



Andra AP-fonden
Second Swedish National Pension Fund - AP2

Annual Report 2004



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

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

This is the Second AP Fund

The capital assets invested in Sweden's publicly financed national pension system are managed by five "buffer funds", which invest these assets in the capital markets. The joint investment regulations, which are identical for the First to Fourth Swedish National Pension Funds, permit investment in several different classes of asset and on different markets.

The Second Swedish National Pension Fund/AP2, located in Gothenburg, started operations on January 1st, 2001. Since then, it has 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 is 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 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. The Fund shall achieve this through the successful in-house management of assets and skilled "management of managers".

2004 in brief

- The capital assets of the Second Swedish National Pension Fund/AP2* totalled SEK 158.1 billion as per December 31st 2004, an increase of SEK 17.8 billion compared with the preceding year. During the year, the Fund reported a net inflow of SEK 1.7 billion, posting a total return of 11.6 percent on invested assets for the full twelve months ending December 31st 2004. Net profit for the year totalled SEK 16.1 billion.
- The solid growth in Fund capital may be attributed primarily to the maintenance of a high allocation of equities throughout 2004, fully in line with the Fund's long-term investment strategy.
- During 2004, the focus and organisation of asset management activities has changed, moving towards a clearer distinction between the passive and active management of risk. A number of external mandates awarded for management of equities on the Swedish and European markets have been terminated and a substantial amount of these assets are now managed in-house. The proportion of active mandates awarded will increase in the field of tactical asset allocation and in the form of global mandates to manage equity, fixed-income and FX portfolios. During the year, the Fund has established a quantitative analysis group.
- The Fund has also developed a completely new model for its strategic portfolio. In the new strategic portfolio for 2005, the level of foreign currency exposure has been increased from 8 to 9 percent.

* The Second AP Fund is officially translated as the Second Swedish National Pension Fund/AP2. In body text, for convenience, this is shortened to the Second AP Fund and, in some cases, AP2.

Three-year review

	2002	2003	2004
Fund capital, SEK bn	117.1	140.4	158.1
Net inflows from RFV and liquidation/special funds, SEK bn	5.0	2.6	1.7
Net profit for the year, SEK bn	-21.4	20.7	16.1
Return on total portfolio, excl. expenses, %	-15.3	17.8	11.6
Relative return on market listed assets, excl. operating expenses, %**	0.6	-0.5	-0.6
FX exposure, %	7	8	10
Under active (incl. enhanced) management, %	62	89	90
Under external management (incl. investments in private equity funds) , %	38	45	37

** Relative return refers to the difference in return between portfolio and benchmark index.

1

Second AP Fund step-by-step

This spread describes the Second AP Fund's commitments, objectives, strategies, investments and business services activities in terms of a flow chart. The presentations given in the Annual Report mirror this approach.

The pension system in brief

Sweden has established a robust national pension system. Approximately 90 percent of the national pension system is financed from contributions in the form of taxes and premiums levied based on the "pay-as-you-go" system, whereby the gainfully employed part of the population pays on an ongoing basis for the pensions of those who have retired. The remaining 10 percent is financed from investments managed by Sweden's National Pension Funds. Each krona paid into the system carries one krona in pension entitlement. Should the system lack full financing, it features an inbuilt automated balancing function.

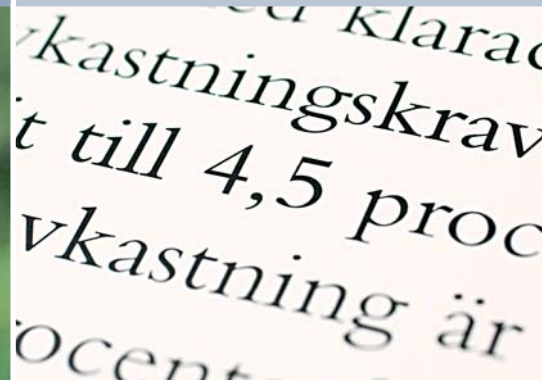
The Second AP Fund is one of the five "buffer funds" that comprise this system. The combined capital assets of these funds are designed to act as a buffer, smoothing out eventual periods of surplus and deficit experienced over the longer term.

2

Overall target and result

The Second AP Fund's overall goal is to generate a maximum long-term return on invested assets, with a view to minimising the impact should automatic balancing (of a deficit within the pension system) be required. Assets shall be managed with a low level of risk.

The Second AP Fund had established a target of 3.5 percent for real return on investment in 2004. The return on the total portfolio for 2004 was 11.6 percent, whereby the Fund achieved its broad objective. As of 2005, the Fund has raised its target for real return on investment to 4.5 percent. As for relative return, the goal is to outperform the return on the Fund's strategic portfolio by 0.5 percentage points. The Fund failed to achieve this objective in 2004.



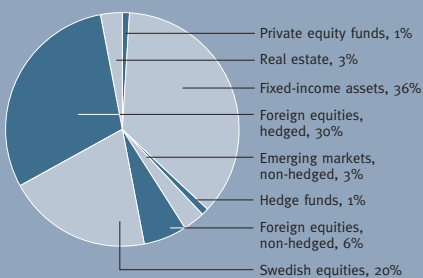
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Investment strategy

The Second AP Fund's strategic portfolio is developed with the aid of an "ALM model", used to make a qualified prediction of anticipated development over a period of more than 30 years. The model is an aid to determine the allocation of asset classes in the strategic portfolio and the strategy adopted concerning foreign currency exposure. The composition of the strategic portfolio for 2004 and 2005 is 59 percent equities, 36 percent fixed-income assets and 5 percent alternative investments.

To spread the risk, the Second AP Fund invests worldwide in a broad range of asset classes.

Strategic portfolio



4

Investments

The Second AP Fund invests its assets in four different ways.

Tactical allocation

Tactical allocation enables the Fund to generate a higher return by deviating from its own strategic portfolio. In practice, this means that market perceptions are translated into decisions concerning under or over-weighting in foreign exchange or classes of asset.

Equities

The Second AP Fund is a global fund manager. The majority of the Second AP Fund's investments in Swedish and European equities are handled in-house, while investments outside Europe are handled by external managers.

Fixed-income and FX

The portfolio of fixed-income assets consists of nominal and real Swedish bonds and global government securities and corporate bonds. The Fund also trades in foreign currencies.

Alternative investments

To spread the investment risk and generate a higher return, the Fund invests in private equity funds, hedge funds and real estate.

5

Business services

The Second AP Fund operates a sophisticated business services organisation. Investments already made are subject to thorough analysis, with a view to creating the best possible prospects for future investment. This analytical process is conducted in three stages, based on a daily appraisal of the Fund's portfolio assets.

Analysis of trades

Trading efficiency is analysed and measured against transaction costs and rate of portfolio turnover.

Analysis of Fund's positions

Risk and return on investment are analysed and monitored daily in various dimensions and at different levels, e.g. by sector and geographic area. Risk utilisation, for the total portfolio as well as per asset class and mandate, is monitored and checked against current risk limits.

Attribution analysis

Attribution analysis is used to determine the impact of individual portfolios on the Fund's total return and risk utilisation. This attribution analysis is based on factors such as type of security selected, nature of industry and geographical area.



Chief Executive's review



2004 was a good year for the Second AP Fund. Net profit for the full twelve months amounted to SEK 16.1 billion. This satisfactory trend is primarily attributable to the Fund's implementation of a consistent and long-term investment strategy, a strategy that has been applied consistently since the Fund's establishment in 2001.

The Second AP Fund has now been in operation in Gothenburg for the past four years. We have established a reputation as a modern, high-quality and professional fund manager. The Fund currently manages assets amounting to SEK 158 billion.

The Second AP Fund's primary objective is to generate a high absolute return on invested capital. This is the very essence of the Swedish National Pension Funds' mission.

We shall of course avoid incurring more risk than absolutely necessary. At the same time, the demands made with respect to return on investment are high. The Second AP Fund has established a target nominal average return of 6.5 percent per year.

Balance between short and long term

The Second AP Fund's mission is very long term, with an investment horizon of up to 30 years. This said, we must meet our targets in terms of return over the shorter term too, within a five-to-ten-year horizon.

Generating ongoing value growth while focusing on the need for solid long-term investment is far from easy. There is constant debate about the need to generate results here and now, while at the same time attention must be paid to long-term financial market trends.

In practice, fund managers have always had to try and resolve these issues. The difference now is that they are so much more prevalent, largely due to the globalisation process. Globalisation is resulting in the

harmonisation of global markets. Numerous conflicts arise in the wake of this process, either of a political, ethnic or religious nature. We must take these factors into account.

A national pension fund is well suited to the long-term management of capital assets.

The consistency and clarity required of the role may sometimes appear to be in sharp contrast to the perceived wisdom of the time. What may appear to be a smart decision in the heat of the present's conflicting demands can only be confirmed in retrospect, after the consequences have become clear.

A typical example of this was the Second AP Fund's decision not to desert the equities market, as so many others did, when stock markets nosedived in 2001 and 2002.

Since the market bottomed out in 2002, the Fund's capital assets have increased by SEK 50 billion, thanks to confidence in our long-term asset management policy.

Strong performance in 2004

Financially, 2004 was a good year, with an 11.6 percent return on investment. The worth of the Fund's capital assets increased by SEK 17.8 billion. Net profit for the year was SEK 16.1 billion.

Since the Fund was established, its capital assets have increased by SEK 24.1 billion, including inflows of SEK 13.7 billion. This has been achieved in spite of what can only be described as a difficult stock

market climate in the first few years.

The relative return on assets was negative in 2004. This derived mainly from the Swedish portfolio's sharp dependence on a limited number of large Swedish companies. Measured from the Fund's inauguration in 2001, relative return for the whole period is positive.

Curiosity, flexibility and innovative flair

No organisation or business activity is ever fully "complete". The Second AP Fund is committed to a constant search for new solutions and new approaches, to challenging conventional limitations and daring to change whatever fails to satisfy. An open corporate culture offers the most direct route to just such a business climate – a culture that encourages Fund employees to be innovative and constructively critical, as well as responsible.

2004 was a highly active financial year, during which a number of important steps were taken. Time and resources were invested in maintaining a leading position in the business services sector, among others. This has involved increased automation and new solutions that translate into lower costs. These measures have also created more time to invest in our most crucial value-adding business activity – analysis.

After the low of 2002, the Fund's capital assets have grown by SEK 50 billion.

A new corporate governance policy was developed during the year. It features new ideas on the concept of active ownership and is formulated in compliance with the new Swedish corporate governance code, presented by the Code Group in 2004. One consequence of this new policy is that the Fund will adopt a more clearly defined and active stance in future.

New partners

During the year, the Fund invested in Swiss fund manager SAM (Sustainable Asset Management), which analyses and evaluates companies in terms of sustainable criteria – something from which we hope to benefit even when conducting our more traditional asset management analyses.

The Fund has also developed its activities in tactical asset allocation, including the signing of a joint partnership agreement with Goldman Sachs and First

Quadrant LP, in the form of a GTAA (Global Tactical Asset Allocation) mandate.

The Fund strove to enhance the efficiency of its asset management during the year. Compared to similar fund managers, it is already competitive. The fees charged by asset managers such as hedge funds, private-equity and emerging-markets funds are still relatively high. High fees may be acceptable if investments generate the anticipated added value. On the other hand, tolerance of underperforming asset managers has declined. This has led to the termination of a number of partnerships and the establishment of several new ones.

Own model for scenario simulation

During the year, the Fund has developed a completely new ALM (Asset Liability Modelling) model in association with Fraunhofer Chalmers Research Centre for Industrial Mathematics. The model describes the dynamic relationship between asset and liability sides of the national pension system, by simulating the various building blocks of which the system is comprised in a clearer way. This makes it easier to compose a strategic portfolio of assets. Based on this model, a radically new picture has emerged concerning the stability of the national pension system.

In the field of asset management, this has resulted in a change of both focus and organisation. This change is contributing to lower costs and more efficient asset management.

Good prospects

There is reason to feel fairly optimistic about the prospects for 2005, even though there could be a slight slowdown in the global economy's rate of growth. At the Second AP Fund, we endorse the view that we can always get a little bit better and a little bit wiser. The responsibility we bear, for managing the pension assets of the Swedish people, demands careful planning and an ability to make decisions. We believe in our chosen strategy which is why we are optimistic about the future, even when confronted by difficulties.

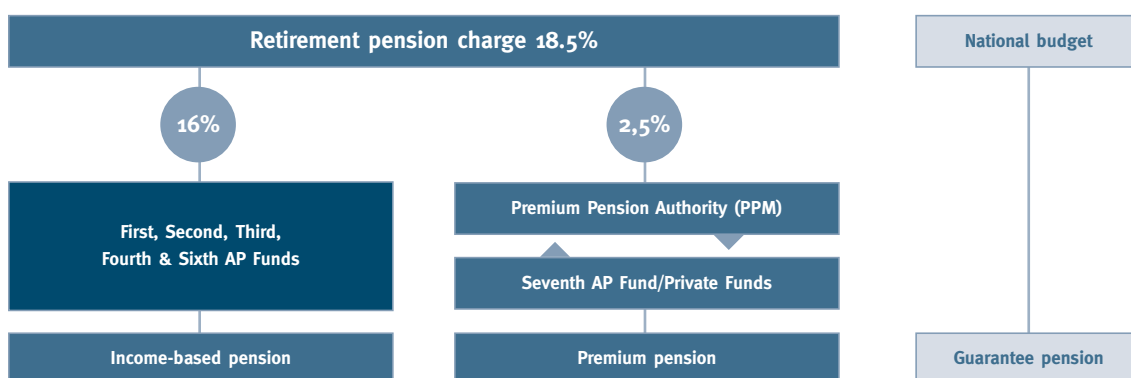
Gothenburg, February 2005.



Lars Idermark, CEO

The Second AP Fund: key component of the Swedish national pension system

The Second AP Fund is one of the Swedish national pension system's "buffer" funds. The Fund is tasked with achieving the highest possible return on assets under management and is also intended to act as a counterbalance at times when the national pension system is required to make major pension disbursements. When the baby-boomers of the 1940s and 1960s are due for retirement, the demands made on the pension system will be considerable.



The reformed income-based pension system, in contrast to a publicly funded system, is a separate and independent model. In future, pension entitlement will be fundamentally determined by the individual's income, based on lifetime income.

The national retirement pension will consist of three elements

The national retirement pension to which individuals will be entitled will comprise three elements: an income-based pension, a premium pension and/or a guarantee pension.

The retirement pension is funded by an 18.5 percent charge levied on total income up to 7.5 times the income base amount (via social charges and taxes) on each wage/salary payment. Of this total

charge, 16 percentage units are utilised to fund pension disbursements for the year (income-based pension). The remaining 2.5 percentage units are saved and generate interest in an individual premium pension account.

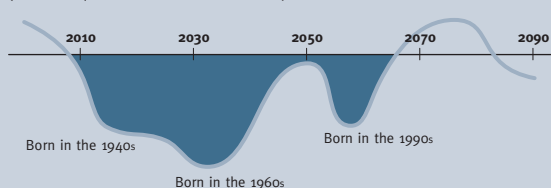
The guarantee pension provides a supplementary pension for those with low or no incomes. This guarantee pension is funded from the national budget.

The role of the buffer funds

Income-based pension contributions are transferred to the system's buffer funds: the First, Second, Third and Fourth AP (National Pension) Funds. Each fund contributes a quarter of the total charges levied and funds a quarter of total pension disbursements. The Sixth AP Fund is also considered to be a buffer fund,

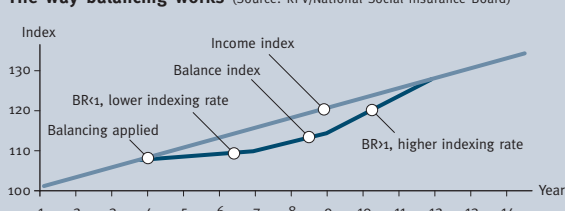
Impact of retirement peaks on pension system

(Source: RFV/National Social Insurance Board)



When baby-boomers retire, they create a demand for a buffer in the pension system. The system's disbursements will exceed contributions after 2010, when the large post-war generation of baby-boomers retire from gainful employment.

The way balancing works (Source: RFV/National Social Insurance Board)



The balance ratio (BR) represents the system's assets divided by combined pension liability. If the balance ratio is less than 1, balancing is applied. This means that pension liability and pensions are adjusted upwards only by wage growth multiplied by the balance ratio. This process continues until parity is reestablished.

but differs from the others, partly the consequence of a different administrative directive. Monthly disbursements from the income-based pension system are therefore made from the buffer funds. In principle, contributions received during a given month are more or less the same as the sums disbursed in the form of payments to pensions for the same period. This means that the income-based pension system generates almost no savings at the national level. For those covered by the system, however, the pension contribution may be seen as a form of saving.

Automatic balancing*

Seen in the broader context of the Swedish national budget, the pension system is highly robust and able to tolerate significant economic and demographic change. It features a number of special inbuilt control mechanisms.

To counteract an actual decline in purchasing power, the total pension liability is adjusted on an ongoing basis, to reflect changes in the income index. Nevertheless, there are a number of exceptions where this basic principle is ignored.

In some cases, certain demographic and economic trends, when combined with a fixed level of contributions for funding income-based pensions, make it impossible to adjust the income-based pension at a pace commensurate with average growth in income, without jeopardising the system's long-term stability. In such a situation, instead of raising the pension contribution from the current 16 percent of total income, it is possible to diverge from the income index, by means of automatic balancing.

Balancing ensures system stability

Dividing the pension system's assets by the total pension liability generates a measure of its financial health. This is illustrated by a ratio known as the balance ratio. If the balance ratio exceeds one (1), the assets outweigh the liabilities. If the balance ratio is less than one, the liabilities outweigh the assets.

Balancing is applied when the balance ratio falls below one. When this automatic balancing process is activated, pension assets and pensions are indexed according to the change in balance index rather than income index. The rate at which pensions are adjusted upwards is modified until the system is in balance again (see chart below).

A mechanism for distributing dividends on surplus generated by the pension system is currently under consideration.

The pension system's balance sheet

In 2003, the national pension system had total assets amounting to approximately SEK 6 042 billion, of which the AP Funds accounted for SEK 577 billion. Pension liabilities amounted to slightly less than SEK 5 984 billion, resulting in a balance ratio of about 1.01. The balance ratio represents total pension system assets divided by total pension liabilities. Pension assets are the sum of contributions to the system, and liabilities are the sum of disbursements due to pensions. In 2003, this generated a surplus of approximately SEK 58 billion (see table below).

* The term "brake" is sometimes used to describe the automatic balancing system. When the "brake" is applied, pensions are revised upwards at a rate lower than income index.

Status of Swedish pension system as per December 31st 2003

ASSETS (SEK bn)		+
Contributions	5 465	
Buffer funds	577	
	6 042	
LIABILITIES (SEK bn)		-
Pension disbursements due	5 984	
Surplus	58	
	6 042	



Target and result

The Second AP Fund exceeded the in-house target for real return on invested assets in 2004. The growth in return on assets is mainly attributable to the portfolio's high degree of equities and low degree of foreign currency exposure.

The Second AP Fund's assets are managed with a view to generating a buffer for future pension disbursements as part of the reformed national pension system. To ensure the greatest possible benefit, the primary focus in managing these assets must be to maximise return on investment, so as to minimise the consequences of automatic balancing within the pension system over the longer term. The Second AP Fund's specific risk is a weak return on the assets under management, especially if the pension system underperforms.

The Fund's activities are long term and are therefore judged over a long period. Rolling five-year periods are considered adequate for measuring performance. The Second AP Fund's operational activities started in 2001.

Good absolute return in 2004

To satisfy the pension system's long-term overall objective, the AP funds must select asset portfolios that fulfil certain criteria in terms of return on investment. If the Second AP Fund and its fellow buffer funds are able to satisfy this long-term target, it is likely that the pension system, at least the national pension system, will function smoothly. In this context, demographic and general economic trends will play a critical role.

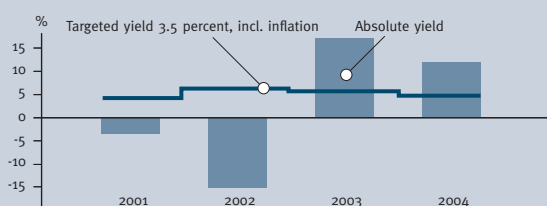
Until year-end 2004, the real target for return on investment was 3.5 percent. The table below presents absolute return in relation to the Fund's real target for return on investment for the years 2001–2004.

The Fund met its targets for long-term return on investment in 2003 and 2004, but not in 2002 and 2001.

The Second AP Fund posted a real return of 11.3 percent for 2004, confirming achievement of the long-term target. The stock market recovery during the latter part of the autumn boosted market rates beyond the top levels noted during the first quarter. This also meant that, on balance, 2004 was a good year, with both fixed-income and equity portfolios generating solid returns.

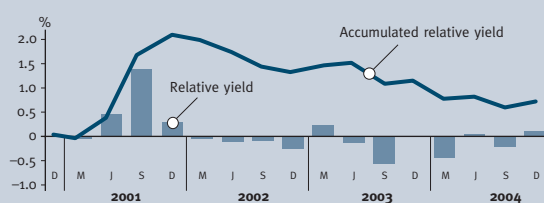
The Fund met its targets for long-term return on investment in 2003 and 2004, but not in 2002 and 2001. This may be attributed primarily to derive to the overall portfolio's high weighting in equities, which had a negative impact on return due to the sharp decline of stock markets in 2001 and 2002.

Four years' statistics on absolute return



The Second AP Fund met the long-term target for absolute return in 2003 and 2004. Targeted return is 3.5 percent, incl. inflation.

Relative return for Fund's listed assets, 2001-2004



The graph shows the Fund's accumulated relative return since its inauguration in 2001. The bars show relative return by period.

Target raised for 2005

As of 2005, the in-house target for real return on investment has been raised to 4.5 percent. The raising of this target is a result of the work carried out in connection with the Fund's ALM study and the risks which it defines (see pages 12–15). The Fund deems this target essential, if it is to satisfy its long-term commitments.

