



Andra AP-fonden
Second Swedish National Pension Fund - AP2

Half-year report

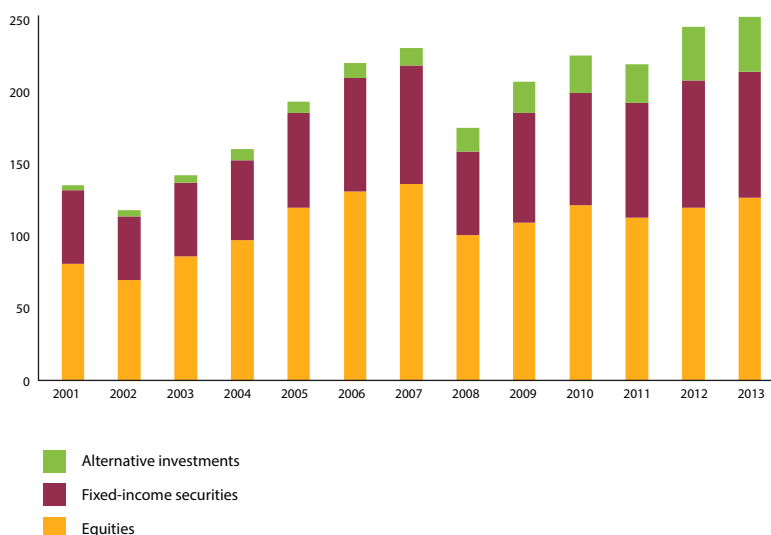
January 1 – June 30 2013

Diversified portfolio maintains stable return

The Second AP Fund posted a total return of 4.3 percent, excluding costs, for the first half of 2013. Relative to benchmark index, return was 0.2 percent, excluding alternative investments and costs. Fund capital increased by SEK 6.9 billion to SEK 248.3 billion by June 30 2013.

- The Second AP Fund's assets under management totalled SEK 248.3 (227.3) billion on June 30 2013, against which net outflows to the national pension system were charged in an amount of SEK -3.1 (-1.7) billion.
- The Fund posted a first-half net result of SEK 10.0 (12.3) billion.
- The Fund's return on the total portfolio was 4.3 (5.8) percent, excluding commission costs and operating expenses. Including these costs, the portfolio generated a return of 4.2 (5.7) percent.
- The relative return on the portfolio of quoted assets, excluding alternative investments and costs, amounted to 0.2 (0.5) percent, corresponding to a net contribution of SEK 0.4 billion.
- Operating expenses in terms of asset management costs remained low, totalling 0.07 (0.08) percent for the period.
- Over the past ten years, the Fund has generated a return on invested assets of 102.7 percent, corresponding to an average annual return of 7.3 percent. Less inflation, this is equivalent to an annual real return of 6.0 percent.
- Since its inception in 2001, the Fund has generated an overall return of SEK 109.2 billion, corresponding to an average annual return of 4.5 percent, after costs.
- The Fund's level of currency exposure was 20 (15) percent.

Fund capital growth, 2001 – June 30 2013, SEK billion



* 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/the Fund and, where space requires, AP2.

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. 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 million). Figures in parentheses refer to the preceding year.

Chief Executive's review

During the first six months of the year, the financial markets noted quite favourable general growth, both in the US and Europe. Even so, the period ended in a state of some financial turbulence when, in May, the Fed started preparations to cut back on the extraordinary fiscal measures it had introduced to stimulate the economy. This had an immediate impact on global stock and bond markets.

The Fund's long-term asset management strategy, which focuses on increased portfolio diversification as a means of securing a more stable return on investment, continued to prove successful. Total return for the period amounted to 4.3 percent, the Fund noting an active return of 0.3 percent. Also pleasing is the fact that all asset classes outperformed against the benchmark index. Swedish equities generated a return of 8.8 percent, foreign equities 7.6 percent and alternative investments 6.3 percent, while fixed-income securities noted a return of -0.7 percent.

