,179	545,311,939	Industry
Microsoft Corp	1,209,848	545,009,439	Information Technology
Exxon Mobil	1,775,589	540,565,107	Energy
Pfizer Inc	1,752,429	466,786,773	Healthcare
Citigroup	1,457,263	446,827,487	Finance
BP	6,922,931	414,666,715	Energy
Johnson&Johnson	864,321	404,494,746	Healthcare
Vodafone Group	24,252,385	385,277,780	Telecommunication Services
Merck & Co	664,787	327,912,777	Healthcare
Wal-Mart Stores	744,358	327,598,497	Consumer Discretionary
International Business Machines Corp	480,522	324,487,257	Information Technology
Royal Dutch Shell	835,409	320,446,165	Energy
Total Fina Elf	250,591	311,851,299	Energy
GlaxoSmithKline	1,800,324	301,028,923	Healthcare
Novartis N	925,819	294,337,085	Healthcare
Royal Bank of Scotland	1,366,003	285,125,383	Finance
American International Group	550,620	277,547,951	Finance
Procter & Gamble	336,110	251,686,224	Consumer Staples
HSBC Holdings	2,556,744	246,211,926	Finance

\*) The above table of Second AP Fund shareholdings lists the 20 largest Swedish holdings and 20 largest foreign holdings, by worth. "Swedish shareholdings" even includes companies that have changed their legal domicile after merging with a foreign company, as with AstraZeneca and StoraEnso. Share of capital and voting rights for shareholdings listed principally on foreign exchanges in no case exceeds 0.3% and is therefore not reported.

A complete list of the Second AP Fund's Swedish holdings may be found on the Fund's website at [www.ap2.se](http://www.ap2.se). A complete list of foreign holdings may be ordered from the Second AP Fund.

## Second AP Fund holdings in unit trusts and fixed income funds

	No. of equities, participations	Market value, SEK m
<b>Unit trusts, foreign</b>		
F&C Global emerging markets portfolio	8,631,944	517
State Street, emerging markets	157,462	339
Pictet Funds, emerging markets	189,753	258
Deutsche Bank Global emerging market Fund	2,372,620	178
Genesis emerging markets	2,244,669	174
Skandia Småbolag (Small Business) Europe	930,075	60
	No. of equities, participations	Market value, SEK m
<b>Fixed income funds, foreign</b>		
Ishares Investop Corp	1,645,510	1,573
The Finch Neutral Fund	82,043	88

	No. of equities, participations	Market value, SEK m
<b>Unit trusts, Swedish</b>		
Carlson Sverige Småbolagsfond (Small Business Fund)	1,478,868	756
SEB Sverige Småbolagsfond (Small Business Fund)	89,942,397	721
SHB Småbolagsfond (Small Business Fund)	1,992,709	379
Enter Sverige Focus	301,686	200
Robur Småbolagsfond (Small Business Fund)	13,951,588	197
Lannebo Småbolagsfond (Small Business Fund)	16,635,056	163
Eikos	920	153
RAM One	150,000	149
SEB Sverige Småbolag Chans/Risk (Small Business Fund)	1,577,156	46

## Bonds and other fixed income securities

### Swedish inflation-linked bond portfolio, five largest holdings

Bond	Face value, SEK m
Sgb 3101	1,307
Sgb 3105	1,296
Sgb 3104	1,010
Sgb 3001	756
Sgb 3102	677

### Swedish nominal bonds, five largest holdings

Bond	Face value, SEK m
Sgb 1035	1,387
Sgb 1040	1,332
Sgb 1044	1,231
Sgb 1041	1,094
Sgb 1043	1,006

### Global government bond portfolio, five largest holdings

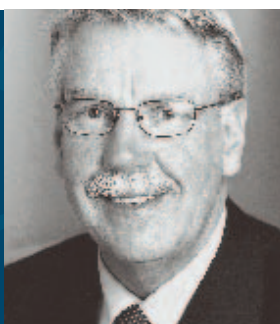
Bond	
Us Tsy 2006-11-15	MUSD 61
Us Tsy 2004-11-30	MUSD 58
Us Tsy 2016-11-15	MUSD 56
Ger Bund 137	MEur 50
Us Tsy 2004-03-31	MUSD 51

### Global credit portfolio, five largest holdings

Bond	
DB Iboxx linked note	MEur 50
IADB 2005-01-18	MUSD 20
FHLMC 2013-01-15	MEur 15
IBRD 2004-04-30	MUSD 15
KFW 2007-08-17	MEur 12

Detailed information about the Second AP Fund's holdings in fixed income securities is available on request from the Fund.

# Board of Directors and Executive Management



**Gunnar Larsson**

CHAIRMAN

Chairman of The Swedish Sports Confederation. Chairman of the boards of Tholin & Larsson-Gruppen AB and GöteborgsOperan. Member of several boards, including Castellum AB and Samhall AB. Former authorised public accountant and Municipal Commissioner for Gothenburg. Born 1940.



**Bo Dockered**

VICE CHAIRMAN

Chairman of the boards of AB Trav and Galopp, Sveaskog AB and The Swedish University of Agricultural Sciences. Honorary Doctor of Agronomy (Dr.h.c. Agronomy) and farmer. Born 1941.