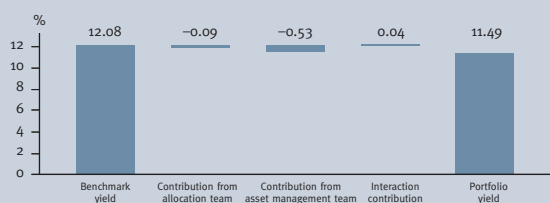
Relative return below target

The Second AP Fund's targeted relative return on investment is 0.5 percent per annum. This means that the Fund must post a return on investment that outperforms the strategic portfolio by 0.5 percentage units. This is a measure of how successful the Fund is in managing its assets to generate value beyond mere exposure to market trends. In 2004, the Second AP Fund posted a relative return on investment of – 0.6 percent. This is largely attributable to the performance of the portfolio of Swedish equities.

Investment regulations for Swedish National Pension Funds

- Investments are permitted in all capital market instruments that are quoted and marketable.
- No more than 5% of a fund's assets may be invested in unlisted securities. Such investments may only be made indirectly, via private equity funds, mutual funds or by similar means.
- At least 30% of a fund's assets shall be invested in interest-bearing securities with low credit and liquidity risk.
- Equities held in listed Swedish companies may not exceed the equivalent of 2% of total market value.
- Each fund may own no more than 10% of the votes in any single listed company. The corresponding limit for unlisted private equity funds is 30%.
- 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% of a fund's assets shall be exposed to foreign currency risk.
- No more than 10% of a fund's assets shall be exposed to one issuer or one group of issuers.
- At least 10% of assets shall be managed by external fund administrators.

Attribution analysis of relative return



The relative return on market-listed assets for 2004, excluding operating expenses, may be attributed to the negative contribution from asset management and tactical asset allocation.



New ALM model forms investment strategy

The Second AP Fund has developed its own model for analysing assets and liabilities within the pension system. The new ALM model demonstrates the high probability of a temporary activation of the automatic balancing in the next few years.

The pension system's primary objective is to ensure the security of future pensions (see also pages 8 and 9). Consequently, this is also the primary objective of the buffer funds. The analytical process on which the choice of long-term investment strategy is based must take into account the relationship between the "unfunded" element of the pension system and the buffer funds. The analysis must address the requirement for returns in buffer funds that the "unfunded" segment of the pension system creates. Uncertainty about the pension system's future development and buffer funds' long-term return on investment must be explicitly modelled. This can be addressed within an "ALM" (Asset Liability Modelling) framework, based on an analytical horizon of 30–35 years.

ALM components offer valuable insights

The Second AP Fund has developed a new ALM model in association with Fraunhofer Chalmers Research Centre for Industrial Mathematics. The model comprises three interlinked components:

- *Scenario simulation:* This component is used to simulate the different patterns of development in the various asset classes of the Fund's portfolio, Swedish inflation, the capacity utilisation rate and wages. To define it in its simplest terms, the model features a component that describes the anticipated or average trends for these variables, and another that describes deviations from the average.
- *Calculation of pension system's balance and income statement:* This component calculates the key ratios that are decisive to the pension system's development and status. Different demographic scenarios can be used, but these are strict projections, with no departure from mean average.

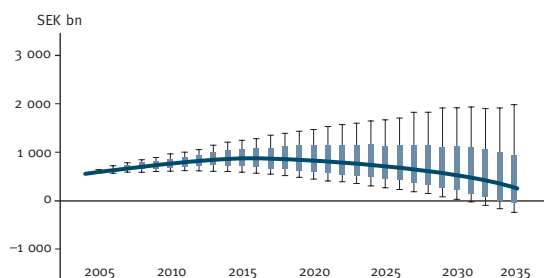
- *Optimisation:* This component is designed to identify the portfolio that best fulfils the overall objective – to minimise possible negative impact on future pensions. This optimisation process is based on the scenarios developed in the other components of the ALM model.

The model describes the annual development of the Swedish pension system's primary elements:

- *Contributions due:* Future contributions to the pension system.
- *Pension liability:* Future pension commitments to individuals covered by the pension system.
- *Buffer fund:* Where it is assumed that the Second AP Fund's investment strategy comprises the combined value of the assets of the First to Sixth AP funds.

Possible outcome for buffer fund assets, 2005–2035

(Source: RFV/National Social Insurance Board)



The graph indicates the outcome of possible scenarios concerning the size of buffer fund assets. The bars represent 50% of the possible outcome.

Key ratios addressed by the model

The central key ratios calculated with the help of the model are the balance ratio (the quotient from dividing assets by pension liability) and net flow (inflow of contributions less disbursements) to the buffer funds. The balance ratio is the most important key ratio, since it affects the upward adjustment of the individual's pension assets. If the balance ratio is less than one (i.e. less than pension liability), automatic balancing is applied, and pension assets are written up at a slower rate than would otherwise be the case (see pages 8–9).

Model will help achieve long-term objective

The balance ratio is the rudder of the reformed pension system and forms the core of the Second AP Fund's ALM model. The operational objective of the ALM model is to facilitate the selection of a long-term investment strategy to minimise the negative impact of automatic balancing – where such balancing cannot be avoided. Differences in future pension disbursements, between scenarios where balancing is never applied and scenarios where it is periodically applied, should therefore be as small as possible. A higher return on the AP funds' invested assets reduces the risk of having to rebalance, thereby normally limiting negative impact on future pensions. At the same time, a portfolio of high-risk assets may in extreme cases increase the risk of a negative impact on capital assets, with a consequently negative effect on future pensions. The optimal allocation of assets in the funds' portfolios is also determined by the degree to which such assets correlates with other parts of the pension system. The negative effects on future pensions become particularly obvious where demographic factors are unfavourable and when seen over the longer term. For this reason, the ALM model is based on what, from the pension system's perspective, constitutes a negative demographic scenario.

Many assumptions are made independently

Financial market trends are analysed independently, to form the hypothetical basis for the ALM

model. This applies to anticipated long-term return on investment as to short-term variations.

Other factors analysed include key macroeconomic factors such as wages/salaries, inflation and capacity utilisation outside the model's strict framework. Demographic assumptions are also made exogenously from the model's framework.

Uncertainties and risks associated with short-term variations affecting fundamental assumptions are handled within the model's parameters. An extremely large number of random simulations is used to describe the possible behaviour of the macroeconomic and financial factors embraced by the model. These in their turn result in a large number of potential scenarios describing the balance ratio and effect on future pensions. The distribution of the results of these scenarios provides a useful measure of the interaction between the risks posed by the buffer funds' various portfolio combinations and the inherent risks of the pension system.

Addresses the issue of uncertain investments

The ALM model focuses explicitly on uncertainties in the assumptions made outside the model's parameters. Both the assumptions and the uncertainties surrounding them have an impact on the analysis, and contribute to the investment strategy that best serves to minimise the effects of automatic balancing on future pensions. The results featured in the ALM model are therefore expressed in terms of the probability of automatic balancing at various points in time, and of the probable consequences for future pensions. The model assumes that the Fund's portfolio of investments will generate a relatively low future return. Current interest rates are very low, which will be reflected in a low return on bonds over the long run. The risk premiums predicted for equities markets are also relatively low, especially when compared with the return on investment generated historically by equities. This reflects the current relatively high valuation of equities markets. Taking these various factors into account, the Fund's portfolio is expected to generate a nominal long-term average

return on investment of 6.5 percent per annum.

Relatively high risk that balancing may have to be applied

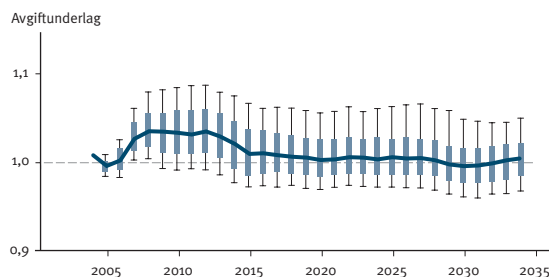
The Second AP Fund's ALM model indicates a relatively high risk that an automatic balancing of the pension system will be activated in the next few years. This is primarily attributable to a temporary weakening of the demographic profile. This will be followed by a period of stabilisation prior to a more general decline during the second half of 2010, if the demographic trend forecast in the "pessimistic" scenario published by Sweden's Central Bureau of Statistics (SCB) is confirmed. The risk that the current surplus in the pension system will be reversed on a longer term basis and be transformed into a deficit within the next five years seems unlikely. Even so, the possibility that this could happen is still assessed to be about ten percent. The ALM model results suggest that the likelihood of the need for extended rebalancing could have grown to 25 percent before 2015.

Risk of severe strain in ten years

Generally speaking, it can therefore be said that the pension system risks finding itself under intense strain within the next ten years. This conclusion derives from the pessimistic demographic scenario and the anticipated weak return on investment on which the analysis is based. Under these conditions, current inflows to the AP funds are expected to become outflows within five years.

Possible outcome for balance ratio, 2005-2035

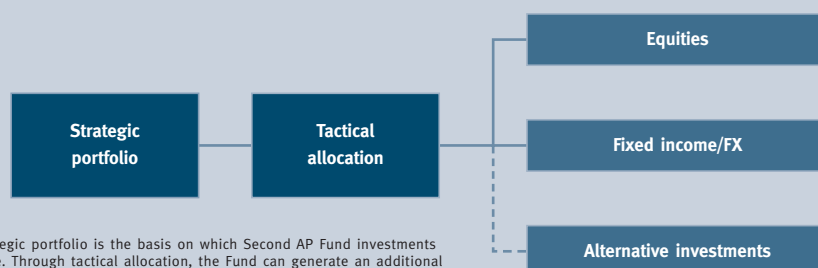
(Source: RFV/National Social Insurance Board)



The graph indicates the outcome of possible scenarios concerning the balance ratio. The bars represent 50% of the possible outcomes and indicate a high probability that automatic balancing will be temporarily applied over the next few years.

To achieve any degree of certainty about avoiding the need for automatic balancing, the buffer funds would have to generate an annual return of some 15 percent on their portfolio assets. In the Second AP Fund's view, this is totally unrealistic, also demonstrating that the ability of AP funds to compensate for negative aspects of the pension system are generally quite limited. In the light of the expectations of a lower return on investment on which the Second AP Fund's analysis is based, the buffer funds would consequently need to be about twice as large to provide any solid assurance of avoiding a negative impact in future pensions.

First and foremost, it is the actual value of the pension received that is most important to individual pensioners. Based on an average scenario, the Second AP Fund's ALM model indicates in broad terms that pensions will not be at risk before 2018.



The strategic portfolio is the basis on which Second AP Fund investments are made. Through tactical allocation, the Fund can generate an additional return on investment by translating a market perspective into decisions re. under or overweighting in foreign exchange or liquid asset classes.

Conclusions determining investment strategy

The main conclusion drawn from the ALM model is that a high allocation of equities is the best way to minimise negative effects on future pensions.

About 60 percent of the Second AP Fund's portfolio assets are in the form of equities. The results of the analysis also show that the long-term return on buffer-fund assets need to be higher than what may be expected from the current portfolio. It is therefore justifiable to increase the proportion of assets that, because of higher risk, have the potential to generate higher returns. There is also a need for a long-term active return on investment, to complement passive return on investment.

Investment horizon and demography of crucial importance

The length of investment horizon is of crucial importance to the investment strategy selected. With a short horizon, such as ten years, the optimal portfolio will feature a higher proportion of bonds. With a twenty-year horizon, the portfolio should be evenly allocated between equities and bonds. With a thirty-year horizon, the proportion of equities should be increased to current levels, since only such an extended horizon can cover the period during which the pension system is under greatest strain.

The demographic scenario selected also affects the result of the ALM analysis. Determined to do the greatest possible good in a future threatened by the negative development of the pension sys-

tem, the Second AP Fund has chosen the "pessimistic" demographic scenario as the basis for its ALM analyses.

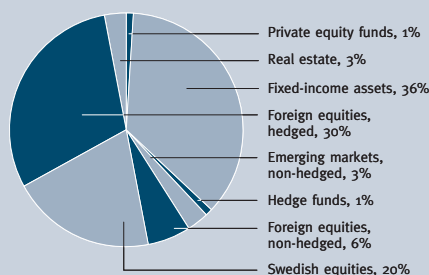
Changes in the strategic portfolio

The changes planned for the Second AP Fund's strategic portfolio at the start of 2005 will be limited, and related strictly to the strategic currency exposure of the Fund's foreign equities. Since 2001, the Second AP Fund has maintained a relatively low level of exposure in foreign currency in its strategic portfolio. In 2004, the Fund's exposure in foreign currency amounted to eight percent of total assets. In the new strategic portfolio for 2005, exposure has been increased from eight to nine percent.

A more significant change in the strategic portfolio has been made concerning the regional distribution of exposure in foreign currency. Earlier, exposure in foreign currency was distributed equally, regardless of region or currency. Now, the greater part of this exposure is linked to the euro and pound sterling, accounting for 35 percent of total exposure. At the same time, the Fund's exposure in US dollars, Japanese yen and other Asian currencies has been reduced to a combined total of five percent.

Currency exposure is a strategic factor, and is determined by the degree of risk that exposure in a foreign currency poses to the portfolio, and by the correlation between different currencies and the return on investment in underlying equities markets.

The strategic portfolio 2005



Tactical asset allocation: absence of clear market trends

During 2004, equities markets were driven by “mini-cycles”, with no clear market trend emerging. These swings and roundabouts were reflected in the relative returns on equities and bonds. The tactical positions taken by the Second AP Fund during the year were relatively limited, tending to an overweighting in equities.

Tactical allocation 2004

	%
Contribution to relative return on investment	-0.09
Percentage under in-house management	100

General economic trend

The year 2004 saw a continuation in the recovery of the global economy. Generally speaking, the global economy grew more rapidly than anticipated at the beginning of the year, producing the highest rate of growth in the past 20 years. In the US, the rate of growth was estimated at 4.4 percent. In the EMU zone, however, the rate was lower, at 1.8 percent. The difference indicates that the USA remains the driving force behind the international upswing and that the EMU has yet to benefit fully from the global recovery. The 3.9 percent growth noted by Japan, however, was the most surprising, mainly due to the reduced risk of continuing deflation. Forecasts for the Swedish economy were below the 2.5 percent noted at the start of the year, although these were expected to be exceeded towards the end of the year by almost a whole percentage unit.

Quarterly reports were a pleasant surprise

The financial markets were notable for the absence of clear trends in terms of equities and interest rates, presenting a relatively low volatility environment.

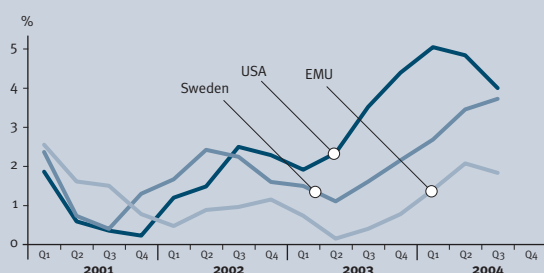
The favourable trend established on the Swedish equities market during 2003 was maintained during the first quarter of the new year. The global equity markets developed much more slowly, however, while key markets, such as the US stock market, noted a decline.

Positive surprises in the quarterly reports of some companies gave substance to the peaks attained by equities markets in April. Interest rates also rose during this period, a consequence of sustained strong growth, inflationary tendencies and expectations of imminent action by central banks to raise base rates.

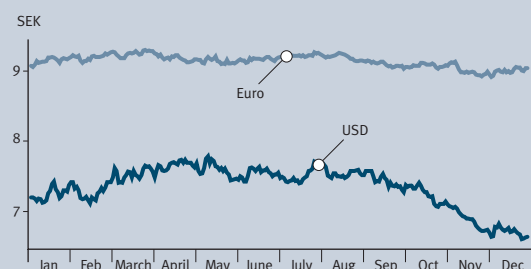
Fuelled by rising oil prices

During the late spring and summer, the financial markets were driven increasingly by rising oil prices, while equities markets declined. Market rates rose initially, only to fall back later. This decline was mainly due to the fact that rising oil prices were seen more as a threat to the global economy than as posing a risk in terms of accelerating inflation.

Growth in GDP 2000-2004 (Source: EcoWin)



Swedish krona against euro and US dollar, 2004 (Source: EcoWin)



Three other factors contributed to the declining interest rates noted during the summer. The first was a distinct slowdown in the American economy. The second was a downward revision of earlier expectations of a possible rise in central bank rates during the remaining months of 2004 and in 2005. The third contributory factor was the fact that several Asian central banks, in particular the People's Bank of China, continued to buy US government securities to counteract the upward pressure on foreign exchange rates.

Growing optimism during the autumn

Following the US presidential election, interest in the equities market recovered. Falling oil prices and an increasingly bullish US economy added to the buoyant mood. This optimism was further fuelled by positive signals from the Chinese economy and by the fact that many corporations continued to favourably surprise the market, posting sharply increased profits for the third quarter.

During the autumn, the US dollar fell sharply again, noting its lowest level in eight years.

Modest rise in inflation

Earlier anxiety over possible deflation scenarios was replaced by growing concern over the risks of possible inflation. In the event, there was only a modest rise in inflation, in part the result of in-

creased capacity, cautious wage increases and a credible monetary policy.

With the coming of spring, however, a new cause for concern arose, as the US economy's underlying inflation started to accelerate unexpectedly fast. This led to growing expectations that a more aggressive global monetary policy would be adopted in the near future.

Change in monetary policy

The central banks interpreted last year's rising energy costs as a temporary consequence of inflation and made it clear that monetary policy should be based on a more long-term planning horizon. In spite of this, monetary policy was revised during the year, and interest rates were raised on a number of key markets.

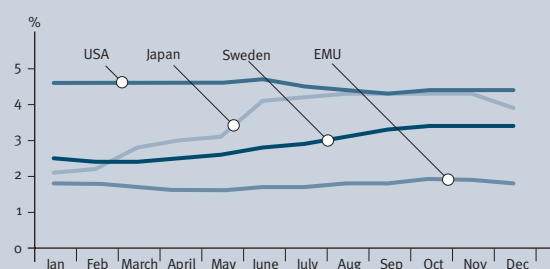
Great Britain was first to raise interest rates, in part a response to rising property prices.

In the USA, the Federal Reserve decided to increase interest rates during the summer, which signalled the start of a period of higher interest rates that continued to the end of the year. The increase, implemented at a time when the rate was historically low, was the first since the mid-2000.

The Riksbank, Sweden's central bank, cut the interest rate in two stages during the first six months of the year, but left it unchanged during the autumn, in the light of the economic incentives contained in the Government's budget and the relatively positive prospects of growth.

The European Central Bank (ECB) main-

Forecast changes in GDP, 2004 (Source: Consensus Economics)



Oil price, 2004 (Source: EcoWin)



tained its low two-percent base rate throughout the year. There was some inflation, certainly, but the inherent strength of the economy was inhibited by rising energy costs and a strong euro.

Currency markets less affected by “trends”

The currency markets were less subject to “trends” during 2004. The key factor driving change was the decline in the US dollar rate. The steady weakening of the dollar during the period 2001–2003 slowed and was replaced by a gain in value during the first quarter of 2004. Until the end of the summer, the currency markets showed relatively little volatility. During the autumn, the dollar once again fell sharply, reaching its lowest level in eight years. Taken as a whole, the Swedish krona firmed against the basket of currencies representing the Second AP Fund’s global exposure in foreign equities in 2004.

Positions taken in tactical asset allocation

The often brief rise and fall in the market value of broad asset classes during the year required rapid repositioning with respect to tactical asset allocation. In this sense, timing was critical. The tactical positions taken during the year, which were consistently small, ranged from a neutral weighting to a two-percent overweighting in equities.

In its foreign exchange dealings, the Fund reported a tactical overweighting of one percentage unit in Swedish kronor at the start of the year. This was neutralised in mid-April. Throughout the rest of the year, the Fund’s tactical asset allocation featured no foreign exchange position. The overweighting in Swedish kronor during the first quarter had a negative impact on tactical asset allocation, which totalled eight base points. Including rebalancing, this resulted in an impact on relative return of nine base points.

External asset management mandates and rebalancing

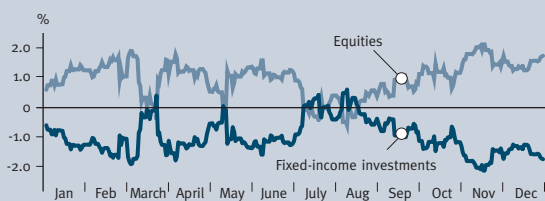
During 2004, the Fund awarded mandates for GTAA (Global Tactical Asset Allocation) to five external managers. At the start of 2005, two of these mandates were activated: Goldman Sachs Asset Management and First Quadrant LP. The Second AP Fund has also devoted increased attention to rebalancing of the strategic portfolio, in situations where market development results in a drift into active positions in the portfolio. Previously, active tactical asset allocation and rebalancing have constituted parts of the same process. These activities have now been separated, to form two distinct mandates.

Return on equities relative to fixed-income instruments



The diagram shows the Second AP Fund’s benchmark index for equities relative to benchmark for fixed-income investments. When the graph points upwards, equities generate a higher return than fixed-income instruments, and vice versa.

Deviations in asset classes



The Second AP Fund’s benchmark index comprises 59 percent equities and 41 percent fixed-income and alternative investments. The graph shows how actual asset weightings differ from the benchmark weightings specified in the strategic portfolio.



The Second AP Fund's equity management: increased in-house management

Global equity markets developed favourably during the year, despite anxiety stemming from factors such as high oil prices. The Fund increased the share of total equities under in-house management during 2004 and terminated a large number of external mandates. The Fund's equity management activities made a major contribution to the growth of its capital assets in 2004.

Equity management 2004		
	Swedish equities	Foreign equities
Share of equities in total portfolio, %	20.7	40.4
Absolute return, %	19.0	11.5
Relative return, %	-1.2	-0.3
Share under in-house management, %	73	23
Share under active management, %	94	80

In line with the spread of asset classes determined by the Fund's long-term investment strategy, equities account for 59 percent of invested capital. During the year, the Fund has periodically maintained a tactical overweighting in equities.

