



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

# **Half-year report**

## **January 1 – June 30 2011**

# Positive result despite turbulent market

The SEK 5 billion return on invested assets achieved during the first half of 2011 increased the Fund's total capital assets to SEK 227.5 billion. The Fund posted a total return, excluding costs, of 2.4 percent. Relative to benchmark index, return was 0.1 percent, excluding alternative investments and costs.

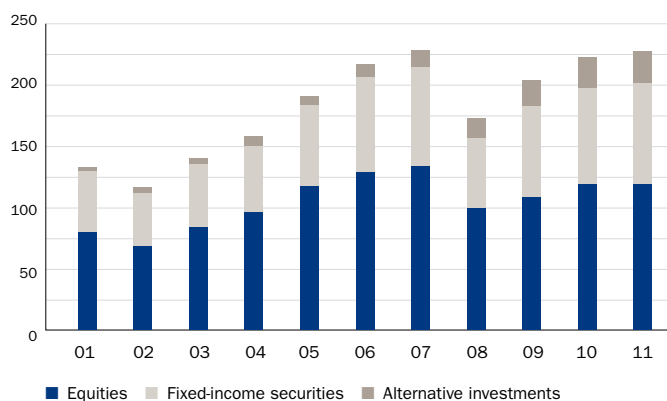
- The Second AP Fund's assets under management amounted to SEK 227.5 (204.8) billion as of June 30 2011.
- The Fund posted a first-half net result of SEK 5 (2.5) billion.
- The Fund's return on the total portfolio was 2.4 (1.3) percent, excluding commission costs and operating expenses. Including these costs, the portfolio generated a return of 2.3 (1.2) percent.
- The Fund achieved an active return of 0.2 (0.4) percent. The relative return for the portfolio of quoted assets, including implementation effects but excluding alternative investments, commission costs and operating expenses, was 0.1 (0.4) percent.

- The Fund's level of currency exposure was 18 percent.
- During the first half, the Fund implemented a significant reallocation of assets, from Swedish equities and fixed-income securities to equities and credit instruments on emerging markets.
- During the report period, the Fund has formed a joint real-estate company in association with the First AP Fund, focused on investment in European real estate. The Fund has also established a joint company with US pension fund TIAA-CREF, for investment in agricultural real estate in the US, Australia and Brazil.

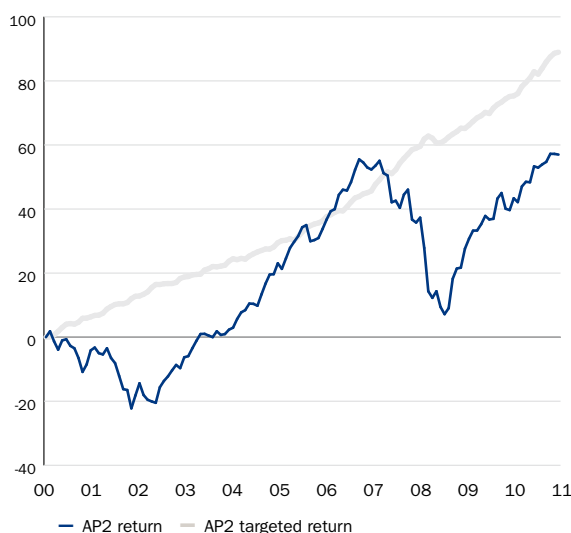
## Events after close of report period

Since the close of the report period, the turbulence on financial markets has intensified. This has not led to any new changes in the Fund's strategic portfolio. The Fund will continue to further diversify the portfolio, with a view to diminishing its sensitivity to the volatility of the equities market.

**Fund capital growth, 2001 – June 30 2011, SEK billion**  
(including a net inflow to the Fund of SEK 13.1 billion)



**Accumulated return, %**



Figures in parentheses refer to the corresponding values for June 30 2010. Unless otherwise stated, the portfolio assets referred to in this report are 'allocated exposures'. In addition to booked market values, these also refer to allocated (not yet invested) capital for the specific class of asset, and other assets 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 market values. All monetary amounts are expressed in Swedish kronor and abbreviated as SEK k (thousand), SEK million or SEK m (million) and SEK billion or SEK bn (thousand billion). Figures in parentheses refer to the preceding year.