**Kurth Augustson**

Former president of SCA Mölnlycke AB and AB Marabou. Member of several boards, including Cloetta Fazer AB, Pergo AB, Royal Scandinavia A/S and Oy Paulig. B. Econ. Born 1944.



**Cecilia Kragsterman**

Director and Head of Business Unit Global Business Development at Skandia. Former president of Skandia-Link. Member of the London Business School Regional Advisory Board. B. Econ. Born 1960.



**Clas Nykvist**

Controller, Swedish Building Workers' Union. Member of several boards, including Folksam Spar AB. Born 1948.



**Anne-Marie Pålsson**

Senior Lecturer in Economics at the University of Lund. Member of The Royal Swedish Academy of Engineering Sciences. Working member of The Royal College of Forestry and The Royal Academy of Agriculture and Forestry. Member of several boards, including Aktiespararna. Advisor to the Government Commission on Securities Funds. Member of the Swedish Riksdag (Parliament). Born 1951.



**Lilian Ringsand**

Senior Deputy Chairman of Sif (Swedish Union of Clerical and Technical Employees in Industry) and TCO (Swedish Confederation of Professional Employees). Member of the board of the Authority for Advanced Industrial Training. Research engineer at Boliden Mineral. Born 1942.



**Roland Svensson**

President and CEO of Coop Norden AB. Chairman of the boards of KP Pension & Försäkring and The Cooperative Employers' Association (KFO), as well as of the Swedish National Museum of Art. Born 1941.



**Ylva Thörn**

President, Swedish Municipal Workers' Union. Chairman of The Public Services International. Member of several boards, including LO (The Swedish Trade Union Confederation) and Riksborgen. Assistant nurse. Born 1954.



**Lars Idermark**

CEO. Member of the boards of AP-fastigheter AB, Södra Skogsägarna, Södra Cell, Dimension AB and Swedish Meats. Born 1957.





## executive management

### Fund management, Second AP Fund

Above, from left:  
Lennart Jonsson, Head of Communications  
and Corporate Governance, born 1952  
Petter Odhnoff, CIO, born 1956  
Margaretha Veres, Personal Assistant  
to the CEO, born 1945  
Lena Smeby-Udesen, CFO, born 1961  
Martin Jonasson, General Counsel, born 1964  
Lars Idermark, CEO, born 1957

## auditors

Anders Bäckström  
Authorised Public Accountant  
KPMG

Göran Jacobsson  
Authorised Public Accountant  
PriceWaterhouseCoopers

# Glossary of terms

## Absolute/relative return on investment

The return generated on a portfolio or portfolios of assets, measured in kronor or percent, of the original invested amount.

## Active return (also relative return)

The difference in return between a portfolio and its benchmark index.

## Active/passive management

Active: Management where the portfolio may deviate from the benchmark portfolio, to generate an active return.

Passive: Management where the portfolio is identical with the benchmark portfolio.

## ALM study

Asset Liability Modelling. An analytical model used to determine the Fund's benchmark portfolio. The study, which is revised on a continual basis, is designed to determine the optimal composition for the different asset classes under Fund management, to ensure that it satisfies the Fund's long-term commitment to the collective requirements of the Swedish national pension system. The judgements based on this analysis shall take into account demographic change as well general economic trends.

## Investment grade

A borrower's rating is determined by various credit rating institutes. These ratings provide investors with a consistent means of gauging the borrower's creditworthiness. The rating is based on the borrower's ability to fulfil his obligations to the lender, i.e. to pay interest and amortisation on the sum borrowed. "Investment grade" means that the borrower is among those awarded the highest credit rating. Investment in companies with a lower rating is normally considered a "high yield" or "speculative" investment.

## DEFINITIONS OF RISK

### Market risk

The market risks most relevant to the Second AP Fund are share-price risk, interest-rate risk and currency risk.

## Credit risk and counterparty risk

"Credit risk" refers to the risk that an issuer becomes insolvent and is unable to fulfil his obligations, or is awarded a lower credit rating. "Counterparty risk" refers to the risk that some other party to a business agreement may be unable to meet its obligations.

## Operational risk

"Operational risk" refers to the risk that an error or stoppage in operations could lead to economic loss or reduced credibility.

## Liquidity risk

"Liquidity risk" refers to the risk that securities cannot be converted into cash, because of reduced access to or demand from the market, which either precludes the purchase or sale of such securities, or would require their sale at a loss.

### Absolute return on investment

Return on portfolio =  $R_p$

### Absolute risk

Volatility = standard deviation for return on portfolio

### Risk-adjusted absolute return

$$\text{Sharpe ratio} = \frac{R_p - R_f}{\sigma_p}$$

Where  $R_f$  = risk-free interest and  
 $\sigma_p$  = standard deviation for return on portfolio

### Relative return

Surplus return =  $R_p - R_i$

Where  $R_i$  = return on index

### Tracking Error

Standard deviation relative to return =  $\sigma_{p-i}$

### Risk-adjusted relative return

$$\text{Information ratio} = \frac{R_p - R_i}{\sigma_{p-i}}$$

Solberg

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**Andra AP-fonden**  
*Second Swedish National Pension Fund - AP2*

Andra AP-fonden · P.O. Box 11155 · SE-404 24 Gothenburg · Sweden

Visitors: Östra Hamngatan 26–28

Phone +46 31 704 29 00 · Fax +46 31 704 29 99

[www.ap2.se](http://www.ap2.se)