The market value of the Fund's portfolio of foreign equities amounted to SEK 63.8 billion at year-end 2004, of which SEK 47.8 billion was hedged and SEK 16.0 billion non-hedged. Return on investment was 11.5 percent. The Fund's benchmark index for the same period noted a return of 11.8 percent. The difference was largely attributable to the type of securities selected, in which the Ericsson share played a key role.

The return on the portfolio of Swedish equities for 2004 was 19.0 percent, compared to the 20.2 percent noted by the Fund's benchmark index for the same period. The difference was primarily attributable to the choice of securities. By year-end, the estimated market value of the

portfolio was SEK 32.8 billion.

Given the low volatility of the market and its clear impact on the performance of different equities, many asset managers did not utilise their risk mandate, although the number of actively managed positions remained at the same level. The erratic movement of the market during the year made it difficult for asset managers to identify clear trends and thereby locate promising investments.

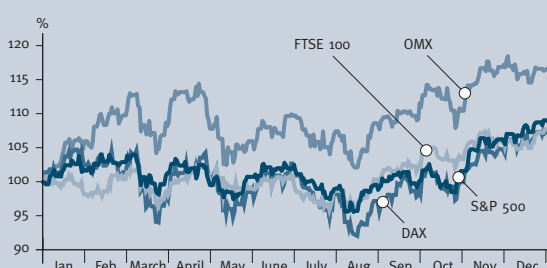
Stock markets reflected short-term trends

In 2004, short-term trends dominated global stock markets. The strong upward trend noted during the latter half of 2003 was sustained during the first quarter of the year.

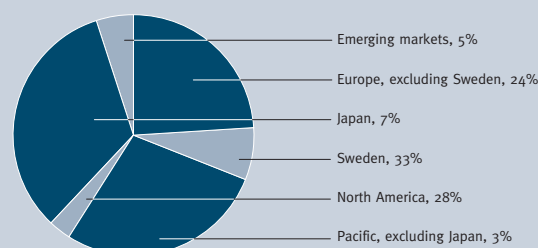
In the late spring and summer, equities markets movements were driven increasingly by rising oil prices. In May, the equities markets suffered sharp new declines. A brief recovery during the latter part of the summer was followed by an extended period of major declines on global stock markets. These declines were largely attributable to the continuing rise in oil prices. Uncertainty over the outcome of the US presidential election further reduced the market's appetite for risk, and its willingness to invest in equities markets during the late summer and early autumn.

After the presidential election, and slightly encouraged by falling oil prices, interest in the equities market recovered during the autumn.

Market movement (Source: Reuters)



Exposure of equities-linked securities by region, excluding liquidity



Companies continued to regale the market with positive reports of sharply improved earnings for the third quarter as well. The recovery staged by the stock market during the latter part of the autumn drove share prices beyond the top levels noted during the first quarter on all key equities markets.

Pharmaceuticals hit by tougher regulation

The upswing noted by stock markets in the USA (Dow Jones), Great Britain (FTSE100) and Japan (Nikkei 225), translated into Swedish kronor, corresponded to -4.7 percent, 6.5 percent and 3.9 percent respectively. Calculated in local currency, and compared with the start of the year, this represented gains of 3.1 percent, 7.5 percent and 7.6 percent respectively. The upswing on Nasdaq, America's technology dominated exchange, represented a 0.3 percent gain in Swedish kronor (8.6 percent in local currency). MSCI's Global Growth Index performed very strongly: 16.0 percent (16.1 percent in local currencies).

Among market sectors, pharmaceuticals have been negatively affected by the stricter regulation introduced by US licensing authorities, which has caused the withdrawal of certain drugs from the market. In the power-generation sector, the main driving force has been the rise in oil prices. The climate for IPOs (Initial Public Offerings) improved on several markets during the year. Google's introduction on the Nasdaq was very well received.

Strong financial reports from Swedish stock market

2004 proved to be a good year for the Swedish equities market. Even though Ericsson was alone responsible for much of the overall rise in index, the steady inflow of bullish reports from the major Swedish engineering companies and banks had a positive impact on the market as a whole. Given

the strong cash flows and already strong balance sheets, the market anticipates increased dividends.

The Swedish stock market's SBX index rose by 20.8 percent over the full twelve months, with the IT and finance sectors performing best.

The market for IPOs stayed sluggish, a consequence of sellers' expectations of high prices.

Equity management: focus and organisation

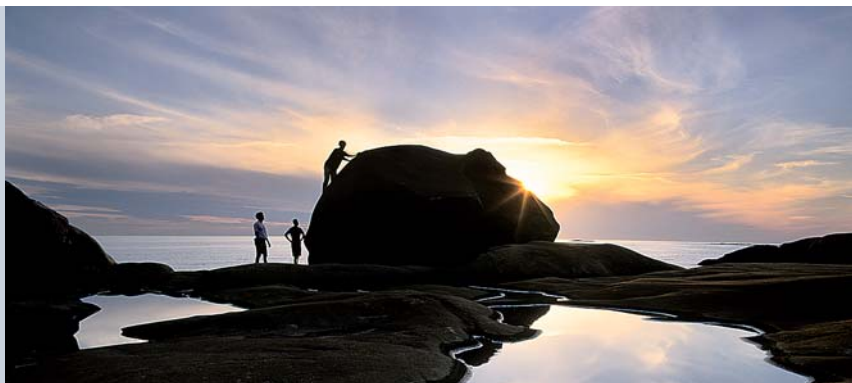
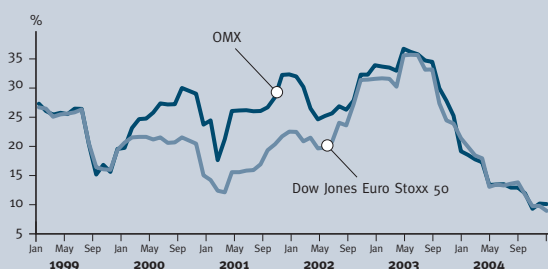
The Second AP Fund's equity management activities are global by nature. Equity management is handled both in-house and in association with a number of external partners, based on clearly defined mandates. Portfolio managers operating under external mandates invest in a specific area, defined by geographic market, sector or other criteria.

The style of management is determined by the level of risk permitted for the individual portfolio. Assets handled under a passive mandate are managed to replicate the index. With an active mandate, the portfolio manager aims to outperform the selected index. An "enhanced index" mandate involves managing a portfolio with a low level of risk and a targeted return of between 0.5 and one percent-age unit over benchmark index.

Greater share of assets now managed in-house

The combination of in-house and external portfolio management, initiated four years ago, has developed further. As a result of this transformation, no more than 59 percent of the equities portfolio was under external management by year-end 2004, compared to 72 percent at the end of 2003. A more clearly defined asset management strategy was implemented during the year. Consequently, the Fund is now more distinct in assigning mandates with respect to the relative levels of risk incurred. As a consequence of this refined investment strategy, four external

Market volatility (Source Goldman Sachs)



Swedish mandates have been terminated. The fact that the management of these assets failed to generate the targeted return contributed to this decision. Twelve mandates awarded to European fund managers have also been terminated in line with the strategy.

In-house “enhanced index” portfolios scheduled for 2005

In-house resources for the management of Swedish and European portfolio assets have now been focused on what is both a fundamental and new quantitatively focused type of asset management, where the aim is to launch “enhanced index” portfolios under in-house management during 2005.

Risk will be reallocated from first and foremost the Swedish market to broad global mandates. The general opinion is that an excess return on investment is more likely when portfolio managers are given opportunities for making many independent investment decisions.

Three models for management of Swedish equities

Many Swedish portfolio managers have once again encountered difficulties associated with the problem of generating excess returns on a market dominated by a limited number of big stocks. Managers whose portfolio's lacked significant exposure to Ericsson stock during the year often found themselves out of step with their targeted return on investment.

The Second AP Fund employs three investment approaches in its activities on the Swedish equities market:

- Fundamental management, focused on outperforming the broad SBX index.
- Enhanced management, focused on revealing incorrect market pricing, based on an in-house developed quantitative model. The model has been tested against index during the year: the aim is to activate quantitative models, developed in-house, during 2005. A Swedish enhanced-index portfolio of this type is also under external management (Svenska Handelsbanken/SHB).
- The third approach involves management of a

strategic portfolio of long-term holdings, where the Second AP Fund is able to exercise its corporate governance rights, e.g. participating in nomination committees etc. Major holdings include shares in Volvo, Handelsbanken, SCA, Skandia and Electrolux.

At year-end 2004, nine percent of the Fund's portfolio of Swedish equities consisted of small cap funds, managed by external funds.

Fund management of foreign equities

The management of European equities has also been restructured. These assets are still managed by sector, but are largely handled in-house.

Management of these assets is combined with an index featuring a low risk profile and quantitative management (Barclays) and other actively managed higher risk mandates. Internal “enhanced index” management is expected to be started during 2005. Another initiative taken during the year involved investment in the SAM (Sustainable Asset Management) fund. SAM has developed an evaluation model that assesses environmental and ethical risks. The mandate's directive outlines an investment focus in which the initial selection of equities is based on a number of sustainable criteria. SAM only invests in companies that satisfy these criteria.

In the USA, the Second AP Fund invests by mandate in low risk assets, managed either to reflect index, or to exceed index, based on quantitative analysis. In Asia and Japan, assets are actively managed under four mandates, formulated to generate a return in excess of index. Fund investments in emerging markets are made via six externally managed funds.

Negotiations with global fund managers

In awarding its global mandates, the Second AP Fund selects fund managers that practise index, enhanced index and active asset management. Following the decision to allocate a greater share of the risk-weighted portfolio for management under broader mandates, the Fund initiated negotiations with global managers at the close of 2004.

Regional equities mandates

	Management style	ROI, %	Negative/excess return compared to index, %
Europe			
› In-house management	Active	10.8	– 0.8
› Barclays Global Investors ¹	Passive	7.2	– 0.8
› Barclays Global Investors ²	Enhanced	6.2	1.6
› Goldman Sachs Asset Management ¹	Active		
Consumer Discretionary		– 2.4	– 6.1
Consumer Staples		2.7	1.2
IT		– 2.6	1.7
Telecom		8.8	4.2
› Citigroup Asset Management ¹	Active		
Consumer Discretionary		0.9	– 2.9
Consumer Staples		– 0.1	– 1.6
Financials		5.4	1.2
Healthcare		0.4	– 2.4
IT		– 5.1	– 0.9
Telecom		5.5	1
› Crédit Agricole ¹			
Asset Management	Active		
Financials		– 1.0	– 5.1
› Deutsche Asset Management	Active		
Healthcare		7.3	3.2
› BankInvest Asset Management	Active		
Healthcare		– 2.4	– 6.5
› SAM Sustainable Asset Management Fund ²	Active	3.0	– 2.9
› Skandia Småbolagsfond	Active	17.7	6.0
North America			
› Barclays Global Investors	Passive	2.6	0.4
› Barclays Global Investors	Enhanced	2.9	0.6
Japan			
› Martin Currie Investment Management Limited	Active	6.6	– 0.4
› BankInvest Asset Management	Active	4.9	– 2.1
Asia/Pacific (excluding Japan)			
› Singer & Friedlander Investment Management Limited	Active	13.3	– 5.3
› BankInvest Asset Management	Active	8.8	– 9.8
Emerging Markets			
› DB Globalspectrum ¹	Active	12.4	– 0.4
› F&C Global Emerging Markets	Active	11.5	– 4.5
› Genesis Emerging Markets	Active	20.3	4.3
› Pictet Emerging Markets	Active	14.2	– 1.7
› State Street Emerging Markets	Active	13.9	– 2.1
› Citigroup Emerging Markets	Active	13.6	– 2.4
› AIG Global Emerging Markets ²	Active	– 1.1	– 1.3

Global equities mandates

	Management style	ROI, %	Negative/excess return compared to index, %
MFS Institutional Advisors	Active	10.9	5
Merrill Lynch Investment Managers	Enhanced	6.5	0.6
State Street Global Advisors	Passive	6	0

Swedish OSX mandates

	Management style	ROI, %	Negative/excess return compared to index, %
In-house management, strategic portfolio	Active	22.4	2.2
Carnegie Kapitalförvaltning ¹	Active	13.6	– 3.3
Carlson Investment Management ¹	Active	5.6	– 6.5
SEB Asset Management ¹	Active	5.5	– 2.9
E. Öhman J:or Kapitalförvaltning	Active	9.7	– 8.2
Fund portfolio:			
› Enter Sverige Fokus	Active	8.3	1.0

Swedish SBX mandates

	Management style	ROI, %	Negative/excess return compared to index, %
In-house management:			
› Portfolio 1	Active	20.2	– 0.6
› Portfolio 2 ²	Enhanced	4.3	0.0
SEB Asset Management	Active	19.9	– 0.9
Carlson Investment Management ¹	Active	13.8	– 3.4
Swedish Handelsbanken AB	Enhanced	20.9	0.1

Swedish small-cap funds

	Management style	ROI, %	Negative/excess return compared to index, %
SEB Sverige small-cap fund	Active	28.8	9.1
SEB Sverige Opportunity/Risk small-cap fund	Active	34.6	14.9
Carlson Sverige small-cap fund	Active	15.8	– 3.9
Lannebo small-cap fund	Active	20.5	0.8
Handelsbanken small-cap fund	Active	18.4	– 1.3
Robur small-cap fund	Active	23.8	4.1

1) Terminated in 2004

2) Initiated in 2004

Governance issues 2004: Second AP Fund corporate governance policy aims at creating value

During the year, the Second AP Fund has embarked on ensuring a more distinct integration of governance issues in its day-to-day activities. New working routines have been introduced and a new corporate governance policy has been adopted.

The Second AP Fund's commitment to governance issues is focused on value creation.

Active ownership and strengthening of the Fund's involvement in governance issues is designed to improve the prospects of a higher return on invested assets. By adopting an active role in terms of governance, the Fund can inspire boards of directors and executive managements to improve the way a company is run, thereby enhancing the value of its investment.

Good governance creates value

Most investors subscribe to the idea that well run companies also tend to be a good investment. This conviction is supported by a number of academic studies in the field. Gompers, Ishii and Metrick (2001) used 24 separate corporate governance criteria in studying 1 500 American companies between 1990 and 1999. They concluded that American companies with a high standard of corporate governance produced a return that was significantly higher (8.5 percent per annum) than that generated by companies that were poorly rated in terms of corporate governance criteria. Similar studies conducted in Europe by Bauer, Guenster and Otten (2003) reveal the same pattern. After adjustment for sector variations, they were able to confirm that companies that achieved high ratings based on governance criteria achieved a three-percent per annum excess return on investment.

The Second AP Fund adopts the attitude that every company is unique. What works for a capital-intensive power generating utility is seldom the right answer for a research-intensive biotech company. For this reason, it is essential to seek the optimal solution for each individual company, through a combination of analysis and dialogue.

AGMs and nomination committees

During 2004, the Second AP Fund participated in 50 Annual General Meetings (AGMs) and seven extraordinary general meetings. The Fund also exercised its voting rights by proxy (Internet-based) at the AGMs of companies representing its 50 largest foreign holdings.

The Second AP Fund has been represented in the nomination process for the boards of Artimplant, Castellum, Feelgood, Observer, Pergo, Sardus, Skandia, Song Networks, Wedins and WM-data. In the run-up to

the 2005 AGM season, the Second AP Fund has been represented on the election committees of Artimplant, Capio, Castellum, Electrolux, Feelgood, Handelsbanken, Karo Bio, Pergo, ProAct, Sardus, Skandia, Vitrolife, Volvo, Wedins and WM-data.

The Fund has also been actively engaged in preparatory work prior to many of these AGMs. This has involved analysing the various proposals that boards have planned for submission to their respective AGMs, discussing them with other institutional investors and representatives of the companies' boards. The issues most often raised during the year have centred on incentive systems and the board nomination process.

The remuneration issue

In a number of cases, attention focused on remuneration policies that lacked a direct correlation to performance, or that were inadequately performance-linked. At Atlas Copco, the board of directors withdrew its incentive programme proposal, while SEB changed its proposed options programme under pressure from institutional investors. In the case of SEB's incentive programme, the Second AP Fund abstained from voting.

On the occasion of Intenia's extraordinary general meeting in September, the Second AP Fund voted against the board's proposal for a preferential issue of shares. The reason was that the proposal failed to comply with the principles expressed in the Second AP Fund's corporate governance policy.

Female representation index

The Second AP Fund's index for charting female representation on the boards and executives of exchange-listed companies was presented for the third year in succession. Although there has been a significant increase in the number of women represented on the boards of quoted companies in recent years, the number of women represented in executive managements has remained more or less the same. Since 2002, female representation on the boards of quoted companies has more than doubled, from 6.1 to 14.9 percent. During the same period, the increase in the number of women on executive managements has been only marginal, rising from 11.1 to 12.3 percent.

Female representation on boards and executive managements



Positive to new code

During the autumn of 2004, the Code Group presented a "Swedish code for corporate governance". The Second AP Fund participated in the development process, as a referral body.

The Second AP Fund is positive to the introduction of a corporate governance code for Sweden. It provides a code of practice for self-regulation within the Swedish system, as well as offering useful guidelines for the involved companies. The Second AP Fund sees considerable value in a consolidated code of practice that addresses corporate governance issues. Many of the issues now addressed in the Code are covered by the Second AP Fund's previous corporate governance policy.

New governance policy adopted

In conjunction with the introduction of the Code, the Second AP Fund has adopted a new corporate governance policy that also includes a new way for the Fund to analyse governance issues.

The Second AP Fund approaches governance issues in a huge variety of ways. This approach is founded on a corporate governance analysis that is conducted in-house by the Second AP Fund. Some ten or more key governance issues are considered in depth, leading to a decision on how the Fund should act as a major investor. The analysis embraces structural issues (corporate structure, capital structure and ownership structure), management (board of directors, nomination, executive management and remuneration), transparency (information, provision of information, reports), investments (corporate acquisitions, sales and investments), corporate culture and ethics, environment and equal opportunities.



The corporate governance policy, which is published in an updated version on the Second AP Fund's website, defines its key principles with respect to these issues.

Ongoing dialogue with portfolio companies

In companies where it sees a need for change, the Fund strives for contact with the company at an early stage. This may involve cooperation with other investors. The Second AP Fund is convinced of the considerable value in maintaining an ongoing dialogue with its portfolio companies.

The Second AP Fund strives for participation in the election committees of companies in which it is one of the largest investors. When not itself represented on the election committee, the Fund submits its viewpoints to the chairman of the individual committee.

Environmental and ethical issues are integrated in the policy

Environmental and ethical issues form an integral part of the Second AP Fund's corporate governance policy. During the year, no companies have been excluded as targets for investment, although this might become appropriate where a company transgresses the law or international conventions.

However, questions have been submitted to some half a dozen companies. These have focused mainly on environmental impact and employee rights in developing countries, as well as to how companies have responded to injunctions from the authorities.

The Second AP Fund was an official sponsor for the Gothenburg International Environmental Award 2004. The Award was presented to Joan Bavaria and Tessa Tennant, who have started sustainability funds in the USA and Great Britain.

Pursuing its commitment to positive selection based on sustainability criteria, the Second AP Fund invested in a fund managed by Swiss fund manager SAM (Sustainable Asset Management). This fund's investment strategy is based on an evaluation model that judges a company's actions in terms of its performance with respect to a number of key sustainability issues.



Management of Second AP Fund's fixed-income portfolio and FX: 2004 notable for cautious rate increases and weak US dollar

During the year, global fixed-income markets reflected expectations of reduced inflation and cautious increases in US interest rates. On the currency market, the US dollar continued to weaken, due in part to the dual deficit burdening the US economy.

Management of fixed income portfolio 2004

	%
Share of total portfolio	34.5
Absolute return	7.3
Relative return	-0.3
Share under in-house management	92
Share under active management	94

2004 was an eventful year on global fixed income markets, in which inflation and macroeconomic indicators were not the only factors to have a major impact on market rates. Anxiety over the geopolitical situation and the impact of terrorist atrocities still played a major role, directly and indirectly, by affecting the price of commodities, such as crude oil. The dual US deficits (trade and balance of payments deficits) and their underpinning by Asia's central banks had an impact on supply and demand. Bond markets also reflected discussions and speculation of a possible change in China's exchange rate strategy.

Central banks hint at gradual increase

At the start of the year, there were expectations that the world's central banks would once again tighten monetary policy and normalise key interest rates by raising them. These expectations were partially realised, even if several central bank rates remained at the same low level at the end of 2004.

Some key interest rates were actually lower than they had been at the start of the year. This was true of Sweden, for example. The American Federal Reserve raised its key interest rate to 2.25 percent during the year, somewhat lower than most market analysts had anticipated at the start of the year. The central banks are generally agreed that inflationary pressures on their economies remains low and that key interest rates need be raised only gradually.

During 2004, the Swedish Central Bank (Riksbanken) continued to reduce the repo rate, which is now down at the same level as quoted by the European Central Bank (ECB). At the same time, the Riksbank warns of rate rises ahead.

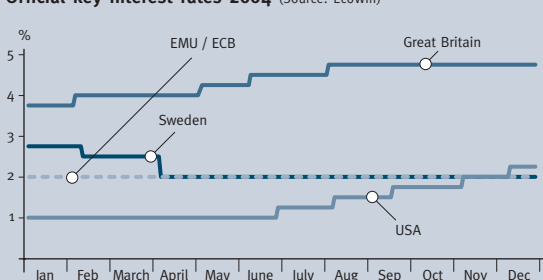
The Bank of England expressed worries about these low interest rates during the year – noting that an over-expansive monetary policy can lead to specific imbalances, in areas such as real estate. This is thought to be one of the reasons that the Bank of England was the central bank that introduced the most aggressive rate increases in 2004.

Bond markets affected by the USA

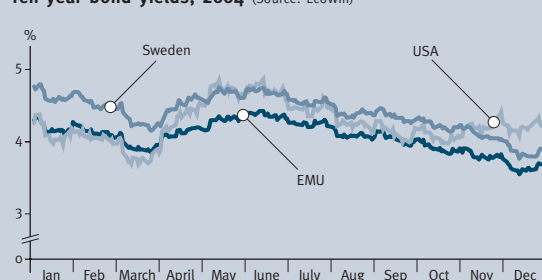
Players on bond markets have spent a lot of time speculating about the true strength of growth in the US economy. Market yields have been relatively stable over long periods, only to react sharply when macroeconomic indicators have deviated from market expectations.