Over the past ten years, the Fund has generated a real average annual return of six percent, which significantly exceeds our long-term target of an average annual real return of five percent.

Ongoing shift in portfolio focus

As part of our long-term strategy for securing a stable return, we continue to shift the focus of our portfolio towards increased investment in emerging markets and alternative asset classes. A year ago, as the first Swedish investor, we applied for a licence that would enable us to invest directly in China's domestic equities market. The licence was granted in September. At the end of June, SAFE (the Chinese licensing authority) confirmed that the Fund had been granted an investment quota of USD 200 million. In conjunction with this, the Fund has been engaged in recruiting portfolio managers to handle the Chinese mandates, a process that is now entering its final phase. The Fund plans to make its first investments during this autumn.

Towards the end of last year, the Fund started to build up its own balanced portfolio of 'alternative risk premiums'. Among other measures, we are in the process of winding up our long-only convertible portfolio and have instead added convertible arbitrage as one of our strategies for this asset class. Alternative risk premiums are intended to promote greater diversification and generate a higher risk-adjusted return, given that the portfolio is designed to be independent compared to traditional equity market risk. Investment in this asset class has continued during the first half of this year.

During the spring, the Fund started to 'take back' the management of its portfolio of emerging-market equities. These are now being managed both in-house and under external mandates, as part of

our long-term strategy to steadily establish a more business-like and cost-efficient approach to the management of Fund assets, through consistent utilization of our own resources.

As a natural consequence of the current changes of the portfolio, involving an ever greater share of investment in emerging markets and alternative asset classes, we must ensure that our in-house processes are adjusted accordingly and developed in pace with these changes. For this reason, in the past year, a thorough review has been conducted of the processes and routines on which investment decisions about unquoted assets are based, as well as of the ongoing monitoring and evaluation of such investments. This process has been implemented in close consultation with the Board's risk committee and has been the subject of regular consideration by the Board.

Need to change investment regulations

In recent years, on a number of occasions, we have pointed out the need for a review of and change in the investment regulations applied to Sweden's national pension funds. This is also an area to which special attention is devoted in the Buffertkapitalsutredning (Buffer Capital Report). In my opinion, the introduction of more relaxed investment regulations would improve the potential for achieving a more stable and higher return. Current investment regulations, which feature a high proportion of fixed-income securities, result in a somewhat bipolar portfolio. To attain the targeted return, the modest nature of the anticipated return on fixed-income securities has to be balanced by adopting a relatively high level of risk in other asset classes. I am hopeful that changed investment regulations will enable us to balance risks better, thereby also generating a more stable return on the Fund's total portfolio.

Broad focus on sustainability

During the report period, the Fund has maintained progress on integrating sustainability issues with the portfolio management process. This work has included participation in drafting a framework to be adopted by private equity companies when reporting on ethical, environmental and governance issues. More about this and our other activities related to sustainability may be found in our Corporate Governance Report, which will be published early in October.

Diversity and equality of opportunity are crucial to the formation of a sustainable society. The Women's Index, compiled annually by the Second AP Fund, reveals that the proportion of women serving on the boards of Swedish publicly quoted companies has declined for the second year in succession, now amounting to 22.3 percent. Conversely, the number of women in executive management positions has been rising steadily and has now reached 17.2 percent.

Although the proportion of women represented on corporate boards has noted only a marginal decline, I feel this to be a worrying trend, in that we have now – in principle – reverted to the level that applied in 2010. As major investors, we must seriously and, to a much greater extent, address the issue of what can be done to reverse this trend. It is nevertheless pleasing that the percentage of women in executive management is on the rise, especially in view of the fact that this group constitutes the main recruiting base for seats on corporate boards.

Consistent improvements

The above mentioned examples are some of the consistent improvements we are working on at the Second AP Fund, which contribute to our organizational and individual development – all with the intention of generating the best possible return for Sweden's pensioners. I look forward with confidence to the second half of the year, in the knowledge that we shall continue the process of creating world-class asset management.