\*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, where space requires, AP2.

# Chief Executive's review

The Second AP Fund's net result for the first half of 2011 amounted to SEK 5 billion, increasing Fund capital to SEK 227.5 billion. During the first six months of the year, the financial markets have experienced considerable volatility. This has derived primarily from a rise in oil prices, a consequence of political uncertainty and conflicts in North Africa, the economic repercussions of the Japanese earthquake and ongoing worries about sovereign debt within the eurozone. These factors have all served to increase uncertainty concerning the prospects for economic recovery in the West, resulting in the fluctuating price of many assets.

## Continued volatility

In July and August, the volatility experienced by financial markets has intensified still further. This has not caused us to make any new changes in our strategic portfolio. Nevertheless, we continue to implement the changes planned earlier, in line with the fundamental long-term strategy adopted for the management of our assets. This is especially important when the situation is so fluid and unpredictable.

A well diversified portfolio is absolutely essential in increasing the stability of our future return on assets. During the spring, as part of this strategy, we implemented the most significant change in our strategic portfolio to date, involving a comprehensive reallocation of assets from Swedish equities and fixed-income securities to equities and credit instruments on emerging markets. We believe this will ensure a good spread of risk while offering the prospect of higher returns.

## Alternative investments

During the first half of the year, we have also maintained our strategy of investing in forest and agricultural real estate. These investments are also expected to reduce volatility within the portfolio, given the fact that they have so far exhibited low covariance with other classes of asset, such as equities. We have formed a joint real-estate company in association with the First AP Fund, which will invest in European real estate. This joint project received an international award at the IPE Real Estate Awards ceremony.

We have also established a company in collaboration with US pension fund TIAA-CREF, which will focus on joint investment in agricultural real estate in the US, Australia and Brazil. During the first six months of this year, our alternative investments generated a return of 7.6 percent.

## AP Funds only a small part of the pension system

From an international perspective, Sweden has so far managed well during this period of financial turbulence. Our national pension system enjoys a high degree of stability, since it reflects the state of the economy at large.

Within this context, the extent to which the AP Funds develop is important, although they account for no more than approximately 10 percent of the national pension system's total assets. Most important to the future development of pensions is to create the right conditions for solid economic growth, and to ensure an increase in employment levels. Then can pensions develop in pace with salaries.

## AP Fund investment regulations

The Pensions Group has been commissioned to review AP Fund investment regulations, among other things. We have had ongoing discussions with our principal, concerning the need to review these investment regulations, over several years now, and therefore welcome the planned review. We believe that revised investment regulations could help us create a more stable and higher return on invested assets. We share the Swedish Government's conviction that, for the long-term investor, real estate, infrastructure and other types of illiquid assets can offer an interesting combination of risk and return, when compared with conventional investment in quoted equities and bonds.

## Greater diversity

Our annual female representation survey, the Female Representation Index, reveals that the number of women active on the boards and managements of publicly quoted Swedish companies is on the rise, which is encouraging. This said, the rise is nevertheless from a very low level. We are keen to participate in a down-to-earth debate about how the percentage of women represented on the boards of quoted companies can be increased.

We are also interested in broader issues concerning diversity, such as age, background, experience and competence. The reason is simple. We are convinced that a broader recruitment base enhances prospects for creating better boards of directors and managements that in their turn can create better and more valuable companies.

#### **Looking ahead**

At time of writing, there are few signs that the volatility and uncertainty currently affecting financial markets is going to disappear. Even so, I believe that the Second AP Fund, which celebrates its tenth anniversary this year, has a portfolio that is well conceived with respect to its long-term investment goals, has competent and committed staff, and is therefore well equipped to face the future.

Eva Halvarsson  
CEO

# Asset-class performance

The first half of 2011 was a turbulent time on financial markets. The cumulative effect of rising oil prices in the wake of political uncertainty and conflicts in North Africa, the knock-on effects of the Japanese earthquake and continued anxiety about sovereign-debt problems in the eurozone fuelled uncertainty about the prospects for economic recovery in the West, with consequent fluctuations in the rates at which many assets were traded.

Growth in the emerging countries was to a great extent determined by anxiety over the risk of economic overheating and inflation. During the first half of the year, fixed-income investments in the Western economies generally generated a better return than those in Swedish and foreign equities. However, the Fund's alternative investments have noted the best individual return within the portfolio since the start of the year.