American unemployment figures provide one example of this. In the first few months of the

Official key interest rates 2004 (Source: EcoWin)



Ten-year bond yields, 2004 (Source: EcoWin)



year, most market players expected stronger labour market growth than proved to be the case. The weak performance of the US labour market was reflected in falling market rates.

The late spring brought signals that the US economy was generating new jobs, causing a sharp rise in long interest rates. At its lowest point, the yield on the ten-year US bond was 3.7 percent, which then rose rapidly to 4.9 percent. The rise was fast, but was not sustained.

As the macroeconomic data continued to predict a slowdown in the economic upswing, bond yields fell back to their previously low levels. High demand for US bonds from Southeast Asia's central banks, in conjunction with anxiety that the high price of crude could lead to a slowdown of the global economy, has also contributed to keeping bond yields at a low level.

High demand for corporate bonds

Just as in 2003, demand from bond market investors has continued to focus mainly on corporate bonds. This has either taken the form of direct investment in bonds, or in the fast growing market for synthetic investments and derivative instruments. The index for bond yields featuring an element of enhanced capital risk also generated higher returns than bonds featuring a lower capital risk during 2004. Even so, compared to 2003, the difference was less pronounced. The value of a well diversified portfolio was confirmed yet again in 2004. This with reference to how specific events that affect individual companies can have a major impact on yields.

Strong performance by Swedish market

Sweden's Riksbank continued to cut its key interest rate during the year, in an attempt to stimulate growth while inflation stayed below target. As a result, the Swedish bond market has performed well compared to other markets. Ten-year yields fell by 85 interest points, while two-year yields fell by 115 interest points over the year. During the period, the interest gap between these and long German interest rates with the same term shrank by 15 interest points. Interest in Swedish fixed-income investments has increased sharply, both on the part of those interested in long-term investment horizons, as well as more speculative players.

In-house performance

In-house portfolio management generated a 7.3-percent return on investment for the year. This was somewhat weaker than the benchmark index for fixed-income investment. The deviation is largely attributable to a position taken to benefit from an expected rise in interest rates at the end of the year.

Throughout 2004, management of the Fund's in-house portfolio was based on a fundamental assumption that bond yields would rise to higher levels. During the first few months of the year, the positions taken were relatively limited, but in conjunction with the release of positive US labour market figures for March and April, these positions were expanded. The level of risk accepted has varied during the autumn, while the expectation of rising bond yields has remained a consistent theme.

US dollar rate 2004 (Source: EcoWin)



The USA's Federal Reserve trade-weighted index of the value of the US dollar against G6 countries. The index value reflects the size of the basket of currencies received for 100 US dollars. The lower the value, the weaker the US dollar.

Swedish krona rate 2004 (Source: EcoWin)



The Riksbank's TCW index comprises a balanced mix of the currencies of Sweden's most important export competitors. The diagram shows how the krona exchange rate strengthened during the year, compared with the TCW index. The lower the index figure, the stronger the krona.

Negotiation of external mandates

During the year, the Fund launched a public tender to negotiate bids from external asset managers for the management of portions of the Fund's fixed-income portfolio. The Fund has sought asset managers for three distinct mandates: one for a globally aggregated mandate, one for US bonds and fixed-income securities carrying a credit risk, and one for the management of a portfolio of global credit bonds. The tender reflects a wish for greater efficiency in the management of fixed-income assets and is in line with previously determined strategy.

Following a thorough analysis and evaluation of the candidates, the following asset managers were selected:

- Global aggregated mandate: Bridgewater, Rogge and Capital International.
- US bonds and fixed-income securities: Blackrock, Singer & Friedlander/Denver LL and Wellington.
- Global credit notes: Rogge, Franklin Templeton and Payden & Rygel.

A number of these mandates are expected to be implemented during the first quarter of 2005.

In-house management shall focus on areas where the Fund can either manage assets at low cost, employing an index-type approach, or on active management in areas where the Fund expects to generate return in excess of its benchmark index.

Currency markets reflect impact of weaker US dollar

The start of 2004 saw the trend of a steadily weakening US dollar continue. It soon slowed,

however. This was followed by a relatively trend-free currency market, featuring a stronger US dollar. The US labour market showed new signs of vigour, while ongoing speculation about consequent rises in interest rates strengthened the dollar on currency markets up until the summer. As doubts about the enduring strength of the US economy grew, the trend towards a weaker US dollar regained momentum during the autumn. The dollar weakened especially against the euro, reaching historically low levels in December.

The pound sterling also weakened against other currencies, as raised interest rates impacted on property prices. The value of the Swedish krona rose during the latter part of the year, against the US dollar as well as other currencies. At the close of 2004, the krona was 1.7 percent stronger than at the start of the year.

Tactical positions and active trading

During the year, the Fund took positions involving tactical departures from the strategic degree of hedging specified for the Fund's portfolio as a whole. The positions have been taken to benefit from the increased value of the Swedish krona in relation to the composition of the Fund's exposure in foreign currency. A process to create value from currency market volatility has now been initiated. Subsidiary to this, positions are also being taken to benefit from the intrinsic value of different currencies, not necessarily in comparison with the Swedish krona. The extent of such trading has been limited during the year, but has made a positive contribution to the Fund's overall return on invested capital.



Alternative investments: diversified risk and opportunities for enhanced return

“Alternative investments” embraces the Fund’s combined investments in asset classes real estate, hedge funds and private equity funds. Real estate represents the largest component of alternative investments, accounting for three percent of the Fund’s total capital assets. Hedge funds and private equity funds amount to around one percent each of total Fund investment.

Alternative investments 2004	
	%
Percentage of total portfolio	4.4
Absolute return	12.2
Relative return	5.1
Percentage under in-house management	69
Percentage under active management	100

Asset class “alternative investments” shows a return of 12.2 percent in 2004. Real estate generated a return of 15.1, hedge funds 5.1 and private equity funds 2.1 percent.

Real estate – a long term investment

Investments in real estate have long been a common form of investment for institutional investors. Compared to exchange-listed assets, real estate has generated a stable return. Real estate holdings are relatively non-liquid and should therefore be viewed as extremely long-term investments. Nevertheless, real estate holdings generate a steady return throughout the entire investment period, in the form of dividends, for example. Given the long-term nature of the Second AP Fund’s investment horizon, a certain proportion of real estate holdings is fully justified. The Second AP Fund’s strategy for real estate holdings is indirect investment. Investments shall be made in unlisted real estate companies and funds, or similar structures. The Second AP Fund has no intention of becoming involved in direct ownership of real estate.

Rental market shows signs of turnaround

For the past three years, the real estate market has been adversely affected by rising vacancy levels and falling rents. The Stockholm real estate market has been worst affected, although the trend in

most other areas has also been negative, if more limited. In central Stockholm, commercial rents have fallen on average by about 40 percent. By the close of 2004, the rental market appeared to have bottomed out. There are signs of falling vacancy levels and a slight increase in rents in certain especially attractive areas.

All the indications point towards an ongoing gradual recovery, with a steady decline in vacancy levels and a gradual rise in rents. On other larger regional markets, the trend has been more stable.

The investment market is still strong. In recent years, the liquidity offered by the Swedish real estate market has been among the highest in Europe. Foreign real estate funds (mainly German, British and American) have predominated. This keen international interest in Swedish real estate, focused mainly on major commercial properties, is expected to be sustained, since return on investment continues to be attractive from an international perspective.

Solid profit growth

The Second AP Fund’s investments in unlisted real estate consist of NS Holding AB (Fastighetsbolaget Norrporten) and AP Fastigheter Holding AB. The value of the Fund’s holdings, including debenture loans, is estimated at SEK 4.7 billion.

Norrporten’s business concept involves the acquisition, development and management of real estate, primarily for commercial use, in centrally located regional centres that offer high growth potential. The company has continued its strategic expansion, acquiring additional properties in Helsingborg, Uppsala and other locations. The real estate portfolio has also been consolidated, with the divestment of significant holdings in residential properties in Umeå. At year-end 2004, the estimated market value of real estate holdings in Norrporten was SEK 12.4 billion. The company

reports solid profit growth.

AP Fastigheter's real-estate holdings are concentrated mainly to the major urban centres of Stockholm, Uppsala and Gothenburg. The properties are attractive and well located. Having been weak for the past few years, the commercial rental market in Stockholm stabilised during 2004, and the first signs of a possible recovery could be discerned. The market value of AP Fastigheter's real-estate holdings amounted to SEK 29.5 billion at year-end. The company reports solid profit growth.

Hedge funds produced inconsistent returns

The Second AP Fund has invested in hedge funds since 2002. These investments previously formed part of the equities and fixed income portfolios. The introduction of the 2004 strategic portfolio led to a reallocation of investment capital to hedge funds, amounting to one percent of the Fund's total assets. Previous and new investments have been placed in a portfolio that consists exclusively of hedge funds. The Fund's return on investments in hedge funds amounted to 5.1 percent during 2004. The portfolio's benchmark index is an absolute return equivalent to a three-month treasury bill plus three percentage units.

The return on investments varied during the year. Some funds generated returns in line with or above target, while others have seriously underperformed against expectations. Some have been divested during the year, to be replaced by alterna-

tive investments. Due to the relative absence of distinct trends and the low volatility of the market, hedge funds as a whole found it difficult to achieve anticipated returns during certain periods in 2004. The Fund is continuing to develop its portfolio of hedge funds, to ensure that it can achieve the targeted return on investment, whatever the market conditions.

The Fund has currently invested in ten funds, mostly based in Sweden. It is restrictive in its selection.

Private equity funds – chance of high gains

In recent years, institutional investors such as insurance companies and pension funds have started increasingly to invest in unlisted equities (private equity). Investors cite the possibility of high returns and well-diversified risk as the main factors driving this increased activity. Furthermore, investments in unlisted companies offer private equity funds excellent opportunities to exercise active ownership and participate in the development of the individual companies.

The investment regulations to which the First to Fourth AP Funds subscribe present the possibility of indirect investment in unlisted equities via private equity funds. In principle, private equity funds function as an intermediary in the flow of capital between investors and the companies in which they invest. The Fund is responsible for investment decisions and for fulfilling its corporate governance role in portfolio companies.

Different ROI profiles

Investments made in private equity funds are based on a long-term horizon, with limited options for realising liquidity prior to maturity. Contracts with these funds often run from ten to twelve years. Those who invest in private equity funds must be patient and prepared to wait more than ten years to benefit fully from the return on the initial investment.

When investing in private equity funds, the return is often negative in the first few years. This negative return derives from two things. First: it takes a long time to invest in, develop and sell off

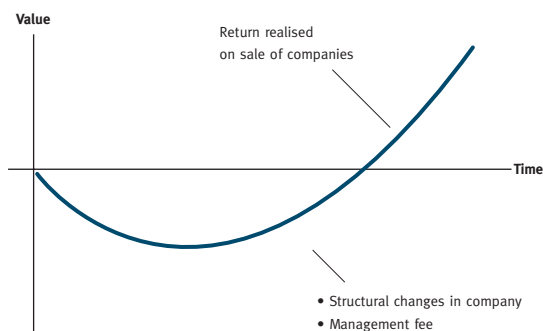
Hedge funds, 2004

	Management style	Return, %
RAM One	Active	8.3
Eikos	Active	10.1
Zenit	Active	-1.5
Nektar	Active	0.0
Finch	Active	-3.2 ³
Nordic ¹	Active	1.8
Prisma ²	Active	6.6
Lynx ²	Active	10.2
Amplus ²	Active	8.8
Tanglin ²	Active	5.9
Goldman Sachs Global ²	Active	-0.7

¹ Terminated in 2004 ² Started in 2004 ³ Return in local currency

During the year, hedge funds have been included in two different asset classes. As of March 1st, the return generated by hedge funds is included in "alternative investments". This asset class has an absolute targeted return equivalent to SHB treasury bills (1-3 months), plus 3%.

portfolio companies. Second: the funds' annual management fee is calculated on the basis of the entire sum that the investor has agreed to invest. When limited capital is employed, management fees have a dramatic negative impact on return. Increases in the value of the portfolio companies in which private equity funds have invested are normally realised during the latter part of the investment period, as the portfolio companies develop and increase in value. The normal profile describing the return on investments in private equity funds is often compared to the shape of the letter "J" and is therefore known as the "J-curve effect" (see graph below).



The Second AP Fund's strategy is based on the gradual build-up of a diversified portfolio of investments in unlisted equities, by investing in private equity funds. The Fund believes a careful selection of quality funds based on a well-documented ability for creating added value in portfolio companies will generate attractive levels of return on investment.

Increased market activity in 2004

The economic upswing initiated in 2003 was sustained in 2004. The greater stability of the equities market also contributed to the fact that both Swedish and international investors in the private equity market saw a higher level of activity in 2004 than in the years immediately preceding. This applied equally to the purchase and sale of equities. The high degree of liquidity enjoyed by the capital market has made it easier to secure bank loans when acquiring mature businesses.

Nowadays, private equity funds are also seeing

a significant increase in interest from industrial purchasers of their portfolio companies. In Sweden, as on the international market, a growing number of funds have been started by established market players. A number of additional new funds are planned for launch in 2005.

Strategic focus on geographical diversity

During 2004, the Second AP Fund has continued to play an active role on the Scandinavian market. Meetings have been held on the Fund's initiative, and as a direct consequence of our "open door policy". These meetings have resulted in further development of the stable network that the Fund has already established. The Fund has also continued to expand its network of contacts beyond the Nordic countries. This has involved the conscious establishment of new contacts with reputable and experienced market players in Europe and the USA.

The Second AP Fund has also been an active participant in meetings with the largest international institutional investors. This ensures that the Fund has access to extremely valuable sources of information, and that it is able to take part in industry-wide discussions that offer opportunities for influencing issues of common interest.

The Fund's strategy is to create a geographical-ly well diversified portfolio of private equity funds. The first steps in this direction were taken in 2004, in connection with the Fund's first investment outside the Nordic countries. This involved investing USD 150 million in a "fund-of-fund", Pathway Capital. Even so, Swedish private equity funds continue to account for the majority of Fund investments in this area.

Total investment commitments

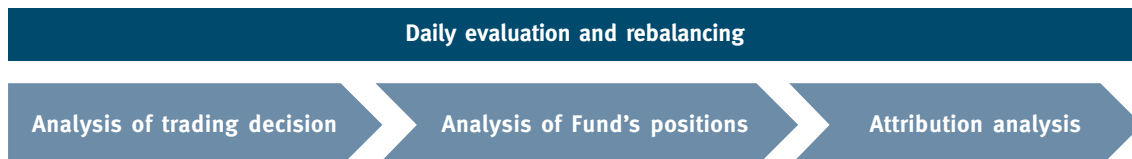
At the close of 2004, Fund investment commitments to private equity funds totalled SEK 2 806 million, of which completed investments accounted for SEK 649 million. Management fees amounting to SEK 34 million (calculated on the basis of total investment commitment) have been written off for the year 2004. Turn to page 46 for a complete list of the Fund's commitments in private equity funds.



Second AP Fund business services: added value through detailed analysis

The Second AP Fund has a compact and efficient business services organisation. Detailed analysis of completed investments ensure optimal conditions for future investment. This analytical process, conducted in three stages, involves daily evaluation and rebalancing of Fund holdings.

Daily evaluation and rebalancing



The business services function of the Second AP Fund comprises five departments: business control, performance, risk management, IT and financial control. The Fund's HR function is also organised under business services.

When business services functions were organized in conjunction with the establishment of the Fund in 2001, a number of strategic decisions were made concerning systems and processes. One key goal was to create fully integrated business process flows, automated from completed trade to delivery and final accounting. This laid the foundations for a flexible organisation that enables changes in investment strategy and focus to be implemented speedily and cost-efficiently within the existing structure. The Fund's systems support and efficient business processes and working methods are designed to permit concentration on investment analysis and strategic and tactical choices.

Daily analysis of completed trades

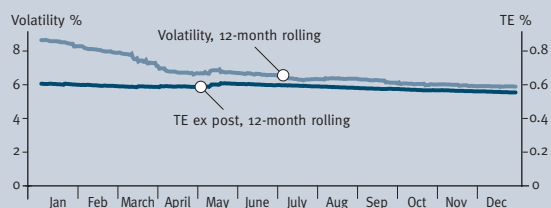
The Second AP Fund's ambition to place in-house and external asset management activities on an

equal footing in terms of working methods and analytical capability involves processing huge trading volumes and demands advanced systems support and an efficient infrastructure. The Fund's internal portfolio management system has therefore been supplemented with a system developed to enable the direct and secure execution of trades by external portfolio managers.

All trades executed under the Fund's mandate, including corporate actions, dividends and so on, are updated daily. This enables detailed follow-up, evaluation and analysis of the entire Fund capital and its degree of exposure.

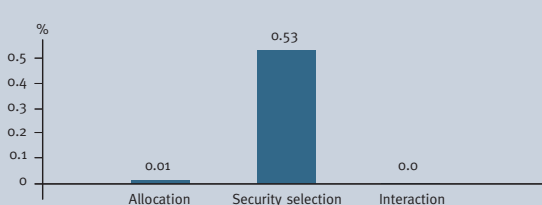
Trading efficiency is analysed and measured on the basis of transaction costs and rate of turnover of portfolio assets. Both direct and indirect costs and revenues are calculated when analysing the transaction cost. The analysis includes rate of turnover, commission, taxes payable and trade impact. Trade impact is an example of indirect impact and is a measure of fund manager efficiency in executing a trade. This gives an indication of what prices the external fund manager is trading at, com-

Absolute and relative risk, total portfolio



The graph shows the trend for absolute risk measured in terms of the volatility of the total portfolio, and relative risk measured in terms of the tracking error for the total portfolio of listed assets in 2004.

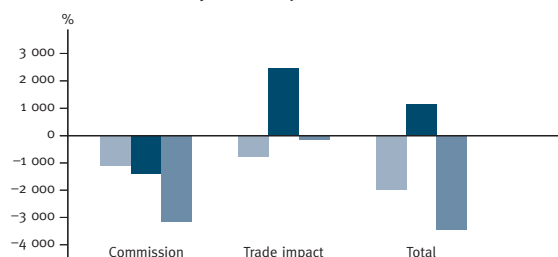
Attribution of risk, total portfolio



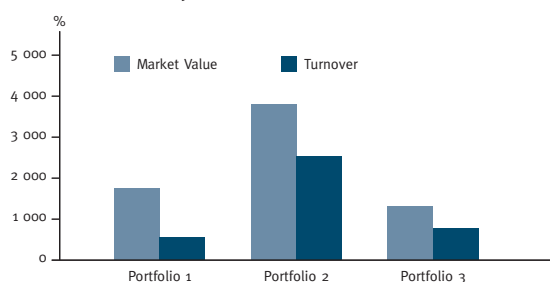
The graph shows attribution of active risk ex post for the total portfolio, for the factors allocation, security selection and interaction.

pared to his benchmark index. Regular analysis of the comparative costs of managing the Fund's various portfolios provides additional decision data when comparing and appraising mandates and portfolio managers.

Transaction cost analysis, example



Turnover rate, example



In the above two diagrams, the differently coloured bars represent the outcome for different portfolios.

Daily evaluation and rebalancing

The evaluation and rebalancing of portfolios is conducted on a daily basis against benchmark index, at fixed weights. Day-to-day knowledge of the degree of exposure per asset class and market is vital in determining the Fund's tactical allocation. The Fund observes the principle that each

benchmark, where possible, shall be calculated by an independent external supplier. For aggregated and partial indexes, this calculation is carried out within the portfolio management system, where all sub-indexes are also implemented.

Analysis of positions taken

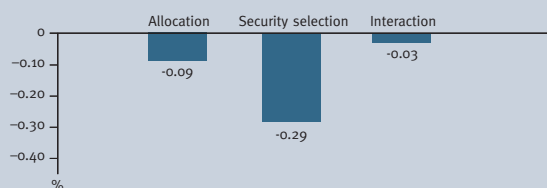
Risk and return are analysed and followed up daily in different dimensions and at different levels, such as sector and geographical area. The level of risk utilisation for the total portfolio, as well as per asset class and mandate, is monitored and matched against current risk limits as defined in the Act relating to Swedish National Pension Funds, 2000:192, and the Investment Guidelines. Individual mandates are monitored to confirm compliance with current Investment Guidelines. The Fund's exposure to risk must fall within the limits defined for respective asset classes.

The Second AP Fund employs an external risk system to monitor forecast risk. Both the Fund's relative and absolute risk are monitored and analysed. Absolute risk is monitored with respect to volatility, Sharpe ratio, currency exposure and duration. Relative risk is monitored against benchmark index via tracking error (active risk), information ratio and beta.

The risk model, which contrasts actual outcome with the previously forecast level of risk, as per the Value at Risk (VaR) model, is reviewed on a quarterly basis.

In certain cases, this active and preventive form of risk analysis involves stress test, back testing of selected risk models and an evaluation and review

Attribution of relative return, total portfolio



The graph shows attribution of relative return for the total portfolio, excluding operating expenses, for the factors allocation, security selection and interaction.



of the limit structure. Stress tests enable the Fund to identify and clarify potential financial risks that can derive from extreme market volatility. An historic or hypothetical market event/scenario is applied to the specific current portfolio to provide insight into how the total risk may be affected. The portfolio's sensitivity to various risk factors is also analysed. At present, stress tests are based on historic events.

Performance is analysed daily. This analytical process involves both an absolute and relative approach. Each individual security is matched against index to ensure correct pricing. At portfolio level, the analysis focuses on criteria such as consistency, beta and distribution of relative return. At asset class level, the analysis focuses on how weighting is allocated, and its impact on respective asset classes and portfolios. At the total portfolio level, the analysis is used to determine the result of tactical allocation between asset classes, and on the degree of hedging.