Eva Halvarsson
CEO

Asset-class performance during first half

The performance of the financial markets was largely the consequence of a stabilization of the global macroeconomic situation. At the start of the year, the US economy barely escaped from falling over the much discussed 'fiscal cliff'. Subsequently, increasingly clear signs have indicated that the US economy is slowly recovering from the extended period of weak growth that arose in the wake of the financial crisis. This resulted in vigorous growth on the US stock market, but also in rising bond rates. Towards the end of May, responding to the improved economic situation, the Federal Reserve started to prepare the rest of the world for a cutback in the extraordinary fiscal measures introduced to stimulate the economy. This created fairly considerable financial turbulence, affecting both stock markets and bond markets across the globe.

The European economy continued to reflect the impact of the fiscal constraints imposed by the euro crisis. Once again, growth was negative, but the downturn slowed down. There is hope that this negative trend has bottomed out during the first half of the year. Overall, growth on the European stock markets was neutral and, in most cases, bond rates were somewhat higher in June, compared to the start of the year.

The newly elected Japanese government launched an ambitious programme to breathe new life into the weak Japanese economy after decades of stagnation. Especially notable during the first six months was the Japanese Central Bank's announcement of comprehensive fiscal stimuli. The Japanese currency noted a sharp decline and the stock market in general performed very strongly during the period, in spite of a significant downturn in conjunction with market anxiety in May and June.

Following a nervous autumn, the Chinese economy started to regain stability as it focused on the regime's growth targets. Even so, many emerging economies experienced declining export demand and lower global prices for commodities. This caused a slowdown in their economies and several countries introduced stimulatory monetary measures. The market turbulence that arose in the wake of the Fed's announcement had a particularly dramatic impact on emerging markets: yields on both equities and bonds for the half year were negative.

The Swedish stock market rose in expectation of stronger global economic growth. Reflecting this upward global trend, Swedish bond rates also rose, resulting in a negative return on Swedish bonds.

Seen over the first six months, total returns generated on the Fund's portfolios of Swedish and foreign equities were 8.8 percent and 7.6 percent respectively, while fixed-income securities noted a 0.7 percent decline in value. The Fund's alternative investments, comprising unquoted real estate, private equity funds, convertibles, alternative risk premiums and alternative credits, generated a return of 6.3 percent.

The Fund's active management of assets exceeded the benchmark index by 0.3 percent, excluding alternative investments and costs. The relative return (active return including implementation effects) was 0.2 percent or SEK 0.4 billion. Yet again, all the Fund's in-house portfolio management units exceeded the benchmark index. The Fund's external asset managers also made an overall contribution of SEK 0.2 billion to the positive active result.

Composition of strategic portfolio, share of portfolio and return, June 30 2013

Asset class	Strategic portfolio, %	Share of portfolio, %	Market worth, SEK bn	Absolute return, %	Relative return, %	Active risk ex post*, %
Swedish equities	11.0	11.3	28.1	8.8	0.6	0.4
Foreign equities	38.0	39.1	97.0	7.6	0.2	0.4
Fixed-income securities, including liquidity and accrued interest	35.0	34.5	85.8	-0.7	0.0	0.3
Total quoted assets, excluding commission costs and operating expenses				3.9	0.2	0.2
Alternative investments	16.0	15.1	37.4	6.3		
Total Fund capital, excluding commission costs and operating expenses	100.0	100.0	248.3	4.3		

* Historical outcome, 12 months rolling.