## Swedish equities

Swedish equities are managed in four separate portfolios, each with its own benchmark index. During the first half, Swedish equities under management generated a combined return of -0.9 percent, outperforming the benchmark index by 0.3 percentage units. The Fund's fundamental active in-house management of Swedish equities outperformed index by 0.4 percentage units.

The broad quantitatively managed portfolios are invested at low active risk, to reflect index. These asset classes outperformed index by a small margin. The management of small caps outperformed index by 0.6 percentage units.

## Foreign equities

Management of foreign equities generated an overall negative return of -0.9 percent during the first half of the year, prior to currency hedging, which was nevertheless an improvement of 0.2 percentage units against index. The Fund's quantitative in-house management of equities, which embraces a large part of the foreign equities under management, outperformed the benchmark index in all subsidiary portfolios. The performance of portfolios managed actively under external mandates was mixed, where the management of emerging market equities was especially notable for failing to achieve targeted returns. During the report period, the Fund implemented a major reallocation of portfolio

assets, from Swedish equities to emerging market equities. These have been benchmarked against index.

## Fixed-income securities

The Fund's portfolios of fixed-income securities generated a return of 0.8 percent, prior to currency hedging, underperforming benchmark index by 0.1 percentage units. The portfolio of Swedish government securities under in-house management failed to outperform benchmark index, in contrast to the portfolio of foreign government securities, which outperformed index by 0.6 percentage units.

The external credit mandates achieved mixed results, while investments in foreign emerging-market instruments in hard currency noted a positive relative return. At the end of June, the Fund invested in four new mandates, focused on emerging-market instruments in local currency. The active return on these investments was affected by the fact that the close of the first half coincided with the investment of capital in these markets.

## Alternative investments

Just over SEK 25 billion of Fund capital, about 11 percent, is invested in 'alternative assets'. At the close of the first half of 2011, 50 percent of these assets comprised real estate, 30 percent private-equity funds and 20 percent convertible bonds. During this period, including currency hedging, these alternative investments generated a return of 7.6 percent.

## Private-equity funds

The Fund is committed to a total of 41 investments in private-equity funds, involving 24 fund managers. Combined investment commitments amounted to SEK 14.0 billion at the close of the first half. Of this sum, SEK 8.9 billion has already been invested, of which SEK 828 million during the first six months of 2011. Four new commitments involving a total investment of SEK 853 million have been made during the period. The Fund's investments in private equity are still at a relatively early stage, which is why only SEK 299 million has been repaid so far this year. The market value of the Fund's private-equity assets amounted to SEK 7.9 billion at the close of the first half, compared to SEK 7.2 billion at the start of the year. After currency hedging, these private-equity funds generated a return of 9.5 percent during the period.

### Real estate

The Fund's exposure in real estate consists of its portfolio of quoted shares and holdings in the unquoted real-estate companies Norrporten (50 percent) and Vasakronan (25 percent). The Fund's unquoted real-estate investments posted a combined return of 8.5 percent for the first half of the year.

The market value of its participation in Vasakronan amounted to SEK 7.4 billion, while the Norrporten holding was valued at SEK 4.9 billion. The return on investment in Vasakronan was 10.4 percent and, in Norrporten, 5.6 percent. These returns correspond well to the general trend in real estate (especially with respect to urban areas, led by Stockholm), characterized by a decline in vacant properties, increased rent levels and a growing appetite for investment in real estate. The Fund also has investments in forest and agricultural real estate, amounting to SEK 0.3 billion.