Thirty-seven percent of the Fund's capital assets are under external management. This places considerable demands on the Fund's ability to monitor the performance of its external portfolio managers in relation to specified mandates. The economic performance of each individual external portfolio manager is monitored with the aid of revenue analysis. The portfolio's relative return (compared to specified benchmark index) is expressed in Swedish kronor. After deduction of agreed management fees, net revenues or costs are

compared to the risk budgeted value for each portfolio manager. This enables the portfolio manager's net contribution to relative return to be expressed as shown in the following graph.

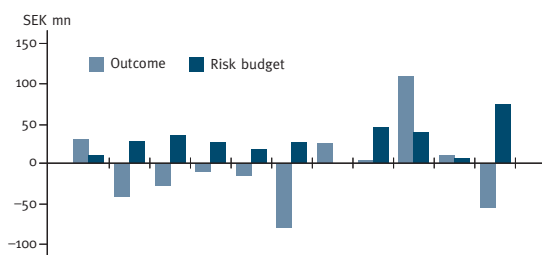
Evaluation by attribution analysis

Where aspects of the portfolio management system have proved inadequate, the Fund has developed its return attribution system in-house. Attribution is conducted in different dimensions, both with respect to return and risk utilisation.

The Fund's working approach at the transaction level and on a day-to-day basis permits analysis of the market performance of both in-house and external portfolio managers. Attribution analysis determines the extent to which individual portfolios have contributed to the Fund's return and risk utilisation. The attribution is made on the basis of several criteria, such as choice of security, industry and geographical area. The Fund also employs attribution analyses to evaluate and analyse the portfolio management style of individual managers. During the year, this attribution technique has been further refined, especially at the total Fund level. Attribution analysis not only presents distribution between asset classes, but even between varying degrees of hedging. The contribution arising from allocation by asset class and security selection are subject to analysis, as well as that arising from rebalancing. This analytical tool gives the Fund considerable insight into the specific decisions and choices that generate relative return.

Risk attribution helps clarify the Fund's risk positions. It describes the marginal risk factors (e.g. asset class or security selection) that contribute most to active and absolute risk in the portfolio. Risk analysis and risk attribution can provide both a forecast (ex ante) and an historical perspective (ex post). Attribution analyses, in which the same parameters are applied in determining both the Fund's risk utilisation and return on assets, are designed to clarify and ensure that the areas and securities to which the portfolio manager has assigned active risk generate a return.

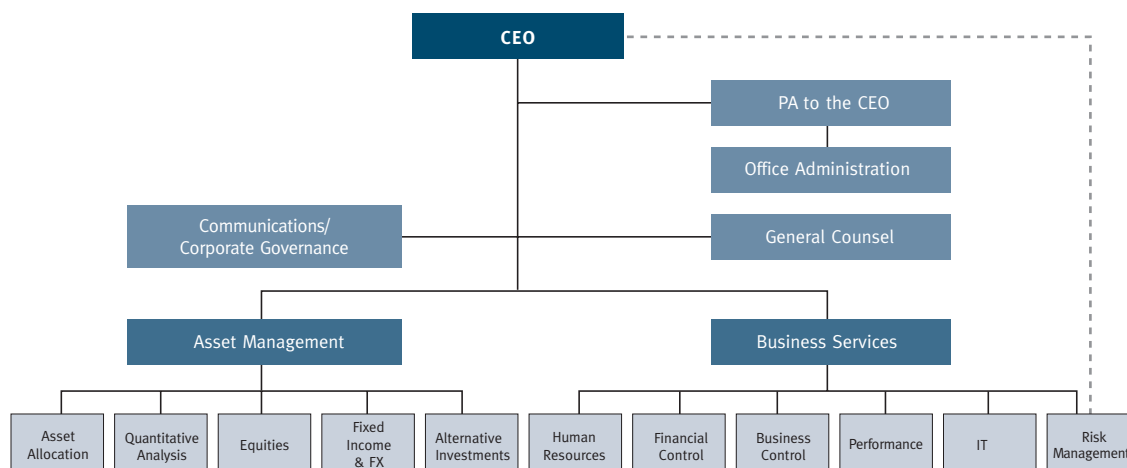
Revenue analysis foreign equities, example



Example of how the net outcome (SEK million) generated on assets under external management compares with their risk-budgeted value.

Structure and staff: In-house and external competence assured

During the year, the Fund continued its strategic activities within the field of Human Resources (HR). Work on the Fund's long-term HR strategy during 2004 has led to the formulation of clearly defined guidelines governing both in-house and external activities.



One element of the Fund's personnel recruitment strategy has involved external promotion at universities and other institutes of higher education. During the year, the Second AP Fund participated in "Gadden", a labour market fair held at the Gothenburg School of Economics. Members of the Fund's staff got the chance to meet the students and provide some insights as to what working life might have to offer on completion of their studies. Through close association with the Gothenburg School of Economics, it has been possible to offer students opportunities to conduct their graduation projects at the Fund, as well as offering temporary employment on a project basis, trainee positions and summer jobs. This has created a recruitment base for employees with long-term potential to develop into new roles.

HR strategy – an effective aid

The HR strategy now established by the Fund is an effective aid in promoting the Fund's operational activities and future development. The strategy is designed to make the organisation still more effective and to advance the Fund's ambition to be perceived as a modern and attractive employer. The organisation functions well and cooperation between the various units has progressed very favourably, thanks to an ongoing process of refinement. The current emphasis is on leadership issues. Areas for development have been identified and work is already in progress.

A code of values**founded on personal responsibility**

One of the keystones of the Fund's HR strategy has been to discuss and implement the special code of values that must govern the activities of a national pension fund. The Fund's activities are based on the assumption that all members of staff shall bear an individual responsibility for tasks assigned and results achieved and, by demonstrating initiative and curiosity, shall strive to develop optimal solutions to every challenge by which the Fund is faced. This places special demands in terms of responsible and ethical behaviour.

Competence development – a daily event

During 2004, Fund staff have made a considerable number of visits to other pension funds, external managers, analysts and other associates, especially in Sweden, Great Britain and the USA. The Second AP Fund has also itself hosted many visits from industry experts and other interested parties. This sharing of experience with major international players has offered staff many excellent opportunities for professional development.

Members of staff are regularly gathered to attend talks and presentations on topics of current interest. As well as the type of information that focuses on the specifics of day-to-day assignments, the Fund also invites external speakers to address

issues of more general relevance to its activities.

During the autumn, for example, Professor Marian Radetzki presented his thoughts surrounding the dramatic rise in the price of oil, while Sweden's former Consul General in New York, Olle Wästberg, gave a talk about the US presidential election and its consequences for the rest of the world.

Good health and balance**generate positive results**

Physical exercise and good health form an integral part of the Fund's corporate culture and are included among the goals established for individual job development plans. Fund employees noted an extremely low level of absence due to illness in 2004, amounting to a mere 0.48 percent. Second AP Fund employees have considerable influence over their own working conditions and accept a personal responsibility for achieving a balance between work and family life. This establishes a favourable climate for an effective business operation.

Financial review

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Performance of capital assets since inauguration January 1st 2001, SEK billion



2004 has been a good year for the stock market, as a result of which the Second AP Fund's strategic asset allocation has generated a high return. The Fund's low exposure in foreign currencies and relatively high exposure on the Swedish equities market has further contributed to this pleasing result. The Fund reported total capital assets, including inflows, of SEK 158.1 billion – an increase of SEK 17.8 billion since the start of the year.

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

The Second AP Fund in 2004

As at December 31st 2004, the Second AP Fund's capital assets were allocated as follows: approximately 61 percent equities, 35 percent fixed income assets and four percent alternative investments. The Fund's portfolio was thereby somewhat over-weighted in equities-related holdings compared with the strategic portfolio. At year-end 2004, the Fund's portfolio assets were broadly exposed on the global market, featuring a well-diversified risk.

The Second AP Fund's reported assets at year-end totalled SEK 158.1 billion, an increase of SEK 17.8 billion on 2003. The Fund's return on investment, excluding operating expenses, amounted to 11.6 percent.

Key events of the year

The 2004 Asset Liability Modelling study used by the Fund was developed in-house in association with Fraunhofer Chalmers Research Centre for Industrial Mathematics. The model measures both the liability and assets side and illuminates a range of different scenarios indicating the future development of the Swedish pension system. The new strategic portfolio for 2005 mainly involves the retention of the current distribution of portfolio assets between equities and fixed income instruments. However, currency exposure will be increased somewhat and hedging strategy adjusted for individual currencies. The target for the new strategic portfolio is a long-term average real return of more than 4.5 percent per annum.

Management of the Fund's equities has been consolidated during the year and adapted to a management strategy with clearly defined mandates concerning active risk utilisation. Negotiations concerning the selection of external managers for the active management of global portfolios were initiated during the year. The share of the total portfolio under in-house management increased during the second half of the year, rising to 41 percent by year-end. In future, a portion of the Fund's in-house management will be based on quantitative analysis.

Within the fixed-income management sphere, negotiations were completed concerning the award of a number of external global management mandates. These negotiations form part of the development and implementation of Fund policy with respect to increasing the relative percentage of fixed-income assets under active management.

The Fund continues the process of creating a geographically well-diversified portfolio within asset group private equity funds. During the year, the Fund reached

decisions concerning a large number of investment proposals, global as well as Swedish. The Fund took its first step outside the Nordic countries by investing in the American "fund-of-fund", managed by Pathway Capital.

The Fund's role as an institutional shareholder has gained increasing importance, not least as a consequence of the new Code of Corporate Governance. The Fund has invested time and effort in clarifying and sharpening its corporate governance policy during 2004. Increased activity and effort in addressing this issue may be expected in future.

Net result for the year

The Fund reported total assets of SEK 158.1 billion, including net flows, as per December 31st 2004. The Fund's return on total portfolio, excluding operating expenses, amounted to 11.6 percent. The relative return on market-listed assets, excluding operating expenses, amounted to -0.6 percent, thereby underperforming against the Fund's benchmark portfolio. Inflows for the year amounted to SEK 1.7 billion, of which SEK 1.4 billion in net payments from RFV (The National Social Insurance Board).

The remaining inflows pertain to dividends from the "Liquidation Fund" and "Special Fund", which are managed by the First Swedish National Pension Fund (Första AP Fonden) and Fourth Swedish National Pension Fund (Fjärde AP Fonden) respectively. The net result for the year amounted to SEK 16.1 billion. Dividends received amount to SEK 1.9 billion and the capital gain on listed equities-related assets was SEK 2.8 billion. Net interest income totalled SEK 2.6 billion and the capital gain on fixed-income-related assets was SEK 0.3 billion.

The Fund's operating expenses amounted to SEK 330 million, of which SEK 64 million in personnel costs, while costs for external management (including fund management and private equity funds), amounted to SEK 198 million. Operating expenses in relation to average capital assets over the year, known as the "asset management cost quotient", corresponded to 0.22 percent. The asset management cost quotient for external management (external management costs in relation to the average fair value of the Fund's capital assets during the year) amounted to 0.13 percent. The asset management cost quotient for market-listed assets was 0.11 percent. The degree of "performance-linked" management assignments increased during the year, an increase that is expected to continue in 2005.

The Fund's operating expenses include provisions for VAT payments totalling SEK 15 million.

The work of the board

The Second AP Fund's board of directors comprises nine members in all, appointed by the Swedish Government. Two members were appointed to the board in 2004. The Fund's CEO also attends board meetings, with any member of staff required in connection with a specific item on the agenda. Even others – such as the Fund's auditors or external partners – may also attend these meetings, as required.

The board met on seven occasions in 2004, one of which was a long meeting on strategy. The Fund's economic development and results were presented and discussed at all these meetings. In addition to reviewing the Fund's day-to-day asset management activities, the board devoted a considerable amount of time to issues of strategic importance to the Fund. During the year, the board approved a new operations plan for 2005, the half-year and year-end accounts and a budget for the Fund's business activities. The Fund's auditors presented their report on the year's operations in conjunction with the board's approval of the year-end accounts. As well as the issues noted above, the board discussed and addressed several questions of principle arising from the Fund's operational activities. These included various rulings on ownership issues, as well as questions and decisions pertaining to investment proposals within the asset class Alternative Investments.

During the year, the board was presented with an appraisal of its activities, conducted by an external consultant. This appraisal has comprised a study of the minutes recorded at board meetings, individual interviews with every member of the board, the presentation

of a report on the consultant's findings and a plenary discussion of the various issues addressed. The appraisal has been forwarded to the Swedish Ministry of Finance. A questionnaire-based evaluation is planned for 2005.

Ministry of Finance appraisal of Second AP Fund

During the year, the Ministry of Finance conducted its usual annual appraisal of the performance and business operations of the AP funds, for subsequent presentation to the Riksdag (Swedish Parliament). Among other topics, the appraisal notes the AP Funds have posted good results in 2003, due to a generally bullish stock market. The appraisal notes that the AP Funds' return on invested assets revealed only minor deviations from their respective benchmark portfolios, indicating a low degree of risk.

The Government also noted that there should be greater diversification of risk between the four AP funds. The appraisal for 2004 was started at the end of the year and is expected to be completed by spring 2005.

The auditors of the Second AP Fund, Anders Bäckström (KPMG) and Göran Jacobsson (Price-waterhouseCoopers) have been appointed by the Ministry of Finance for the period 2002–2004. Anders Bäckström is also responsible for coordinating the audits of all the AP funds. This year's audit comprises an examination of a number of areas common to all Sweden's AP funds, and deals mainly with questions concerning the monitoring and analysis of investments in private equity funds. The auditors have also examined in-house routines and control functions. Any observations made concerning the audit, or comments on the Fund's internal controls, are presented to the board of directors by the auditors in person.

Four-year review	01-12-31	02-12-31	03-12-31	04-12-31
Fund capital, SEK m	133 493	117 090	140 350	158 120
Net inflows from RFV and liquidation/special funds, SEK m	4 523	5 002	2 567	1 651
Net profit for the year, SEK m	-5 005	-21 405	20 693	16 119
Return on total portfolio, excl. expenses, %	-3.2	-15.3	17.8	11.6
Relative return on market listed assets, excl. operating expenses, %*	1.7	0.4	-0.8	-0.4
Relative return on market listed assets, excl. operating expenses, %	-	0.6	-0.5	-0.6
Active risk ex post	1.7	1.0	0.6	0.5
FX exposure, %	10	7	8	10
Under active (incl. enhanced) management, %	37	62	89	90
Under external management (incl. investments in private equity funds), %	82	38	45	37
Share of management expenses, incl. external management expenses, %	0.14	0.16	0.18	0.22
Share of management expenses, excl. external management expenses, %	0.10	0.12	0.10	0.09

* Relative return refers to the difference in return between portfolio and benchmark index.

The Fund's total portfolio

Distribution of Fund assets

The Fund's assets as at December 31st 2004 were distributed as follows: SEK 96.6 billion in listed equities, of which SEK 32.8 billion in Swedish equities and SEK 63.8 billion in foreign equities. Interest-bearing assets, including liquid funds, amounted to SEK 54.6 billion. Holdings in unlisted shares in real estate companies (including subordinated debenture loans) and hedge funds amounted to SEK 4.7 billion and SEK 1.5 billion respectively. At year-end 2004, investments in private equity funds amounted to SEK 638 million, while outstanding investment commitments totalled SEK 2.2 billion. During the year, an average of 45 percent of the Fund's assets were managed, both actively and passively, by external asset managers. These external asset managers have been chosen after a stringent process of analysis and evaluation, in accordance with the regulations governing the procurement of services by public authorities. Mandates have been awarded to a number of Swedish and international asset managers (see Note 4, page 59).

Changes of exposure in derivative instruments

In compliance with the guidelines approved in the business plan for 2004, the Fund has utilised derivative instruments to secure more effective management of assets, to reduce transaction costs and cut risk. During 2004, derivative instruments have mainly been used in the following areas:

- Currency derivatives for handling FX exposure.
- Stock derivatives – especially standardised share futures – for effective rebalancing of the portfolio and when adopting positions in connection with tactical asset allocation.

• Index-linked derivatives – mainly in the form of standardised index-linked futures – for rebalancing, tactical asset allocation and management of the Fund's index-linked risk.

Exposure in derivative instruments is followed up and analysed on a current basis, as required for other investment instruments.

Risk utilisation 2004

During the year, there has been a marginal reduction in the Fund's relative utilisation of risk. The level of active risk utilised in the Fund's total portfolio, ex post, amounted to 0.6 percent at the start of the year, excluding operating expenses. By December 31st 2004, the Fund had reduced its active utilisation of risk to 0.5 percent. In the case of Swedish and foreign equities, however, the level of active risk amounted to 1.3 and 0.9 percent respectively.

Volatility for the Fund's total and benchmark portfolios, expressed in the form of standard deviations, declined during the year from 8.6 percent and 8.6 percent to 5.8 percent and 5.7 percent respectively. The Fund reported a negative information ratio for 2004.

ROI

The return on the Second AP Fund's total portfolio of assets, excluding operating expenses, amounted to 11.6 percent for the full year 2004. This substantial growth in capital assets may be attributed primarily to the Fund's maintenance of a high share of equities throughout 2004, which coincided with a sharp upturn on the world's leading stock markets. Low exposure in foreign currency, with active positions taken to benefit from a

Risk adjusted return for total portfolio, valued by year

	2001		2002		2003		2004	
	AP2	Strategic portfolio	AP2	Strategic portfolio	AP2	Strategic portfolio	AP2	Strategic portfolio
Return, %	-3.2	-5.4	-15.3	-15.7	17.8	18.5	11.6	12.0
Standard deviation, %	9.7	10.2	13.0	13.1	8.6	8.6	5.8	5.7
Active risk, ex post, %	1.7	—	1.0	—	0.6*	—	0.5*	—
Information ratio	1.0	—	0.5	—	neg.	—	neg.	—
Sharpe ratio	neg.	—	neg.	—	1.7	—	1.6	—

*) Total market listed portfolio, excluding operating expenses

stronger krona, in conjunction with a relatively high degree of exposure on the Stockholm Stock Exchange, have further contributed to this strong return on invested assets.

The Fund reports a relative return, excluding operating expenses, of -0.6 percent for 2004. This relative return may be attributed in part to choice of securities, especially on the Swedish market, and partly to positions taken to counteract rising long-term interest rates.

Asset allocation

The Fund's strategic asset allocation has undergone significant changes since its inauguration on Jan 1st 2001. The share of fixed-income assets has declined from the 67 percent allocated in the initial portfolio on Jan 1st 2001 to 36 percent in the strategic portfolio for 2004. Exposure in foreign hedged equities has increased from 0 percent till

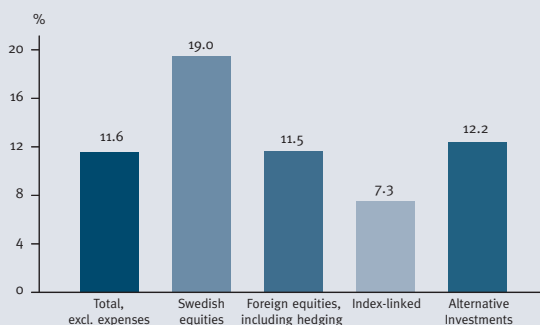
31 percent. In 2001, the Fund instigated an extensive reallocation of the assets in its portfolio, from fixed-income to equities-related assets, in line with its strategic portfolio. During 2002 and 2003, this exposure was extended and refined to include new regions and asset classes, with a view to further diversification and internationalisation of the Fund's fixed-income and equities-related assets. During 2004, the Fund has increased its exposure in hedge funds and private equity funds. Otherwise, the previous allocation of portfolio assets remains unchanged.

The Fund's tactical allocation has contributed negatively to total portfolio return, mainly a consequence of under-exposure against the US dollar during the first quarter of 2004. The absence of definable long-term trends during the year limited the efficacy of the Fund's tactical positions.

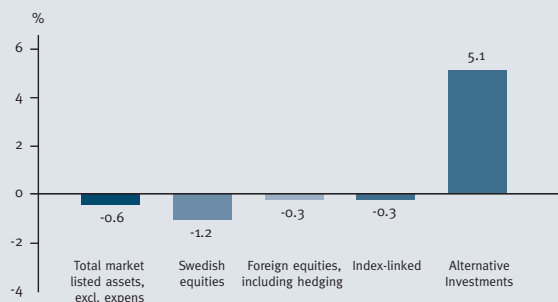
Total return 2004, Second AP Fund



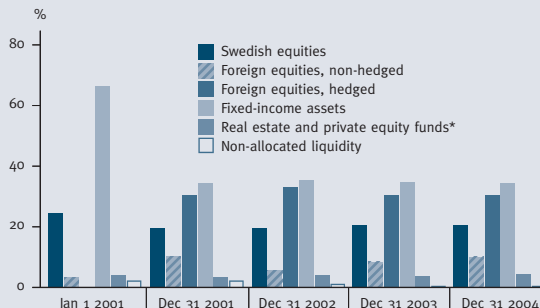
Absolute return per asset class, 2004



Relative return 2004, by asset class



Exposure 2001-2004



* In 2004, hedge funds also included.

Asset class development

A description of the Fund's exposure, reported net realizable value and ROI per asset class at year-end 2004 is given below.

Swedish equities

In 2002, the Second AP Fund adjusted its benchmark index for Swedish equities. Modification of the Swedish equities portfolio was implemented in full during 2003. With the introduction of the new strategic portfolio for 2004, a number of minor adjustments were made to the Fund's portfolio management, starting in March 2004. Equity management is subject to a long-term appraisal based on a combination of three separate parts, each with its individual benchmark index. The portfolio is under both in-house and external management. It is composed of a part that is capital-weighted (65 percent) and benchmarked against the SBX index; a part that is equally weighted (25 percent) and benchmarked against the OSX index, and a part that comprises small-cap funds (10 percent), benchmarked against the CSX index.

To secure a higher return on invested assets, the Fund has focused a significant portion of the Swedish equities portfolio on a longer investment horizon. The Fund had previously gathered these investments in a separate portfolio and, during 2004, completed further investments.

The upswing noted by the Stockholm Stock

Exchange has been especially marked in the IT sector. While the SBX index as a whole has climbed by 20.8 percent, the upswing in the IT sector exceeded 54 percent. The reverse is true of companies in the healthcare sector, which have noted a stock market decline of about 14 percent.