Contributions to absolute return, first six months 2013, %

Swedish equities	1.0
Foreign equities	2.9
Fixed-income securities, including liquidity and accrued interest	-0.2
GTAA	0.0
Overlay	0.0
FX Hedge	-0.3
Alternative investments	0.9
Total assets, excluding commission costs and operating expenses	4.3

Contributions to relative return, first six months 2013, %

Swedish equities	0.1
Foreign equities	0.1
Fixed-income securities, including liquidity and accrued interest	0.0
GTAA	0.0
Market-quoted assets, excluding alternative investments and implementation effects	0.27
Implementation effects*	-0.1
Market-quoted assets excluding alternative investments and including implementation effects	0.2

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

Financial review

The Fund's assets under management amounted to SEK 248.3 billion at the close of the first half of 2013, a net increase of SEK 6.9 billion since the end of 2012. This change derives partly from the Fund's positive net result of SEK 10 006 million and partly from the pension system's continued negative net outflow of SEK 3 130 million. Costs incurred in administering the pension system, invoiced by Pensionsmyndigheten (the Swedish Pension Authority), have been charged against Fund capital in an amount of SEK -115 million.

Excluding the net inflows received since the Fund's inauguration in 2001, its capital assets have increased by SEK 109.2 billion.

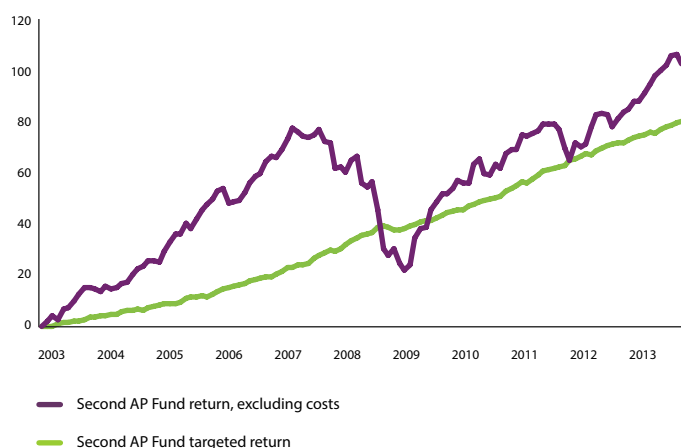
Fund capital performance first half 2013, SEK million

Fund capital brought forward		241 454
Pension contributions received	28 479	
Pension disbursements	-31 494	
Administration contribution	-115	-3 130
Net result for the period		10 006
Fund capital carried forward		248 330

Exceeded our long-term commitment

The focus of the Fund's investment activities, as determined by the Fund's board of directors, is to minimize the negative impact that activation of the 'brake' have on pensions. With this in mind, the Second AP Fund has composed a portfolio that is expected to generate a long-term average annual real return of five percent. In the past ten years, the Fund has generated a return of 102.7 percent, equivalent to an average annual return of 7.3 percent. After deduction for inflation, this corresponds to an annual real return of 6.0 percent.

Accumulated return, ten years (%)



Half-year result

The result for the first half of the year was SEK 10 006 (12 311) million, generated largely by the Fund's portfolios of equities. Both the Swedish and foreign portfolios of equities reported a solid net result totalling SEK 7.3 billion, as well as a direct return in the form of dividends amounting to SEK 2.3 billion. The Fund's unquoted assets in real estate and private equity funds also noted a positive result of SEK 1.6 billion.

Due to rising global interest rates, the Fund's fixed-income securities showed a negative result, partially compensated for by a significant net interest gain. Consequently, the combined result for fixed-income securities amounted to SEK - 0.3 billion.

During the report period, the active risk for the Fund's portfolio of quoted assets declined somewhat, from 0.3 percent to 0.2 percent. In absolute terms, calculated on a rolling basis over 12 months, Swedish equities are the asset class featuring the highest active risk. Calculated over 12 months, the information ratio is high, although it has worsened slightly since year-end 2012, amounting to 3.2 at the end of the first half of this year.