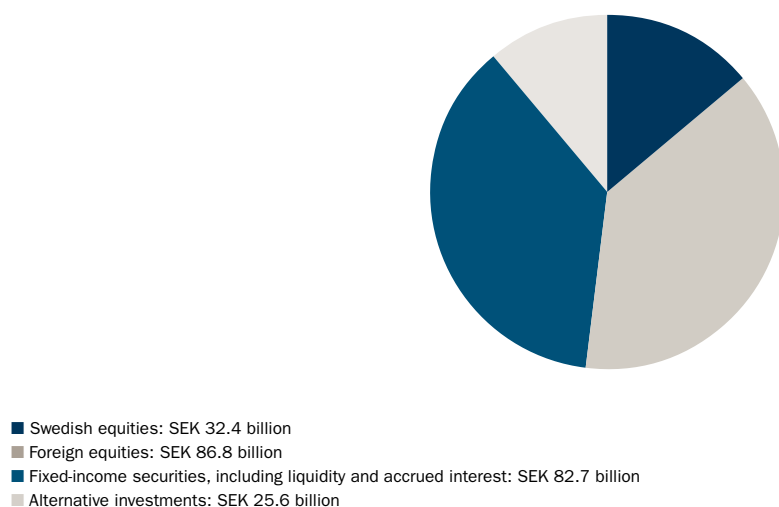
During the report period, the Fund decided to invest EUR 250 million in a joint venture with the First AP Fund, focused on investment in European real estate. Furthermore, the Fund decided to invest USD 250 million in a joint

venture with US pension fund TIAA-CREF, with a view to acquiring agricultural real estate in the US, Australia and Brazil. Both these companies are still in the establishment phase and no investments were made during the period.

### Convertible bonds

During 2009, the Fund invested in convertible bonds, which were then considered to offer solid opportunities for returns on a par with equities, while simultaneously ensuring a diversification of the Fund's relatively high level of investment in equities. During the first half of 2011, the Fund's holdings in convertible bonds generated 3.2 percent, after currency hedging. At the close of this first six months, these convertibles had a combined market value of SEK 5.2 billion, including currency hedging. During the report period, this investment in convertible bonds ensured improved diversification of the overall portfolio and outperformed the return generated by the Fund's broad investments in equities and fixed-income securities.

Second AP Fund portfolio, June 30 2011



### Currency exposure

The Fund's combined exposure in foreign currencies amounted to 18 percent at the close of the first half. The consequences of the hedging strategy on the net result, designed to reduce Fund risk deriving from currency exposure, is reported only as an overall total for the Fund. This amounted to +1.8 percent for the report period.

### Implementation effects

The Second AP Fund defines costs and income attributable to the implementation and rebalancing of the strategic portfolio as 'implementation effects'. These effects, apart from those relating to rebalancing transactions, can arise from positions taken in futures, in connection with foreign exchange transactions and from weighting deviations between indices. During the first half of 2011, the sum of these effects was -0.04 percent. This figure is pleasingly low, in light of the fact that the Fund had completed a major reallocation of the assets in its portfolio, from Swedish equities and fixed-income securities to emerging-market equities and bonds.

#### Composition of strategic portfolio, share of portfolio and return, June 30 2011

Asset class	Strategic portfolio, %	Share of portfolio, %	Market worth, SEK bn	Absolute return, %	Relative return, %	Active risk ex post*, %
Swedish equities	14.0	14.2	32.4	-0.9	0.3	0.4
Foreign equities	38.0	38.1	86.8	-0.9	0.2	0.4
Fixed-income securities, incl. liquidity and accrued interest	37.0	36.4	82.7	0.8	-0.1	0.3
<b>Total quoted assets, excl. alternative investments and costs</b>				<b>1.8</b>	<b>0.1</b>	<b>0.2</b>
Alternative investments	11.0	11.3	25.6	7.6		
<b>Total Fund capital, excl. commission costs and operating expenses</b>	<b>100.0</b>	<b>100.0</b>	<b>227.5</b>	<b>2.4</b>		

\*Historical outcome, 12 months rolling

#### Contributions to absolute and relative return

	Contribution to absolute return, %	Contribution to relative return, %
Swedish equities	-0.2	0.1
Foreign equities	-0.2	0.1
Fixed-income securities, including liquidity and accrued interest	0.4	0.0
GTAA	0.0	0.0
Overlay	0.0	
FX Hedge	1.8	
<b>Total market-quoted assets, excl. alternative investments and implementation effects</b>	<b>1.8</b>	<b>0.2</b>
Implementation effects*		0.0
<b>Total market-quoted assets excl. alternative investments and incl. implementation effects</b>	<b>1.8</b>	<b>0.1</b>
Alternative investments	0.6	
<b>Total assets, excl. commission costs and operating expenses</b>	<b>2.4</b>	

\* Impact on result deriving from maintained exposure to strategic portfolio.