The market value of the Swedish equities portfolio totalled 32.8 billion. Holdings were well diversified among the large exchange-listed companies. The greater part of the portfolio has been under active management throughout the year, with limited relative risk. As per Dec 31st 2004, 27 percent of the Fund's holdings in Swedish equities were under external management. During 2004, an average of 45 percent of the equities portfolio was placed under external management. The return on the portfolio of Swedish equities was 19.0 percent, and 20.2 percent against benchmark index. During the same period, the SIXRX noted a 20.8 percent return.

Largest Swedish holdings

The Fund's five single largest Swedish holdings by worth were Ericsson (4.1 percent), SHB (2.9 percent), Volvo (2.1 percent), H&M (2.0 percent) and Nordea (1.9 percent).

Foreign equities

Some 80 percent of the Fund's holdings in foreign equities are under active management, distributed

Swedish equities

	2001	2002	2003	2004
Exposed value, SEK billion	26.2	22.8	28.4	32.8
Absolute return, %	-15.6	-36.7	34.4	19.0
Relative return, %	-0.8	-0.9	-1.6	-1.2
SIXRX, %	—	—	34.2	20.8
Active management, %	75	100	100	94
External management, %	100	50	56	27

Foreign equities

	2001	2002	2003	2004
Exposed value, SEK billion	53.8	46.1	56.7	63.8
Absolute return, %	-7.7	-24.9	22.5	11.5
Relative return, %	1.0	0.3	-1.0	-0.3
MSCI World, %	—	—	21.8	10.3
Active management, %	11	37	78	80
External management, %	100	64	82	77

Composition of strategic portfolio, exposure and return as per Dec 31 2004

Asset class	Strategic portfolio, %	Exposure, %	Exposed value, SEK billion	Fair value, SEK billion	Return AP2, %	Return benchmark index, %
Swedish equities	20	20.7	32.8	33.8	19.0	20.2
Foreign equities	39	40.4	63.8	53.8	11.5	11.8
Fixed-income assets, including liquidity and accumulated interest	36	34.5	54.6	62.5	7.3	7.6
Real-estate	3	3.0	4.7	4.7	15.1	7.3
Private equity funds	1	0.4	0.7	0.6	2.1	
Hedge funds	1	1.0	1.5	1.2	5.1	4.2
Total	100	100	158.1*	156.6*	11.6	12.0

* The difference between total fair value and exposed value consists mainly of derivative instruments.

according to the geographical regions North America, Europe and Asia/Pacific, as well as in emerging markets and via global mandates. In-house management has focused on European equities, adopting a sector-based approach to the management of these assets. Exposure on other markets has been delegated to a number of external managers. Fund investments in emerging markets amount to SEK 4.6 billion. In a move to increase the degree of active management, the Fund has implemented a gradual transition from passive management against index to “enhanced” management, with a particular focus on its holdings in the North American and European markets.

The market value of the foreign equities portfolio amounted to SEK 63.8 billion at year-end. In line with the Fund’s strategic asset allocation policy, the degree of market exposure in the USA was reduced in favour of European, Japanese and Pacific stocks, as well as emerging markets. Investments were also made in emerging markets. The portfolio of foreign equities has generated a return of 11.5 percent compared with an MSCI World index, hedged and regionally adjusted by the Fund, which generated a return of 10.3 percent for the same period. As per December 31st 2004, 77 percent of assets held in foreign equities were under external management. The average over the full twelve months was 82 percent.

Largest foreign holdings

At the end of the year, the five single largest foreign holdings were BP (0.7 percent), Citigroup (0.6 percent), General Electric (0.6 percent), Vodafone Group (0.6 percent) and Johnson & Johnson (0.5 percent).

Fixed-income and FX

The greater part of the Fund’s fixed-income portfolio has been handled in-house during 2004. The management of Swedish fixed-income assets made

a slightly negative contribution to the relative return, as did the management of investments in foreign fixed-income instruments. The inflation-linked portfolio, which was under passive management, generated a return in line with benchmark index. The negative result is mainly attributable to the taking of active positions to benefit from rising long-term interest rates.

As per December 31st 2004, the duration of the portfolio amounted to 5.1 years, a decline compared to the preceding year’s figure of 5.3 years. National issuers accounted for 63 percent of the fixed-income portfolio. As per December 31st 2004, 78 percent of the portfolio was placed in fixed-income securities, rated from AA- to triple A (AAA). At year-end 2004, government bonds accounted for 45 percent of the total value of the fixed-income portfolio.

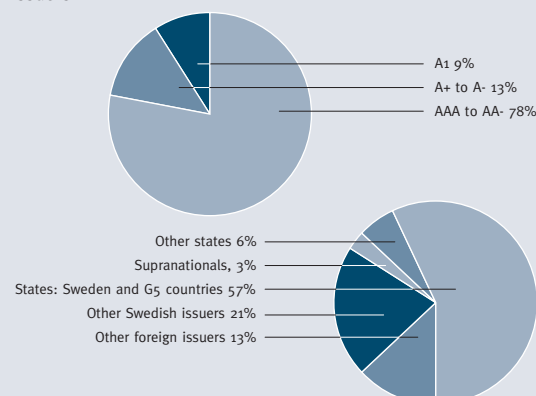
At present, the Fund is currently engaged in only a limited degree of active foreign exchange trading. An active FX mandate was nevertheless initiated during the year, to generate value from foreign exchange market volatility. Under this mandate, positions were taken to benefit from anticipated movement in the intrinsic values of foreign currencies.

Tactical and strategic positions are taken in allocating the Fund’s currency exposure, and when rebalancing to achieve the desired weighting in equities and fixed-income instruments. The market worth of the Fund’s fixed-income instruments, including liquidity, amounted to SEK 50.4 billion on December 31st 2003, compared to SEK 54.6 billion at year-end 2004. The fixed income port-

Fixed-income assets

	2001	2002	2003	2004
Exposed value including liquidity, SEK billion	50.3	43.4	50.4	54.6
Absolute return, %	3.7	8.9	5.3	7.3
Relative return, %	- 0.1	0.0	- 0.1	- 0.3
Active management, %	12	88	98	94
External management, %	57	9	10	8

Issuers



folio consists mainly of nominal and inflation-linked Swedish bonds, as well as internationally traded government securities and corporate bonds. Foreign fixed-income holdings totalled SEK 23 billion. The return on the portfolio of fixed-income securities was 7.3 percent, compared to the 7.6 percent noted by the benchmark index.

Alternative investments

The Fund has gathered its investments in asset groups real estate, hedge funds and private equity funds under asset class Alternative Investments. Real estate, corresponding to three percent of the Fund's total capital assets, accounts for the largest share of Alternative Investments: hedge funds and private equity funds each account for approximately one percent of the Fund's investments.

Private equity funds

The law requires that Swedish AP funds may only invest in unlisted equities indirectly, via private equity funds, mutual funds or their equivalent. The strategy adopted by the Second Swedish National Pension Fund/AP2 is to create a geographically well-diversified portfolio of private equity funds. The first step in this direction was taken in 2004, when the Fund embarked on its first major undertaking outside the Nordic region. This took the form of a USD 150 million investment in a "fund-of-fund", managed by Pathway Capital.

In conjunction with the undertakings made to seven funds in the preceding year, this brought the Fund's total investment commitment to SEK 2.8 billion. Actual investments to date total SEK 649 million, including management expenses, of which SEK 373 million in 2004. This corresponded to a fair value of SEK 638 million.

Fees paid to managers of private equity funds,

which are booked on a current basis, amounted to SEK 34 million in 2004. Since the Fund's inauguration, this means that a total of SEK 66 million has been paid out in the form of management fees for the Fund's investments in unlisted funds. These fees, which are calculated on the total undertaking, will be deducted from future profits in private equity funds and refunded prior to profit sharing.

Hedge funds

During the year, a total of SEK 501 million was invested in hedge funds and the Fund initiated cooperation with three new fund managers. Consequently, the Fund now operates ten external hedge fund mandates at an exposed value of SEK 1.5 billion, of which SEK 1.2 billion has already been invested. The return on these investments was 5.1 percent for the year, outperforming the benchmark index by 0.9 percent. Fees to external managers of hedge fund portfolios amounted to SEK 15 million.

Real estate

The Second AP Fund's real-estate-related holdings consist of shares in both listed and unlisted property companies. The listed holdings are managed within the framework of the Fund's ongoing equities management activities, i.e. with the assistance of both in-house and external managers. Unlisted real-estate holdings, comprising a 25-percent participation in AP Fastigheter and a 33-percent participation in NS Holding AB (Norrporten), are managed in-house by the Second AP Fund. The Second AP Fund's investments in real estate are designed to generate a solid direct return on investment and contribute to a satisfactory diversification of risk in the total portfolio.

AP Fastigheter is owned jointly by the First to Fourth Swedish National Pension (AP) funds and

Investments and undertakings, private equity funds, SEK million

Fund	2001		2002		2003		2004		Total	
	Investment undertaking		Investment undertaking		Investment undertaking		Investment undertaking		Investment undertaking	
EQT Northern Europe KB	52	181	59	—	-1*	—	8	—	118	181
Swedestart Life Science KB	2	25	2	—	2	—	5	—	11	25
Swedestart Tech KB	3	25	2	—	2	—	4	—	11	25
Carnegie Biotech Bridge Fund	—	—	49	50	—	—	—	—	47	50
Nordic Capital V	—	—	—	454	1	—	144	—	145	454
EQT Mezzanine Fund	—	—	—	—	22	272	21	—	43	272
Cevian Capital	—	—	—	—	51	681	125	—	51	176
Pathway Private Equity Fund	—	—	—	—	—	—	32	1 118	32	118
Total	57	231	110	504	77	953	339	1 118	583	2 806
Fair value, total										638

* Refers to repayment of investment.

Strategic asset allocation

has a concentrated and attractively located portfolio of real-estate holdings in the Stockholm, Gothenburg and Uppsala areas. The company owns and manages some 250 properties, totalling 2.2 million square metres of floor space, at a combined estimated market value of SEK 29.5 billion.

Norrporten is owned jointly by the Second AP Fund, the Sixth AP Fund and Vasakronan, all of which hold a one-third interest in the company. The company continued its strategic expansion during the year and has invested in a number of substantial properties in Helsingborg and Uppsala. Norrporten owns and manages some 200 properties, totalling approximately 1.3 million square metres of floor space. These properties have a combined estimated market value of SEK 12.4 billion. The holdings in Norrporten have noted favourable development, generating a SEK 155 million increase in market value and interest income on debenture loans amounting to SEK 100 million. The Fund's holdings in AP Fastigheter have also noted an increase in market value, of SEK 212 million, with interest income on debenture loans amounting to SEK 158 million. The net realizable values of the portfolios of real estate held by AP Fastigheter and Norrporten, including debenture loans, were reported as SEK 3 091 million and SEK 1 627 million respectively.

Unlisted real-estate holdings Dec 31 2004

AP Fastigheter Holding AB, amounts in SEK m

Equities	
Acquisition value	721
Valuation	212
(of which affecting operating result 2004: 212)	
Fair value Dec 31 2004	933
Total dividend 2001–2004 (of which in 2004: 0)	375

Promissory note loan, incl. accrued interest

Promissory note loan, incl. accrued interest per Dec 31 2004	2 158
Total interest income 2001–2004 (of which in 2004: 158)	158

NS Holding AB, amounts in SEK m

Equities	
Acquisition value	372
Valuation	324
(of which affecting operating result 2004: 155)	
Fair value Dec 31 2004	696

Debenture loans incl. accrued interest

Debenture loans incl. accrued interest per Dec 31 2004	931
Total interest income 2001–2004 (of which in 2004: 100)	291

The Second AP Fund's board of directors conducts an annual internal evaluation of the focus chosen for the Fund's portfolio management policy. This process includes an ongoing review of the latest ALM (Asset Liability Modelling) study, which forms the basis of the board of directors' decision concerning the composition of the Fund's strategic portfolio.

In 2001, during its first six months of operation, the Fund conducted a comprehensive reallocation of assets, involving the divestment of fixed-income instruments and purchase of foreign equities. In the late autumn of the same year, the Fund achieved parity between the composition of the actual portfolio and that of the strategic portfolio approved by the board of directors.

In 2002, on completion of the ALM study, and despite the market situation, the Fund's board of directors decided to maintain a high proportion of equities in the strategic portfolio throughout 2003 as well.

The strategic portfolio for 2003 represented a refinement in terms of asset class distribution on different markets and choice of portfolio management style.

Strategic portfolio 2004

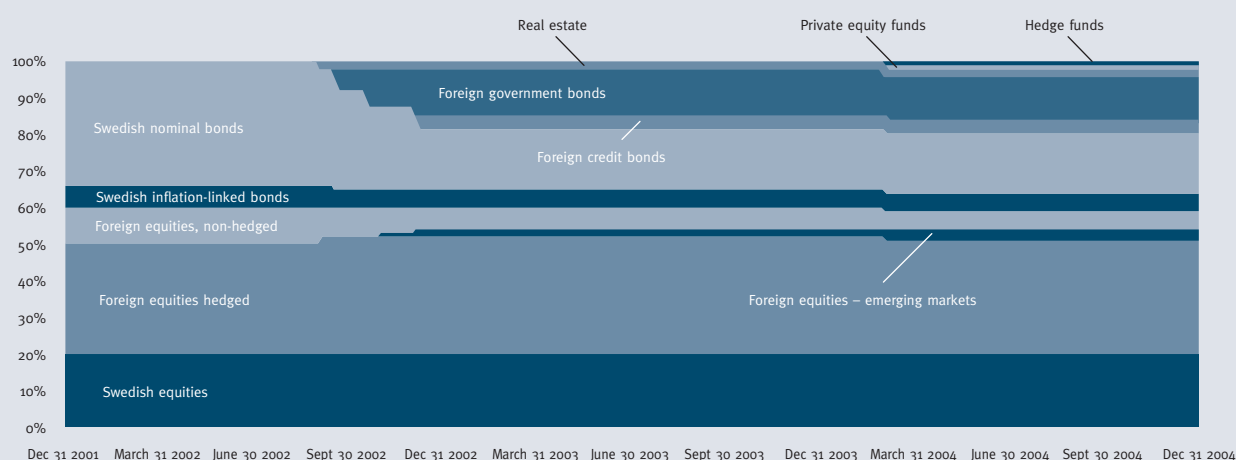
The changes in the strategic asset allocation for 2004 were relatively minor. The differences between the strategic portfolios for 2003 and 2004 included the formation of Alternative Investments as a new asset class comprising asset groups Real Estate, Private Equity Funds and Hedge Funds. In addition to this, the Fund's assets were divided into two separate parts, liquid and non-liquid. The idea was to simplify and clarify an ongoing evaluation of the Fund's portfolio management performance.

Asset class Alternative Investments will comprise five percent of the Fund's strategic portfolio. This asset class consists of Real Estate (three percent), Private Equity Funds (one percent) and Hedge Funds (one percent). These are not new assets, having earlier formed part of the Fund's portfolio, but they have now been gathered to form a joint asset class. Consequently, asset classes Equities and Fixed Income Securities will shrink by one percent each. The new strategic portfolio was implemented in March 2004.

New strategic portfolio 2005

In December, the Board of Directors of the Second Swedish National Pension Fund/AP2 approved a somewhat altered strategic portfolio for 2005. The relative overall distribution of assets

under management remains unchanged at approximately 59 percent equities, 36 percent fixed-income instruments and 5 percent alternative investments. The difference, compared to the preceding year's strategic portfolio, is an increase in the degree of



Benchmark index for strategic portfolio 2004

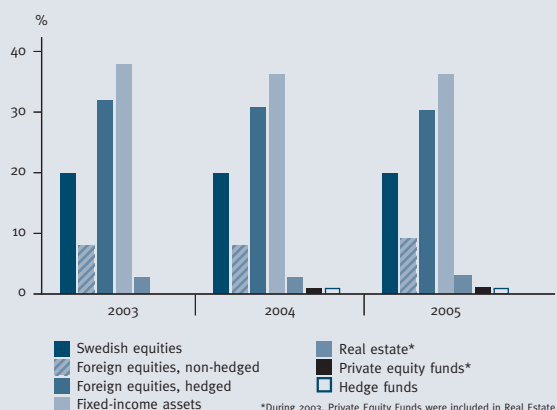
Part-portfolio	Index
Equities	
Sweden	65% SBX "Stockholm Stock Exchange Benchmark Index" 25% OSX "Unweighted Sweden Index" 10% CSX "Carnegie Small Cap Index"
Europe	MSCI Europe
North America	MSCI North America
Japan	MSCI Japan
Asia excl. Japan	MSCI Pacific excl. Japan
Emerging markets	MSCI Emerging Markets
Real estate	SFIX Svenskt Fastighetsindex
Private equity funds	11% per annum
Hedge funds	SHB treasury bills 1-3 months +3%
Fixed-income assets	
Swedish nominal fixed-income securities	SHB Swedish All Bond
Inflation-linked bonds	SHB Index Linked
Foreign government bonds	Lehman Brothers Govt 1000 x Asia
Foreign credit bonds	Lehman Brothers Cred 1000 x Asia

Currency exposure

Dec 31 2004, equivalent in SEK millions	USD	GBP	EUR	JPY	Other	Total
Equities and participations	24 544	7 059	11 186	5 404	6 136	54 329
Bonds and other fixed-income securities	7 674	1 119	14 319		833	23 945
Other assets and liabilities, net	506	116	481	64	88	1 255
Derivative instruments excluding FX derivatives	60	14	9	35	10	128
FX derivatives	-25 635	-5 734	-21 014	-5 155	-5 936	-63 474
Currency exposure, net	7 149	2 574	4 981	348	1 131	16 183

Currency exposure reported as per the Fund's true management of FX risk, which means that it is based on local currency at the trading location, and not the currency pertaining at the company's registered office.

Strategic portfolios: 2003, 2004 and 2005



currency exposure (from 8 to 9 percent), and the adaptation of the Fund's hedging strategy to individual currencies. The Fund has raised its targeted real return on investment from 3.5 to 4.5 percent. The new model for Asset Liability Modelling (ALM), that the Fund has developed in association with Fraunhofer Chalmers Research Centre for Industrial Mathematics, will increase opportunities for developing and refining its strategic portfolio and asset allocation. The model can be used to illuminate possible alternative scenarios for Sweden's future national pension system.

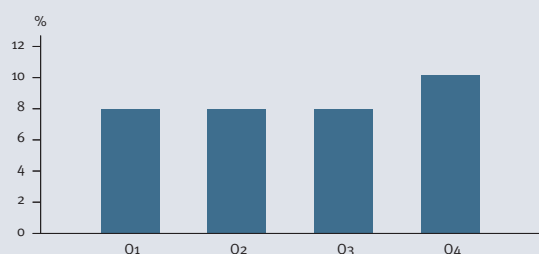
Market-listed and non-market-listed assets

The Fund's portfolio contains assets of varying liquidity. The majority of the Fund's assets are appraised and market quoted daily and are therefore considered to be liquid. The liquid assets consist of equities, bonds and foreign exchange while the non-liquid assets consist of real estate and private equity funds. To ensure that the ongoing monitoring of return and risk is true and accurate, all assets should be valued on the same occasions and at the same intervals, which at present is not possible. The Fund's reported total return shall thereby always consist of the return generated by both parts of the portfolio. Relative return, however, is measured against the development of the market quoted portfolio. In both cases, the Fund's operating expenses for the current year are excluded, in line with the Ministry of Finance's appraisal model.

FX exposure

At year-end 2004, 10.2 percent of the Fund's assets were exposed in foreign currency, an increase compared with the strategic portfolio. Assets exposed in foreign currency, found mainly in the foreign fixed-income and equities portfolios, have been hedged by means of forward exchange contracts. The Fund's total exposure in FX is distributed as shown in the table below.

Currency exposure per quarter, 2004



External portfolio management

The Second AP Fund manages a significant proportion of its total portfolio assets with the assistance of external managers. As per December 31st 2004, 37 percent of the Fund's assets were under external management. The share of assets under active external management, featuring both relative and absolute return requirements, amounted to 78 percent.

Within the equities management sphere, 4 Swedish mandates and 12 European mandates have been terminated to adapt the portfolio to the Fund's change of investment strategy. In the long-term, the Second AP Fund anticipates a market environment of low volatility and high correlation between equities, necessitating a change in strategy with respect to the diversification of risk.

The Fund cooperated with more than 40 external managers in 2004, mainly in equities management and private equity funds. These external managers have first and foremost contributed to specialist expertise in the management of assets outside Europe. As required, opportunities are provided for the rapid and flexible redistribution of assets under management.

Strategy and concept

The strategy and focus of the Second AP Fund's portfolio management policy, which is committed to an increasing degree of active management, especially on markets outside Europe, assumes access to an increasing amount of specialist expertise. External fund managers shall be utilised where it can be demonstrated that they generate a higher return, or function as a useful complement to the Fund's in-house investment activities.

Even on markets where the Second AP Fund is well qualified to conduct the successful management of its assets, external fund managers may still be able to contribute additional experience, as when a need arises to diversify the portfolio. Using external fund managers makes it easier to switch investment style or change risk profile, with

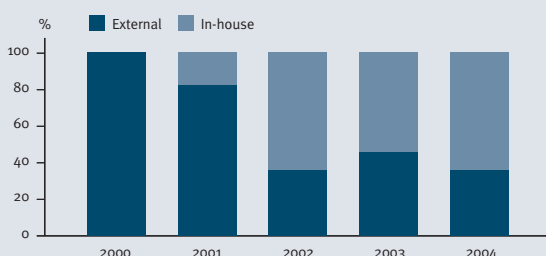
the added benefit that the Fund's organisation is less vulnerable to changes in personnel.