To comply with the Swedish National Pension Funds' Act, no more than 40 percent of invested pension assets may be exposed to exchange risk. Exchange hedging of the Fund's portfolio and the degree to which it is hedged therefore has a considerable impact on the result. The net of exchange gains/losses on foreign assets is reported in the income statement, with the result of the Fund's exchange hedging, under Net result, exchange gains/losses. During the greater part of the first half, exposure in foreign currency was relatively low (about 20 percent) in relation to the Fund's 40-percent limit. Weakening of the Swedish krona against the euro and US dollar during the period generated exchange gains on foreign assets, while at the same time the Fund's exchange hedge had a corresponding and negative effect on the result. The combined result for the Fund's total portfolio of assets exposed in foreign currency, including the exchange hedge, was reported as positive, amounting to an exchange gain of SEK 0.1 billion.

Commission costs

Commission costs of SEK 119 (99) million were charged against operating income, comprising external asset management costs of SEK 113 (95) million and custodial costs of SEK 6 (4) million. Due to the fact that the management fee is linked directly to the volume of assets under management, the increased costs are a consequence of the Fund's growing capital assets, as well as of its clearly stated strategic decision to utilize external asset managers for more narrowly specialized, and more costly, mandates in several new asset classes.

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 2013, the fixed element, reported as a commission cost, totalled SEK 111 (93) million, while the variable performance-linked element amounted to SEK 21 (21) million.

Management fees for 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 90 (71) million. Of this sum, SEK 88 (69) 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 86 (86) million, personnel costs accounting for SEK 57 (51) million and other administration expenses for SEK 29 (35) million. As of 2012, the Swedish National Pension Funds are subject to VAT on the procurement of services from foreign companies. Since the AP Funds are not entitled to reclaim VAT paid on foreign services supplied, VAT registration involves a direct increase in the Fund's costs for these types of service.

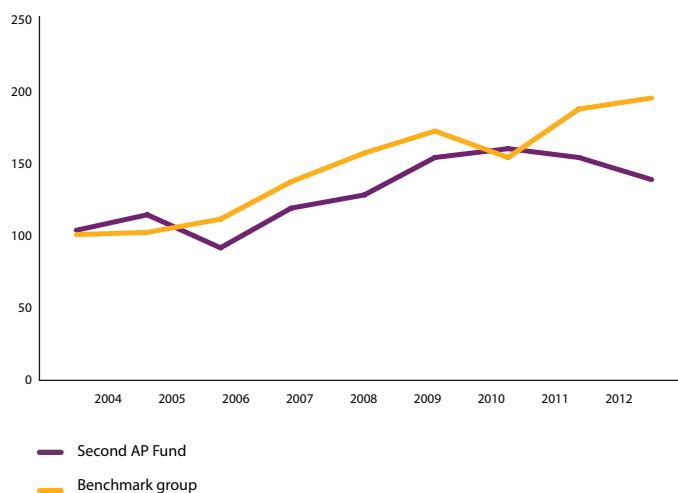
Asset management costs are expressed on a yearly basis and are defined both including and excluding commission costs and in relation to the Fund's average total assets. The Fund's asset management costs remained low during the first half of the year, amounting to 0.17 (0.17) percent of Fund capital, including commission costs. Excluding commission costs, this share amounted to 0.07 (0.08) percent.

Cost-efficient fund management

An established method for measuring and comparing the cost efficiency of pension funds from an international perspective has been developed by CEM (Cost Effectiveness Measurement Inc.). The method permits a comparison that takes into account 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 and external management and the relative allocations for each class of asset. The pension funds' management costs are compared with those of an international group of fund managers of similar size and focus. The Second AP Fund has participated in CEM's annual benchmark study since 2004.

The Second AP Fund's costs for 2012 have been matched against those of 17 other pension funds. The analysis demonstrates that the Fund has a 30 percent lower average cost level compared to the benchmark group (see graph). This is mainly attributable to an effective mix in asset class and style of portfolio management.

Second AP Fund cost efficiency compared to international pension funds 2004-2012, indexation



The graph shows the second AP Fund's level of costs in relation to the benchmark group during the period 2004-2012. Source: CEM

Personnel

As per June 30 2013, the Fund had 62 employees. At year-end 2012, the Fund numbered 60 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 40 of the Second AP Fund's annual report for 2012.