## Costs linked closely to volume of – and growth in – managed assets

The costs incurred in managing Fund assets vary in character and are therefore also subject to a range of different factors and strategic decisions. The Fund's costs primarily comprise four distinct categories: costs related to the volume of assets under management, the costs of exposure as per the strategic portfolio, the costs of in-house asset management and other costs (see diagram below).

Legislation requires that at least ten percent of the AP Funds' capital assets be managed under external mandates. As at June 30 2011, 28 percent of Second AP Fund assets were under external management, a percentage that reflects a clearly defined management strategy. The Fund employs external fund managers for classes of asset and markets that offer the prospect of solid returns, or in cases where the Fund lacks the appropriate resources. In the current year, the Fund has chosen external management for the following areas: Swedish small caps, global equities and credit mandates, global TAA (Tactical Asset Allocation) mandates and equity and fixed-income mandates in emerging markets.

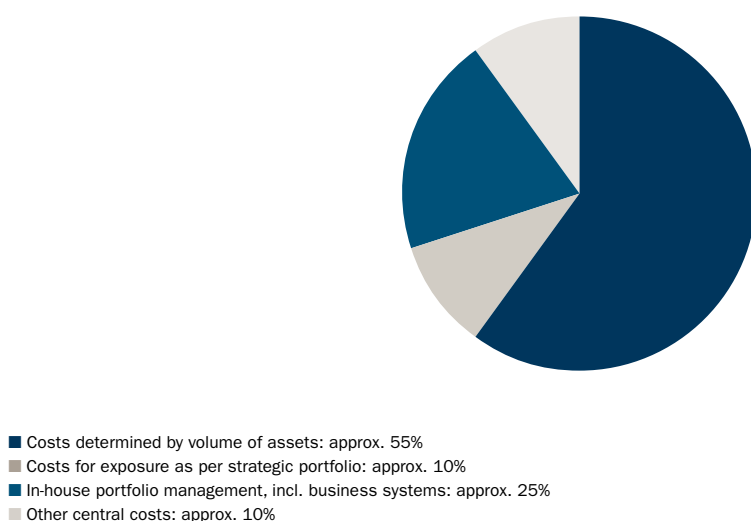
### Decisive to cost level

The degree of risk selected and choice of market are both decisive in determining the level of costs incurred by the Fund.

Almost 60 percent of the Fund's total costs depend on the volume of, and consequent growth of, assets under management. These costs consist mainly of the commission fees paid to external fund managers, where the fixed fee relates directly to the size of the mandate.

Some ten percent of costs are judged to derive from activities related to exposure of the Fund's strategic portfolio in compliance with board decisions. Expenses related to indices, market information and in-house costs involved in the passive exposure and rebalancing of a strategic portfolio are deemed to fall within this category.

Cost distribution, Second AP Fund





Costs associated with the in-house management of assets derive from the funding of portfolio management activities as well as business systems and other aspects of business support, accounting for less than a quarter of the Fund's total costs.

Other costs relate to the Fund's central staff functions, the CEO and board of directors, as well as overall joint costs for business premises and so on.

#### **Cost-efficient portfolio management**

Subsequent to the 2009 change in strategy and the restructuring of the Fund's portfolio management activities, the active return on the market worth of the portfolio of quoted assets was SEK 2.9 billion, excluding operating expenses. This may be contrasted with combined costs of SEK 0.9 billion for the portfolio of quoted assets, including operating expenses and commissions.

For a number of years, the Second AP Fund has collaborated with Cost Effectiveness Measurement Inc. (CEM) in analyzing the Fund's portfolio management costs. The CEM analysis addresses several factors that have a decisive impact on the overall cost of managing the Fund: the volume of assets under management, the degree of active management and the relative allocations for each class of asset. The Fund's costs are compared with those of an international group of fund managers of similar size and focus. The result of the 2010 analysis confirms that the Second AP Fund continues to conduct its portfolio management activities in a successful and cost-efficient manner. Overall costs, including performance-based commissions, are estimated at around 0.34 percent of total assets, which is in parity with the benchmark group.