Contract negotiation and selection criteria

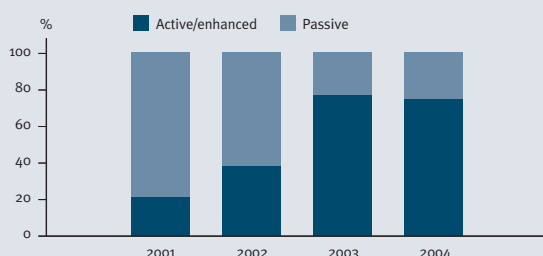
The Fund's selection process involves a number of predetermined selection criteria, such as investment style, analytical quality, organisational structure, staffing and past performance. Qualitative and quantitative factors are subjected to thorough analysis, both during the negotiations and, if selected, during ongoing portfolio management.

In the field of Tactical Asset Allocation, negotiations were completed during the year concerning the award of a number of global asset management mandates. These negotiations form part of the development and implementation of the Fund's strategy for generating higher returns by means of

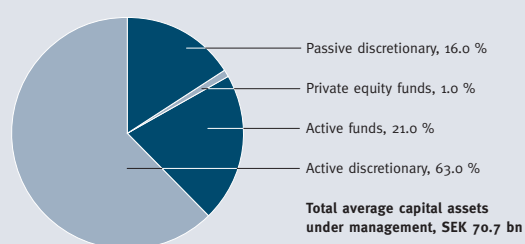
Relative distribution between in-house and external management



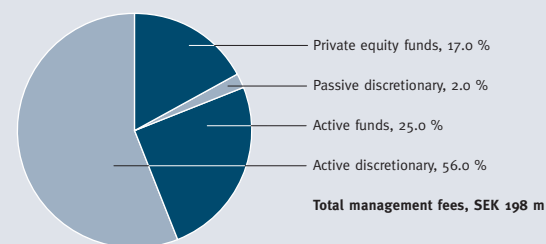
External management, passive/active management style



Capital assets under management, by management style



Management fees, by management style



Revenues and expenses, external management, SEK million

	Market listed assets		Private equity funds	
	Active mandates	Passive mandates	Total market listed assets	
Absolute return	4 680	576	5 256	55
Costs	-161	-3	-164	-34
Net	4 519	573	5 092	21
Capital assets under management				
- as per Dec. 31 2004	45 408	13 093	58 501	638
- average during 2004	55 015	15 347	70 362	354
- total investment commitment	-	-	-	2 806

Follow-up, analysis and control

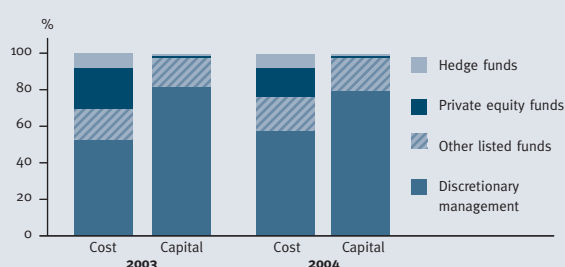
tactical asset allocation. During the year, the Fund also completed negotiations concerning the award of external mandates to manage parts of its fixed-income portfolio. The Fund has sought fund managers for three separate mandates: one for an aggregated global mandate, one for US government and non-government bonds, and one to manage a portfolio of global non-government bonds. The Fund plans to activate these mandates during 2005.

Cost of external management

On average, about 44 percent of the Fund's assets were under external management in 2004. The amount of assets under active external management amounted on average to 78 percent. The degree of active risk accepted is a significant factor in determining the costs incurred in the management of assets. The Fund's external management mandates, excluding alternative investments, have been focused on increasing the level of active risk in 2004, causing an increase in the cost of external management, from SEK 77 million to SEK 149 million. If management fees for alternative investments are included, this brings the Fund's combined cost for external management to SEK 198 million. This is equivalent to 0.28 percent of the average capital assets under external management during 2004. The Fund compares the ongoing cost for external management of capital assets with those for similar market players. A fair and just comparison must take into account the volume of assets under management, the degree of in-house management and the style of management chosen in terms of active v. passive, equities v. fixed-income securities and varying amounts of unlisted asset classes.

By year-end 2004, performance-linked mandates accounted for seven percent of assets under external management, a percentage that the Fund intends to increase in 2005.

External management costs/average capital investment



As a large and internationally active asset manager, with several asset management assignments delegated to external fund managers, the Second AP Fund is subject to stringent demands in terms of its ability to analyse, follow up and monitor portfolio performance. This applies as much to individual mandates as to the portfolio as a whole. To satisfy these demands, the Fund has invested in an advanced IT platform that combines high reliability with flexibility. The Fund monitors, evaluates and analyses holdings on a daily basis, whether the assets are managed externally or in-house.

Reports on exposure, return and risk utilisation are generated on a daily, weekly and monthly basis. Complete balance sheets and income statements are prepared on a monthly basis, together with a whole range of relevant economic analyses.

Systems environment

Since the start of operations, the Second AP Fund has used a fully integrated Front/Middle/Back Office portfolio management system. Since its implementation, this system has been progressively expanded and upgraded with additional functions, to meet the increasingly demanding and constantly changing performance requirements. The system has been designed to provide a high degree of automation and to optimise business processes, whether initiated by the Fund's in-house portfolio managers or by external managers. To satisfy the additional requirements deriving from cooperation with external managers, the basic system was complemented with a web-based system for the import of external managers' trades. External managers are responsible for the entire business process within the parameters of their respective mandates, from execution to settlement and reporting.

A number of developments were introduced during 2004, with a view to further facilitating portfolio analysis. Other functions have been implemented to optimise execution of trades. The Fund's systems architecture provides excellent opportunities for daily follow-up and analysis of its entire holdings, as well as full and direct access to the status of portfolios managed under external mandates, in terms of risk and performance too.

Valuation and rebalancing

The Fund's portfolio is valued and rebalanced daily against benchmark index at fixed weights, which places severe demands on both organisation and sys-

tems. Knowledge of daily exposure per asset class and market is essential to the Fund's tactical allocation. The Fund applies the principle that, as far as possible, each benchmark shall be calculated by an independent supplier. For aggregated and partial indexes, the calculation is carried out by the portfolio management system, where all sub-indexes are also implemented.

Transaction analysis

Trading efficiency is analysed and measured on the basis of transaction costs, direct and indirect, and the portfolio's rate of turnover. The analysis includes commission, any taxes due and "trade impact". Trade impact refers to the portfolio manager's efficiency in executing trades, which provides a measure of the price levels at which the portfolio manager is trading in relation to his benchmark index.

Risk management

The Fund's level of risk utilisation for 2004 was within the specified parameters. Follow-up of investment regulations, limits and financial risks is handled on a daily basis. Follow-up and analysis are conducted for both absolute and relative levels, as well as ex ante and ex post for the total portfolio, per asset class and per mandate. Operative management is conducted so that the anticipated active risk for the entire exchange-listed portfolio

shall not exceed three percent. In the same way, individual limits for anticipated active risk are set for each asset class.

Risk system

The Fund uses an external risk system as a complement to enable analysis and monitoring of the Fund's combined market and credit risk. The risk calculations are based on Value at Risk (VaR). The system permits advanced simulation for calculating alternative risk outcomes by means of stress tests and scenario analyses.

Measure of total risk for the Second AP Fund

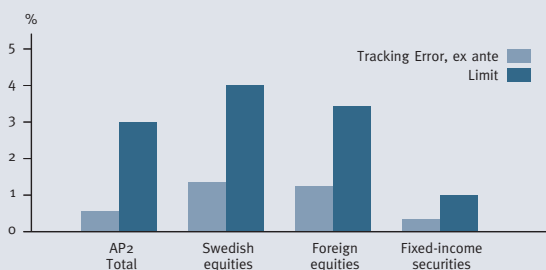
The Fund's absolute and relative risk is monitored and analysed, for the total portfolio, per asset class and per mandate. Absolute risk is monitored with the help of the Sharpe ratio and volatility. Relative risk is measured in terms of active risk, information ratio and beta.

During 2004, the Sharpe ratio (twelve-month rolling) was positive, ending the year at 1.6. The total portfolio's volatility declined during the year from 8.6 to 5.8 percent, while the twelve-month rolling information ratio was negative.

Attribution analyses

The Fund conducts attribution analyses in several dimensions, both in terms of return and level of

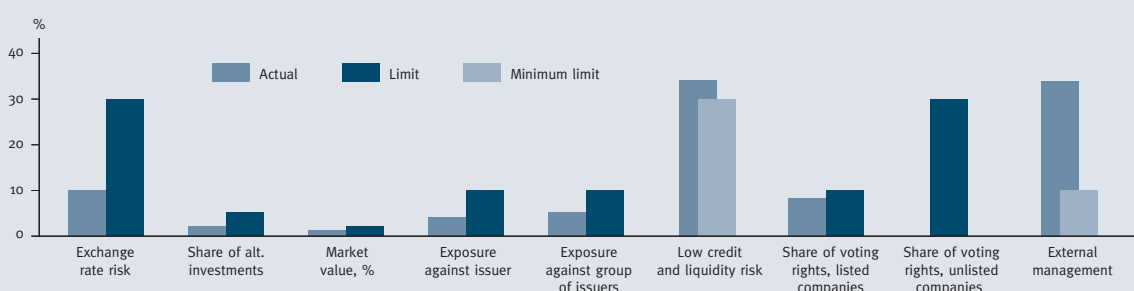
Risk limits, active risk



Sharpe ratio



Limit as per investment regulations



risk. The attribution analysis defines the extent to which the portfolio has contributed to return and risk utilisation. Return attribution is employed to clarify the differences in return between the Fund's portfolio of assets and the strategic portfolio. The analytical process is conducted at several levels: for the total portfolio, between and within each asset class and at the portfolio level. The contribution made, in terms of individual securities as well as sectors, regions, currencies and so on, is analysed at each level.

Risk attribution defines which marginal factors contribute most to relative and absolute risk. Attribution is implemented for a range of factors such as allocation, choice of securities, sectors, countries, ratings, duration and assets. The Fund implements both ex ante and ex post risk attributions.

Commission

In connection with the purchase of equities and participations, the commission is capitalised in accordance with generally accepted auditing standards and thereby included in the acquisition value. Total commission received in 2004 amounted to SEK 105 million. Of this total commission expense, 62 percent is attributable to the Fund's in-house management and the remaining 33 percent to external managers. This corresponded to an expense amounting to 0.05 percent of the total volume of shares traded during the period.

The following five counterparts have received commissions corresponding to 50 percent of commission payments (in alphabetical order): ABN Amro Bank, Carnegie, Citigroup, Goldman Sachs and SEB.

Tax

In its capacity as a government agency, the Second AP Fund is exempt from tax. Nor is the Fund subject to VAT.

Structure and staff

The Second AP Fund initiated implementation of a new HR (Human Resources) strategy in 2004. This new strategy comprises long-term guidelines

for leadership, recruitment, skills-development and communication. The strategy is designed to contribute to a more efficient organisation and to help realise the Fund's ambition of becoming a modern and attractive employer.

At year-end 2004, the Fund numbered 44 full-time staff (of which 16 women), with five additional staff on a project basis. The average age of Fund employees is 38.1 years, with a median age of 38.4 years and an age spread from 26 to 59. Members of staff, with an average work experience of 16 years, represent five different nationalities.

The Fund has a low rate of personnel turnover. During 2004, one employee left and six new employees joined the Fund. The level of absence due to ill health during the year was also low: 0.48 percent.

Corporate governance

Owner-related activities in 2004

During 2004, the Second AP Fund participated in 50 Swedish annual general meetings (AGMs) and seven extraordinary general meetings. The Fund also exercised its voting rights at the AGMs of its 50 largest foreign shareholdings, via "proxy voting". The Second AP Fund has also been represented in the nomination process for the boards of Artimplant, Castellum, Feelgood, Observer, Pergo, Sardus, WM-data, Skandia, Song Networks and Wedins. Together with other major investors, the Fund has been actively engaged in the preparatory work prior to many of these AGMs. In several cases, the subject of discussion was inappropriate, non-performance-linked systems of remuneration.

Owner focus 2005 – a glimpse of the future

A new corporate governance code was presented in 2004. As a consequence of the new code, the Second AP Fund's board of directors adopted a new corporate governance policy at the start of 2005, which clarifies the Fund's position on a number of governance issues. During the year, the Fund initiated a project designed to integrate corporate governance issues more clearly into the Fund's day-to-day management activities. This involves an internal analysis of corporate governance issues, with a view to subsequently incorporating conclusions as part of the investment process.

Income statement

Amounts in SEK million	Note	Jan-Dec 2004	Jan-Dec 2003
Operating income			
Dividends received		1 902	1 639
Net interest income	1	2 632	2 915
Capital gain/loss, net	2	3 119	-1 666
Exchange gain/loss, net		-1 370	-2 621
Unrealised changes in value	3	10 166	20 660
Total operating income		16 449	20 927
Operating expenses			
External asset management expenses	4	-198	-110
Personnel expenses	5	-64	-62
Other asset management expenses	6	-68	-62
Total operating expenses		-330	-234
NET RESULT FOR THE YEAR		16 119	20 693

Comments to the income statement

Operating income

The Second AP Fund's net result for 2004 amounted to SEK 16 119 million (20 693) and comprised a return on managed assets of SEK 16 449 million (20 927), reduced by operating expenses of SEK 330 million (234).

Net return on managed assets

The net of interest, totalling SEK 2 632 million (2 915), consists mainly of interest income from bonds and other interest-bearing securities amounting to a net of SEK 2 418 million, and interest income deriving from fixed forward exchange rates amounting to a net of SEK 246 million.

The net of capital gains/losses was SEK 3 119 million at year-end (-1 666). Of these realised changes in value, listed equities (including derivative instruments) accounted for a net capital gain of SEK 2 766 million, and fixed-income investments (including derivative instruments) for a net capital gain of SEK 353 million.

The net of exchange gains/losses comprised unrealised and realised exchange gains/losses on the Fund's foreign currency exposure. This resulted in a net deficit of SEK -1 370 million (-2 621). The majority of the Second AP Fund's currency exposure at year-end was in US dollars (corresponding to SEK 7 149 million) and in euros (corresponding to SEK 4 981 million). The Fund's total currency exposure amounted to SEK 16 183 million, corresponding to 10.2 percent of Fund capital (eight percent). In accordance with the guidelines governing the Fund's investment activities, no more than 30 percent of the portfolio's fair

value could be invested in foreign equities and securities without hedging in 2004.

The net of unrealised changes in value amounted to SEK 10 166 million (20 660). This profit is in all essential respects attributable to a net gain of SEK 8 429 million on listed equities and derivative instruments, and is explained by the upswing noted by global stock markets during the year.

Fixed-income securities and fixed-income derivatives generated an unrealised gain of SEK 1 323 million.

Unlisted equities and participations generated an unrealised net gain of SEK 414 million, attributable to the Fund's holdings in unlisted real-estate companies and unlisted funds.

Operating expenses

The Fund's operating expenses amounted to SEK 330 million (234), the cost of asset management corresponding to 0.22 percent of the Fund's average total investment capital during the year. Personnel costs accounted for SEK 64 million of this sum (62), other management costs accounting for a further SEK 68 million (62). The cost of external asset management services, including management fees for listed and unlisted funds, amounted to SEK 198 million (110). The level of costs for external asset management services is primarily dependent on the extent and nature of such services (active or passive management). As at December 31st 2004, the Second AP Fund had portfolio assets under both active and passive external management. Of these, assets totalling SEK 59 billion were under external management, of which 78 percent under active management.

Balance sheet

Amounts in SEK million	Note	Dec. 31 2004	Dec. 31 2003
ASSETS			
Equities and participations			
Listed	7	88 844	77 263
Unlisted	8	2 267	4 016
Bonds and other fixed income assets	9	63 223	54 718
Derivative instruments	10	2 278	2 717
Cash and bank balances		1 193	1 562
Other assets	11	103	16
Prepaid expenses and accrued income	12	1 289	1 257
TOTAL ASSETS		159 197	141 549
FUND CAPITAL AND LIABILITIES			
Liabilities			
Derivative instruments	10	741	1 018
Other liabilities	13	214	86
Accrued expenses and deferred income	14	122	95
Total liabilities		1 077	1 199
Fund capital			
	15		
Fund capital at beginning of year		140 350	117 090
Net contributions within the national pension system		1 397	2 143
Transferred from special funds and liquidation fund		254	424
Net profit for the year		16 119	20 693
Total fund capital		158 120	140 350
TOTAL FUND CAPITAL AND LIABILITIES		159 197	141 549
Memorandum items			
Other assets pledged	16	818	679
Obligations	17	2 157	1 411

Comments to the balance sheet

Investment assets

At year-end 2004, the fair value of "Listed equities" amounted to SEK 88.8 billion (77.3). The Fund's equities portfolio comprised Swedish equities with a fair value of SEK 31.3 billion and foreign equities with a fair value of SEK 48.5 billion. During 2004, the Second AP Fund continued to invest in a number of external Swedish and foreign unit trusts, focused on specific sectors of the equities market, such as emerging markets. The fair value of these funds was SEK 9.0 billion by year-end.

At the close of 2004, the Fund's unlisted real estate holdings consisted of AP Fastigheter Holding AB and NS Holding AB. The two companies reported fair values of SEK 0.9 billion (3.2) and SEK 0.7 billion (0.5) respectively. During the year, equity holdings in AP Fastigheter Holding AB were converted into a promissory note loan, resulting in a dramatic reduction in the acquisition value and fair value of the equities. During the report period, the promissory note loan was redeemed in an amount of SEK 500 million. Fair value totalled SEK 2 000 million by year-end.

The Fund owns a convertible debenture in NS Holding AB, of which the fair value, including accrued interest, amounted to SEK 931 million (858) at year-end.

Investment in funds for unlisted equities has continued during the year, with a new investment in Pathway Private Equity Fund. Supplementary investments have also been made in previously capitalised commitments. In 2004, new and supplementary investments, excluding management expenses, totalled SEK 339 million. Remaining investment commitments in funds for unlisted holdings totalled SEK 2 157 million at year-end. The total fair value of unlisted equity holdings amounted to SEK 2 267 million (4 016).

Derivative instruments

In the balance sheet, the fair values of all outstanding derivative instruments are declared gross, regardless of type. Derivatives with a positive fair value amounted to SEK 2 278 million (2 717), while those with a negative value amounted to SEK 741 million (1 018).

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 2004, the volume of currency forwards traded totalled SEK 100.8 billion (93.6).

In the case of the equities and fixed income portfolios, equity index futures and bond 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 in London, and outstanding volume at year-end amounted to SEK 2.9 million (3.9) in bond futures and SEK 12.0 billion (9.1) in equity index futures.

Trading in stock and interest rate options has been limited in 2004.

Fund capital

Fund capital totalled SEK 158 120 billion (140 350). 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 gain of SEK 16 449 million (20 927), with operating expenses of SEK 330 million (234).

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 1 397 million (2 143) in 2004. A retro-active adjustment of pension disbursements was implemented during the year, pertaining to the years 1999-2002, as a result of which the Second AP Fund repaid a total of SEK 400 million to the National Social Insurance Board (RFV). In addition to these capital flows, transfers were made to the Fund from the assets of the former national pension system, currently under liquidation, and held in the form of special funds and a Liquidation Fund, administered by the First and Fourth AP Funds. Transfers made from these funds during the year have amounted to SEK 129 million (394) and SEK 125 million (30) respectively.

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 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 fair value. This fair 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 fair value. The fair value 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/fair 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 (repa), 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 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 2004	Jan-Dec 2003
Interest income		
Bonds and other fixed income assets	2 418	2 154
Derivative instruments	576	921
Other interest income	19	45
Total interest income	3 013	3 120
Interest expenses		
Derivative instruments	-330	-180
Other interest expenses	-51	-25
Total interest expenses	-381	-205
Net interest income/expense	2 632	2 915

NOTE 2 Capital gains/losses, net

Amounts in SEK million	Jan-Dec 2004	Jan-Dec 2003
Equities and participations		
Listed	1 955	-3 580
Unlisted	-	-439
Bonds and other fixed income assets	311	455
Derivative instruments	853	1 898
Total capital gains/losses, net	3 119	-1 666

NOTE 3 Unrealized changes in value

Amounts in SEK million	Jan-Dec 2004	Jan-Dec 2003
Equities and participations		
Listed	8 466	20 310
Unlisted	414	168
Bonds and other fixed income assets	1 330	-163
Derivatives	-44	345
Unrealized changes in value, net	10 166	20 660

NOTE 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 capital between external mandates and in-house asset management as at Dec. 31st 2004 (SEK m):

Mandate		Benchmark index	Average capital under management, 2004	Fair value, Dec. 31st 2004*	Share of Fund capital, %	External asset management expense
External management mandate						
Equities mandate						
Active management						
SHB	Swedish equities	SBX	1 777	1 895		
SEB	Swedish equities	SBX	2 531	2 702		
SEB	Swedish equities - equally weighted, terminated	OSX	1 018	–		
Carlson	Swedish equities, terminated	SBX	4 717	–		
Carlson	Swedish equities - equally weighted, terminated	OSX	983	–		
Carnegie	Swedish equities - equally weighted, terminated	OSX	1 265	–		
Öhman	Swedish equities - equally weighted	OSX	1 209	1 327		
MFS	Global equities	MSCI World	3 991	4 089		
Merrill Lynch	Global equities	MSCI World	2 442	2 453		
Citigroup	European equities - sector mandates, terminated	MSCI Europe – sector index	1 442	–		
Goldman Sachs	European equities - sector mandate, terminated	MSCI Europe – sector index	774	–		
Crédit Agricole	European equities - sector mandate, terminated	MSCI Europe – sector index	719	–		
Deutsche Asset Management	European equities - sector mandate	102	98			
Deutsche Asset Management	Europeiska aktier - sector mandate	MSCI Europe – sector index	266	267		
Barclays Global Investors Ltd.	European equities	MSCI Europe	4 149	4 340		
Barclays Global Investors Ltd.	North America - Equities	MSCI North America	9 758	9 586		
Singer & Friedlander	Asia excl. Japan - Equities	MSCI Pacific excl. Japan	1 538	1 642		
Bankinvest	Asia excl. Japan - Equities	MSCI Pacific excl. Japan	988	1 003		
Bankinvest	Japan – Equities	MSCI Japan	1 791	1 744		
Martin Currie	Japan – Equities	MSCI Japan	2 835	2 772		
Total			44 295	33 918	22	111
Passive management						
State Street Global Advisor UK Ltd.	Global equities	MSCI World	2 674	2 683		
Barclays Global Investors Ltd.	North America - Equities	MSCI North America	8 882	7 452		
Summa:			11 556	10 135	6	3
Fixed income mandate						
Total external management mandate			55 851	44 053	28	114
Investments in listed external funds						
Unit trusts	as per respective fund		8 076	8 645		
Fixed-income and hedge funds	as per respective fund		6 435	5 803		
Total investments in listed external funds			14 511	14 448	9	50
Investments in private equity funds						
Unlisted equities and participations						
in private equity funds	Private equity funds		354	638		
			354	638	0	34
Total external capital assets under management, and management expenses			70 716	59 139	37	198
In-house management mandates						
Listed equities and participations	SBX, OSX, MSCI			37 449		
Fixed income mandate, Swedish	SHB			32 100		
Fixed income mandate, foreign	Lehman			18 516		
Cash and bank balances, incl. deposits and accrued interest					6 217	
Unlisted real estate holdings, incl. subordinated debentures				4 717		
Total capital assets managed in-house					98 999	63
Other assets and liabilities				-18	0	
Total Fund capital				158 120	100	

* Fair value including liquidity allocated for external mandates, and fair value including derivative instruments and interest accrued for in-house asset management.