Board of directors

During the spring, the Swedish Government appointed one new member to the board of the Second AP Fund: Ole Settergren, head of department at Pensionsmyndigheten (Swedish Pensions Agency). Anders Jansson left the board. In June, Niklas Johansson resigned his seat on the board, in conjunction with his appointment as Head of the Department for Local Authorities and State Ownership at Finansdepartementet (Swedish Ministry of Finance).

Next financial report

The annual report and result for the financial year 2013 will be published in February 2014. Furthermore, a separate Corporate Governance Report will be published at the start of October 2013.

Gothenburg, August 29 2013
Eva Halvarsson
CEO

Income statement

SEK million	Jan-June 2013	Jan-June 2012	Jan-Dec 2012
Operating income			
Net interest income	1 976	3 027	6 647
Dividends received	2 302	2 162	2 963
Net result, quoted equities and participations	7 283	4 479	15 557
Net result, unquoted equities and participations	1 565	1 581	2 657
Net result, fixed-income securities	-2 303	1 580	3 848
Net result, derivative instruments	-758	218	1 241
Net result, exchange gains	146	-551	-3 921
Commission expenses	-119	-99	-203
Total operating income	10 092	12 397	28 789
Operating expenses			
Personnel expenses	-57	-51	-101
Other administration expenses	-29	-35	-68
Total operating expenses	-86	-86	-169
NET PROFIT FOR THE PERIOD	10 006	12 311	28 620

Balance sheet

SEK million	30 June 2013	30 June 2012	31 Dec 2012
Assets			
Equities and participations			
Quoted	120 843	105 928	109 747
Unquoted	28 615	17 989	25 412
Bonds and other fixed-income securities	93 294	92 393	92 224
Derivative instruments	8 440	9 059	10 260
Cash and bank balances	2 817	2 689	2 987
Other assets	226	626	184
Prepaid expenses and accrued income	1 340	1 440	1 740
TOTAL ASSETS	255 575	230 124	242 554
Fund capital and liabilities			
Liabilities			
Derivative instruments	5 191	2 289	873
Other liabilities	1 989	455	119
Deferred income and accrued expenses	65	114	108
Total liabilities	7 245	2 858	1 100
Fund capital			
Opening fund capital	241 454	216 622	216 622
Net inflow to the national pension system	-3 130	-1 667	-3 788
Net profit for the period	10 006	12 311	28 620
Total Fund capital	248 330	227 266	241 454
TOTAL FUND CAPITAL AND LIABILITIES	255 575	230 124	242 554

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

Five-year review

	30 June 2013	2012	2011	2010	2009
Fund capital, flows and net result, SEK m					
Fund capital	248 330	241 454	216 622	222 507	204 290
Net outflows to the Swedish Pension Agency	-3 130	-3 788	-1 240	-4 041	-3 906
Net result for the period	10 006	28 620	-4 645	22 258	34 858
Return, %					
Return total portfolio before commission costs and operating expenses	4.3	13.5	-1.9	11.2	20.6
Return total portfolio after commission costs and operating expenses	4.2	13.3	-2.1	11.0	20.3
Annualized return after commission costs and operating expenses, 5 years	5.2	2.4	0.6	3.5	4.9
Annualized return after commission costs and operating expenses, 10 years	7.1	7.4	4.3	4.2	-
Risk, %					
Standard deviation ex-post, quoted portfolio, %	5.9	6.4	10.0	8.4	12.0
Standard deviation ex-post, total portfolio, %	5.1	5.8	-	-	-
Sharpe ratio ex-post, quoted portfolio	1.8	1.9	neg	1.1	1.9
Sharpe ratio ex-post, total portfolio	2.1	2.0	-	-	-
Asset management costs relative to Fund capital, %					
Asset management costs, excluding commission costs	0.07	0.07	0.07	0.08	0.08
Asset management costs, including commission costs	0.17	0.16	0.17	0.17	0.18



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