# Financial review

The Fund's assets under management amounted to SEK 227.5 billion at the close of the first half of 2011, a net increase of SEK 5 billion since the end of 2010. This change derives partly from the Fund's positive net result of SEK 5 145 million and partly from the pension system's continued negative net outflow of SEK 184 million. Costs incurred in administering the pension system have been charged against Fund capital in an amount of SEK 107 million. For the third year running, the pension system reports negative net outflows attributable to changes in contributions to and from the system, where wages and salaries, level of employment and retirement age are key factors.

Excluding the net inflows received since the Fund's inauguration in 2001, its capital assets have increased by SEK 80.4 billion, equivalent to an average annual return of 4.2 percent, including operating expenses.

## Fund capital performance, first half 2011, SEK million

Fund capital brought forward		222 507
Pension contributions received	27 113	
Pension disbursements	-27 190	
Administration contribution	-107	-184
Net result for the period		5 145
<b>Fund capital carried forward</b>		<b>227 468</b>

The positive impact on the net result for the first six months of 2011, amounting to SEK 5 145 (2 545) million, derived mainly from direct returns in the form of dividends and interest gains from the Fund's portfolios of equities and fixed-income securities. Furthermore, the Fund's alternative investments, mainly in the form of directly owned real estate, posted solid increases in market value, further contributing to the net result. Operating income comprised net interest income, dividends received and a net result for respective asset class of SEK 6 770 (2 510) million, together with exchange losses of SEK -1 444 (+212) million and commission costs of SEK 102 (101) million. Operating expenses in the form of personnel and other administration expenses have been charged against Fund earnings in an amount of SEK 79 (76) million.

During the report period, the Fund's total active risk was reduced from 0.3 to 0.2 percent, a consequence of a somewhat lower utilization of risk within asset class 'Equities'. The information ratio declined from an historic high of 2.7 at year-end 2010 to 2.1, mainly the result of a lower relative return.

Thanks to a relatively low degree of currency exposure, around 12 percent, during most of the first half, the effect of the currency hedge at a time when the Swedish krona was strong made a positive contribution to the Fund's net result. By June 30 2011, the Fund's exposure in foreign currency had risen to 18 percent, a consequence of an increased allocation of capital to emerging markets in June.

## Commission costs

Commission costs of SEK 102 (101) million were charged against operating income, comprising external asset management costs of SEK 97 (95) million and custodial costs of SEK 5 (6) million.

Commission costs for the external management of market-quoted assets partly comprise a fixed element and partly, for certain assignments, a performance-linked element. For the first half of 2011, the fixed element, reported as a commission cost, totalled SEK 95 (92) million, while the variable performance-linked element amounted to SEK 43 (72) million.

Commissions paid on the management of unquoted assets, for which repayment is approved prior to profit sharing, and deemed likely, are reported in the balance sheet together with investments in unquoted equities. During the period, management fees for unquoted assets totalled SEK 74 (61) million. Of this sum, SEK 72 (58) million has been reported together with the investment's market value at the close of the first half.

## Operating expenses

Operating expenses for the first six months of the year amounted to SEK 79 (76) million, personnel costs accounting for SEK 46 (44) million and other administration expenses for the remaining SEK 33 (32) million. Asset management costs are expressed on a yearly basis and are defined both including and excluding commission costs and in relation to the Fund's average total assets. During the first half of the year, the Fund's asset management costs, including commission costs, amounted to 0.16 (0.17) percent of Fund capital. Excluding commission costs, this share amounted to 0.07 (0.07) percent.

**Personnel**

As per June 30 2011, the Fund had 56 employees. At year-end 2010, the Fund numbered 54 employees.

**Accounting and valuation principles**

This half-year report has been prepared in accordance with the accounting and valuation principles developed jointly by Sweden's buffer funds. These principles are described on page 42 of the Fund's annual report for 2010.

**Board of directors**

During the spring, the Swedish Government appointed a new member to the board of the Second AP Fund: Helén Källholm, Managing Director of Svenska kyrkans arbetsgivarorganisation (Swedish Church Employer's Federation). Roland Svensson has left the board.

**Events after close of report period**

The turbulence affecting financial markets has intensified following the close of the report period. This is primarily attributable to the fact that growth prospects, especially in the US, have been revised downwards. There is also anxiety about the US budget control and borrowing process, as well as ongoing worries about the viability of collaboration within the framework of the EMU (European Economic and Monetary Union). These factors have not as yet led to any adjustments in the Fund's strategic portfolio. However, the Fund will continue to diversify its portfolio, with a view to further reducing sensitivity to equity-market volatility.