NOTE 5 Personnel costs

Amounts in SEK k

	Jan-Dec 2004		Jan-Dec 2003	
	Men	Women	Men	Women
Average no. of employees	33	17	29	17
No. of employees, Dec. 31*	28	16	26	13
No. of persons in Executive Management Group, Dec.	4	2	3	2
Salaries and remuneration				
Chairman of the Board		100		100
CEO		2 657		2 747
Board of Directors, excl. Chairman		415		400
Executive Management Group, excl. CEO		6 948		7 070
Other employees		29 054		24 257
Salaries and remuneration, total		39 174		34 574
Variable remuneration				
CEO		-		-
Executive Management Group, excl. CEO		-		-
Other employees		-		-
Variable remuneration, total		-		-
Remuneration to Members of the Board, in addition to directors' fees		-		-
Pension costs (incl. special employer's contribution)				
CEO		-430**		1 444
Executive Management Group, excl. CEO		1 799		1 929
Other employees		7 483		7 979
Pension costs, total		8 852		11 352
Payroll overhead				
Chairman		33		33
CEO		895		967
Board of Directors, excl. Chairman		145		131
Executive Management Group, excl. CEO		2 351		2 529
Other employees		9 657		7 786
Total payroll overhead		13 081		11 446
Other personnel costs		2 962		4 682
Total personnel costs		64 069		62 054

* At the close of 2004, the Fund had a staff of 49, of whom 44 were full-time employees.

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.

New terms as of January 2004

As of January 2004, an individual retirement pension insurance policy has been taken out, to apply from a pensionable age of 65 years, with an annual premium corresponding to 34 percent of the agreed salary set each year (i.e. a pension benefit with an agreed premium). If employment is terminated as a result of dismissal by the Fund, the CEO is entitled to receive pension benefits from the Fund from age 60 until he reaches 65. In accordance with the agreement, the size of this pension corresponds to the number of years employed by the Second AP Fund.

** With respect to 2004, the conversion from a benefit-based to premium-based pension policy has resulted in a liquidation of the provisions made in previous years. Consequently, the pension cost for 2004 appears as income.

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 eighteen months' salary, in addition to salary paid during the six-month period of notice, less income from an eventual 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 Deputy Chairman of the Board. The Second AP Fund has not appointed a remunerations committee.

Other directorships held by Members of the Board

See page 68.

Absence due to illness

In 2004, absence attributable to illness at the Second AP Fund was 0.48 percent, calculated as a percentage of total days 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 was 0.26 percent for male employees and 0.86 percent for female employees.

NOTE 6 Other administrative expenses

Amounts in SEK million	Jan-Dec 2004	Jan-Dec 2003
Rental expenses	6	4
IT and computer expenses	26	22
Purchased services	23	22
Other expenses	13	14
Total other administrative expenses	68	62

"Purchased services" includes fees to auditors amounting to SEK 1 million (SEK 3 million).

Audit assignments

KPMG	0.93	1.87
PricewaterhouseCoopers	0.24	0.56

Other assignments

KPMG	0.19	0.15
PricewaterhouseCoopers	0.07	-

Total	1.43	2.58
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NOTE 7 Listed equities and participations¹⁾

Amounts in SEK million	Dec. 31st 2004		Dec. 31st 2003	
	Fair value	Acquisition-value	Fair value	Acquisition-value
Swedish equities	31 273	29 471	25 643	27 278
Foreign equities	48 527	53 398	44 956	52 776
Participations in Swedish funds	3 728	2 527	4 040	3 019
Participations in foreign funds	5 316	4 492	2 624	2 198
Total listed equities and participations	88 844	89 888	77 263	85 271

¹⁾ The twenty largest Swedish and foreign shareholdings, by value, are listed on page 66. A complete list of Swedish holdings may be found on the Fund's website at www.ap2.se

NOTE 8 Unlisted equities and participations

		Dec. 31st 2004			
Amounts in SEK million	Corp. reg.	No. of equities	Participation right, capital	Participation right, votes	Acquisition value
Swedish equities and participations					
AP Fastigheter Holding AB	556650-4196	1 000 000	25%	25%	721
NS Holding AB	556594-3999	1 213 256	33%	33%	372
Swedestart Life Science KB	969675-2337		5%		11
Swedestart Tech KB	969674-7725		3%		11
EQT Northern Europe KB	969670-3405		1%		118
Foreign equities and participations					
Carnegie Fund II BiotechBridge			29%		47
Nordic Capital V, L.P.			3%		145
EQT Mezzanine L.P.			16%		43
Cevian Capital L.P.			22%		176
Pathway Private Equity Fund IX, LLC			99%		32
Total unlisted equities and participations					1 676
Total fair value					2 267

NOTE 9 Bonds and other fixed income assets

Amounts in SEK million	Dec. 31st 2004		Dec. 31st 2003	
	Fair value	Acquisition value	Fair value	Acquisition value
Swedish State	19 773	18 309	18 363	17 718
Swedish housing finance institutes	9 857	9 617	8 704	8 611
Other Swedish issuers				
Finance companies	82	78	100	96
Non-finance companies	4 170	3 934	1 679	1 514
Foreign states	12 801	13 350	12 059	12 715
Other foreign issuers	10 241	10 991	10 913	11 673
Demand loans	6 299	6 290	2 900	2 902
Total	63 223	62 569	54 718	55 229
Inflation-linked bonds	8 111	7 104	6 666	6 129
Other bonds	40 904	41 051	38 912	39 777
Certificates	-	-	23	23
Participations in Swedish index-linked funds	530	520	104	100
Participations in foreign index-linked funds	4 465	4 893	5 270	5 587
Other instruments	2 914	2 711	843	711
Demand loans	6 299	6 290	2 900	2 902
Total	63 223	62 569	54 718	55 229

NOTE 10 Derivative instruments

Amounts in SEK million		Face value*	Dec. 31st 2004 Derivative instruments with positive fair value	Derivative instruments with negative fair value
Currency-related instruments				
Forward contracts		100 796	2 098	683
Total		100 796	2 098	683
of which cleared		–		
Equities-related instruments				
Options	Held	90	6	–
	Issued	117	–	1
Forward contracts		11 955	130	9
Total		12 162	136	10
of which cleared		11 955		
Fixed income instruments				
Forward contracts		2 920	1	5
Total		2 920	1	5
of which cleared		2 920		

*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 42 for a description of the types of derivative instrument employed and the risks that can be managed with derivatives.

NOTE 11 Other assets

Amounts in SEK million	Dec. 31st 2004	Dec. 31st 2003
Incoming payments, unsettled transactions	99	14
Other receivables	4	2
Total	103	16

NOTE 12 Prepaid expenses and accrued income

Amounts in SEK million	Dec. 31st 2004	Dec. 31st 2003
Income accrued	1 159	1 145
Refunds	40	38
Dividends accrued	66	56
Other prepaid expenses and accrued income	24	18
Total	1 289	1 257

NOTE 13 Other liabilities

Amounts in SEK million	Dec. 31st 2004	Dec. 31st 2003
Outgoing payments, unsettled transactions	201	80
Accounts payable	11	5
Other liabilities	2	1
Total	214	86

NOTE 14 Accrued expenses and deferred income

Amounts in SEK million	Dec. 31st 2004	Dec. 31st 2003
Management fees	68	41
Accrued interest expenses on currency forwards	34	35
Other accrued expenses	20	19
Total	122	95

NOTE 15 Fund capital

Amounts in SEK million	Dec. 31st 2004	Dec. 31st 2003
Opening fund capital	140 350	117 090
Net payments to the national pension system		
Payments from RFV of pension contributions received	42 904	41 271
Transfer of pension entitlements from EU	-	-
Payment to RFV for disbursement of pension benefits	-40 696	-38 852
Transfer of pension entitlements to EU	-95	0
Adjustment of pension entitlements	-4	5
Non-recurring adjustment for period 1999-2002	-400	-
Remuneration to RFV for administration expenses	-312	-281
Total net payments to the national pension system	1 397	2 143
Transferred from First AP Fund's liquidation fund	129	394
Transferred from Fourth AP Fund's special fund	125	30
Total transferred from liquidation fund/special fund	254	424
Net result for the year	16 119	20 693
Closing fund capital	158 120	140 350
Capital assets under management of First AP Fund's liquidation fund	4 924	5 214
Capital assets under management of Fourth AP Fund's special fund	806	1 291

Copies of the annual reports of the Liquidation Fund and Special Fund are available on request from the First and Fourth AP Funds respectively.

NOTE 16 Other pledged assets

Amounts in SEK million	Dec. 31st 2004	Dec. 31st 2003
Collateral for forward transactions	507	679
Securities pledged for which guarantees have been secured*		
Securities pledged	311	-
Total	818	679

* Guarantees secured for securities pledged 327 (-).

NOTE 17 Obligations

Amounts in SEK million	Dec. 31st 2004	Dec. 31st 2003
Obligations re. future payments		
Investment obligations, unlisted holdings	2 157	1 411
Total	2 157	1 411

The administration report, income statement, balance sheet and notes for 2004 have been approved
by the Board of Directors.

Gothenburg, February 10th, 2005

Kurth Augustson

Gunnar Larsson
Chairman

Bo Dockered

Märtha Josefsson

Clas Nykvist

Roland Svensson

Eva Persson

Eva Fernvall-Markstedt

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 2003. 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 10th 2005

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

The Second AP Fund's 20 largest Swedish shareholdings¹⁾

Name of company	Share of equity, %	No. of equities	Fair value, SEK m	Share of voting rights, %	Sector
Ericsson B	1.14	183 237 582	3 885	0.68	Information Technology
Ericsson A	0.02	2 613 571	57	0.10	Information Technology
Swedish Handelsbanken A	2.24	16 018 309	2 771	2.44	Financials
Volvo A	1.46	6 448 945	1 635	3.82	Industrials
Volvo B	0.35	1 564 620	412	0.09	Industrials
Hennes & Mauritz B	1.01	8 380 507	1 940	0.49	Consumer Discretionary
Nordea	0.97	27 510 024	1 843	0.97	Financials
Electrolux B	3.30	10 181 872	1 548	2.58	Consumer Discretionary
SCA B	1.94	4 554 656	1 291	0.76	Raw Materials
SCA A	0.18	412 864	118	0.69	Raw Materials
Astra Zeneca Plc	0.36	5 829 536	1 407	0.36	Healthcare
Föreningssparbanken A	1.54	8 130 353	1 346	1.54	Financials
TeliaSonera	0.57	26 653 213	1 061	0.57	Telecommunication Services
Skandia	2.92	29 931 493	991	2.92	Financials
Sandvik	1.16	3 064 684	821	1.16	Industrials
Atlas Copco B	0.87	1 833 979	509	0.12	Industrials
Atlas Copco A	0.47	975 023	293	0.66	Industrials
Skandinaviska Enskilda Banken A	0.79	5 548 791	713	0.82	Financials
Investor B	0.01	5 793 181	490	0.00	Financials
Investor A	0.00	1 381 954	117	0.00	Financials
Assa Abloy B	1.31	4 798 534	545	0.89	Industrials
Castellum	5.07	2 179 212	519	5.07	Financials
Skanska B	1.42	6 045 011	482	0.81	Industrials
Securitas B	1.03	3 773 464	430	0.73	Industrials
Nokia	0.07	3 534 884	370	0.07	Information Technology
Tele 2	0.89	1 312 379	343	0.46	Telecommunication Services

The Second AP Fund's 20 largest foreign shareholdings¹⁾

Name of company	No. of equities	Fair value, SEK m	Sector
BP Amoco Plc	10 063 062	652	Energy
Citigroup Inc	1 807 215	579	Financials
General Electric Co	2 365 984	574	Industrials
Vodafone Group Plc	31 700 566	571	Telecommunication Services
Johnson & Johnson	1 166 370	492	Healthcare
Exxon Mobil Corp	1 433 030	488	Energy
HSBC Holdings	4 285 302	481	Financials
Royal Bank of Scotland	2 063 173	461	Financials
Total SA	307 911	450	Energy
UBS AG	789 901	442	Financials
Bank of America Corp	1 360 638	425	Financials
Microsoft Corporation	2 178 031	387	Information Technology
Novartis	1 141 941	384	Healthcare
GlaxoSmithKline Plc	2 389 919	373	Healthcare
Intel Corporation	2 248 877	350	Information Technology
BNP Paribas	716 812	346	Financials
Cisco Systems	2 633 201	338	Information Technology
Royal Dutch Petroleum	838 164	322	Energy
Canon Inc	895 990	321	Information Technology
Roche	415 574	319	Healthcare
Nestle SA -R-	181 862	318	Consumer Staples
Honda Motor Co Ltd	896 200	309	Consumer Discretionary
Telefonica SA	2 393 278	300	Telecommunication Services
JPMorganChase	1 154 474	299	Financials
Home Depot Inc	1 025 328	291	Consumer Discretionary

¹⁾ The above table of Second AP Fund shareholdings lists the 30 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. A complete list of foreign holdings may be ordered from the Second AP Fund.

Second AP Fund holdings in unit trusts, fixed-income and hedge funds

Unit trusts, foreign	No. of equities, participations	Fair value, SEK m
Genesis Emerging Markets	7 725 431	972
Pictet Emerging Markets	433 142	935
StateStreet Emerging Markets	235 932	752
F&C Global Emerging Markets	8 782 764	738
Sustainable Asset Management Fund	760 380	715
Citigroup Emerging Markets	510 945	710
AIG Global Emerging Markets	367 957	495
Skandia Småbolagsfond (small-cap fund)	979 250	85

Unit trusts, Swedish	No. of equities, participations	Fair value, SEK m
SEB Sverige Småbolag (small-cap fund)	49 418 908	655
Carlsson Sverige Småbolagsfond (small-cap fund)	861 790	649
SHB Småbolagsfond (small-cap fund)	2 141 354	633
Lannebo Småbolagsfond (small-cap fund)	22 243 671	367
Robur Småbolagsfond (small-cap fund)	14 890 702	362
Enter Select Fokus	290 732	325
SEB Sverige Småbolag Chans/Risk (small-cap fund)	3 335 490	183

Fixed-income funds, foreign	No. of equities, participations	Fair value, SEK m
BGI Euro Liquidity	327 447 431	2 958
Ishare Investop Corp	1 795 510	1 331

Hedge funds	No. of equities, participations	Fair value, SEK m
DnB Prisma	1 879 674	213
Eikos	1 004	179
Ram One	157 090	148
Zenit	3 815	143
Tanglin	73 509	106
Nektar	56 686	105
GS Global Opp Fund	150 000	100
Lynx	459 348	82
The Finch Neutral Fond	82 043	75
Amplus	250 000	27

The Second AP Fund's holdings in bonds and other fixed-income securities

Global credit portfolio, five largest holdings

Bond	Fair value, SEK m
DB Iboxx Linked Note	538
IBRD 7 5/8 01/23	162
EIB 5 3/8 06/21	149
Ger Bund 4 1/8 07/08	141
KFW 4 1/4 04/05	134

Global government bond portfolio, five largest holdings

Bond	Fair value, SEK m
Ger Obl 4 02/07	586
France OAT 4 1/4 04/19	504
Us Tsy 6 1/4 08/23	389
Ger Bund 4 1/4 01/14	389
Us Tsy 2 5/8 11/06	369

Swedish nominal bond portfolio, five largest holdings

Bond	Fair value, SEK m
Sgb 1041	1 993
Sgb 1044	1 666
Sgb 1037	1 575
Sgb 1045	1 236
Sgb 1043	1 218

Swedish inflation-linked bond portfolio, five largest holdings

Bond	Fair value, SEK m
Sgb 3105	2 318
Sgb 3104	1 700
Sgb 3102	1 622
Sgb 3101	1 270
Sgb 3001	452

Detailed information about the Second AP Fund's holdings in fixed-income securities may be ordered from the Fund.

Board of Directors



Upper row, from left:

Gunnar Larsson

Chairman since 2000.
Chairman of The Swedish Sports Confederation. Chairman of the boards of GöteborgsOperan and Tholin & Larsson-Gruppen AB. Directorships on several boards, including Castellum AB and Norrporten AB. Former authorised public accountant and Municipal Commissioner for Gothenburg. Born 1940.

Bo Dockered

Vice Chairman since 2000.
Chairman of the boards of AB Trav and Galopp and Sveaskog AB. Honorary Doctor of Agronomy (Dr.h.c. Agronomy) and farmer. Born 1941.

Ylva Thörn

Member of the Board since 2000.
President, Swedish Municipal Workers' Union. Chairman of The Public Services International. Directorships on several boards, including LO (The Swedish Trade Union Confederation) and Riksbyggen. Assistant nurse. Born 1954.

Clas Nykvist

Member of the Board since 2000.
Controller, Swedish Building Workers' Union. Directorships on several boards, including Folksam Spar AB. Born 1948.

Märtha Josefsson

Member of the Board since 2003.
Independent investment consultant. Former Investment Director at DnB Asset Management and Carlson Investment Management AB. Directorships on several boards, including Anoto, Ledstjärnan, Luxonen, Skandia Funds and Uppsala Nya Tidning. B.A. Born 1947.

Lower row, from left:

Eva Persson

Member of the Board since 2004.
Member of Volvo's executive management, with responsibility for legal affairs, taxation and security, and Secretary to the board of AB Volvo. Directorship on the board of Handelsbanken Region Väst. Board member of the Industry and Commerce Stock Exchange Committee. LL.B. Born 1953.

Roland Svensson

Member of the Board since 2000.
Former President and CEO of Coop Norden AB and KF Ekonomisk förening. Chairman of the Swedish National Museum of Art. Born 1941.

Kurth Augustson

Member of the Board since 2000.
Former president of SCA Mölnlycke AB and AB Marabou. Directorships on several boards, including Pergo AB, Bergendahlsgruppen, Orrefors Kosta Boda AB and Oy Paulig. M.Sc (Econ). Born 1944.

Eva Fernvall-Markstedt

Member of the Board since 2004.
Chairman of the Swedish Federation of Salaried Employees in the Hospital and Public Health Services, and chairman of the 24/7 Agency Delegation. Deputy chairman of TCO (Swedish Confederation of Professional Employees). Directorships on the boards of SBU (National Drafting Committee for the Evaluation of Medicine) and the National Board of Health and Welfare. Born 1953.

Lars Idermark

Chief Executive Officer since 2000.
Chairman of Handelsbanken Region Väst. Directorships on several boards, including AP Fastigheter AB, Södra Skogsägarna, Swedish Meats and Stiftelsen Chalmers Tekniska Högskola. Born 1957.

Executive management and auditors



Management

Fund management, Second AP Fund

Back row, from left:

Martin Jonasson, General Counsel, born 1964

Margaretha Veres, Personal Assistant to the CEO, born 1945

Lars Idermark, CEO, born 1957

Front row, from left:

Carl Rosén, Head of Corporate Governance and Communications, born 1959

Lena Smeby-Udesen, CFO, born 1961

Petter Odhnoff, CIO, born 1956

Auditors

Anders Bäckström

Authorised Public Accountant, KPMG

Göran Jacobsson

Authorised Public Accountant,

PriceWaterhouse Coopers

Definitions

Absolute return on investment

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

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 classes of asset 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.

Benchmark index

Index based on the Second AP Fund's strategic portfolio, against which the Fund's management performance is measured.

Enhanced index mandate

Management of assets at low risk, with a targeted return of between 0.5 and one percent above index.

Fair value

Fair value is defined as the amount for which an asset may be transferred or a debt settled, between parties who are mutually independent and who have a vested interest in completing the transaction. Normally speaking, this means that listed assets are valued at the buying-rate (market value) and that the fair value of unlisted assets is estimated with the help of generally accepted valuation models.

Interaction

Interaction is a consequence of the interplay between strict allocation of assets and strict choice of securities.

Quantitative management

Portfolio management that focuses on exposing incorrect market pricing with the help of a mathematical model.

Relative return

The difference in the return generated by a portfolio and its benchmark index.

Strategic portfolio

The Second AP Fund's strategic portfolio is determined annually by the Board of Directors and confirms the Fund's decision on strategic asset allocation. It also serves as the benchmark portfolio in the day-to-day management of the Fund's capital assets.

Total return

Calculated arithmetically and time-weighted.

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 counterpart risk

"Credit risk" refers to the risk that an issuer may become insolvent or be awarded a lower credit rating. "Counterpart risk" refers to the risk that the other party may be unable to meet its business 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

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

Where R_f = risk-free interest and
 σ_p = standard deviation for return on portfolio

Relative return

Excess return = $R_p - R_i$

Where R_i = return against index

Tracking Error (active risk)

Standard deviation relative to return = $\sigma_p - \sigma_i$

Risk-adjusted relative return

Information ratio = $\frac{R_p - R_i}{\sigma_p - \sigma_i}$



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