**Next financial report**

The annual report for the financial year 2011 will be published in February 2012. Furthermore, a separate Corporate Governance Report will be published at the start of October 2011.

Gothenburg, August 25 2011

Eva Halvarsson  
CEO

Figures in parentheses refer to the corresponding values for June 30 2010.

## Income statement

Amounts in SEK million	Jan–June 2011	Jan–June 2010	Jan–Dec 2010
<b>Operating income</b>			
Net interest income	2 772	1 771	2 973
Dividends received	2 252	1 825	2 435
Net result, quoted equities and participations	-796	-2 393	15 042
Net result, unquoted equities and participations	1 361	943	2 135
Net result, fixed-income securities	846	1 422	1 262
Net result, derivative instruments	335	-1 058	1 292
Net result, exchange gains	-1 444	212	-2 525
Commission expenses	-102	-101	-196
<b>Total operating income</b>	<b>5 224</b>	<b>2 621</b>	<b>22 418</b>
<b>Operating expenses</b>			
Personnel expenses	-46	-44	-93
Other administration expenses	-33	-32	-67
<b>Total operating expenses</b>	<b>-79</b>	<b>-76</b>	<b>-160</b>
<b>NET PROFIT FOR THE PERIOD</b>	<b>5 145</b>	<b>2 545</b>	<b>22 258</b>

## Balance sheet

Amounts in SEK million	June 30 2011	June 30 2010	Dec 30 2010
<b>Assets</b>			
Equities and participations			
quoted	109 456	96 794	111 066
unquoted	14 416	11 385	12 759
Bonds and other fixed-income securities	92 716	90 509	85 589
Derivative instruments	8 092	9 659	9 707
Cash and bank balances	3 030	1 816	2 599
Other assets	931	662	28
Prepaid expenses and accrued income	1 577	1 837	1 845
<b>TOTAL ASSETS</b>	<b>230 218</b>	<b>212 662</b>	<b>223 593</b>
<b>Fund capital and liabilities</b>			
<b>Liabilities</b>			
Derivative instruments	1 828	5 152	912
Other liabilities	836	2 437	92
Deferred income and accrued expenses	86	234	82
<b>Total liabilities</b>	<b>2 750</b>	<b>7 823</b>	<b>1 086</b>
<b>Fund capital</b>			
Opening fund capital	222 507	204 290	204 290
Net inflow to the national pension system	-184	-1 996	-4 041
Net profit for the period	5 145	2 545	22 258
<b>Total Fund capital</b>	<b>227 468</b>	<b>204 839</b>	<b>222 507</b>
<b>TOTAL FUND CAPITAL &amp; LIABILITIES</b>	<b>230 218</b>	<b>212 662</b>	<b>223 593</b>

This report has not been subject to special examination by the Fund's auditors.

## Five-year review

	June 30 2011	2010	2009	2008	2007
<b>Fund capital, flows and net result, SEK million</b>					
Fund capital	227 468	222 507	204 290	173 338	227 512
Net inflows from The Swedish Pensions Agency Special Management Fund	-184	-4 041	-3 906	884	2 019
Net result for the period	5 145	22 258	34 858	-55 058	8 718
<b>Return, %</b>					
Return total portfolio, excl. commission costs and operating expenses	2.4	11.2	20.6	-24.0	4.2
Return total portfolio, incl. commission costs and operating expenses	2.3	11.0	20.3	-24.1	4.0
Relative return on quoted assets excluding alternative investments, commission costs and operating expenses	0.1	0.8	0.7	-1.8	-0.4
<b>Risk, %</b>					
Active risk, ex post	0.2	0.3	0.6	1.0	0.7
<b>Management costs relative to Fund capital, %</b>					
Management costs, excl. commission costs	0.07	0.08	0.08	0.08	0.06
Management costs, incl. commission costs	0.16	0.17	0.18	0.16	0.13
<b>FX exposure, %</b>	<b>18</b>	<b>12</b>	<b>10</b>	<b>12</b>	<b>11</b>
<b>Share of assets under external management (including investments in private-equity funds), %</b>	<b>28</b>	<b>23</b>	<b>24</b>	<b>22</b>	<b>24</b>



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