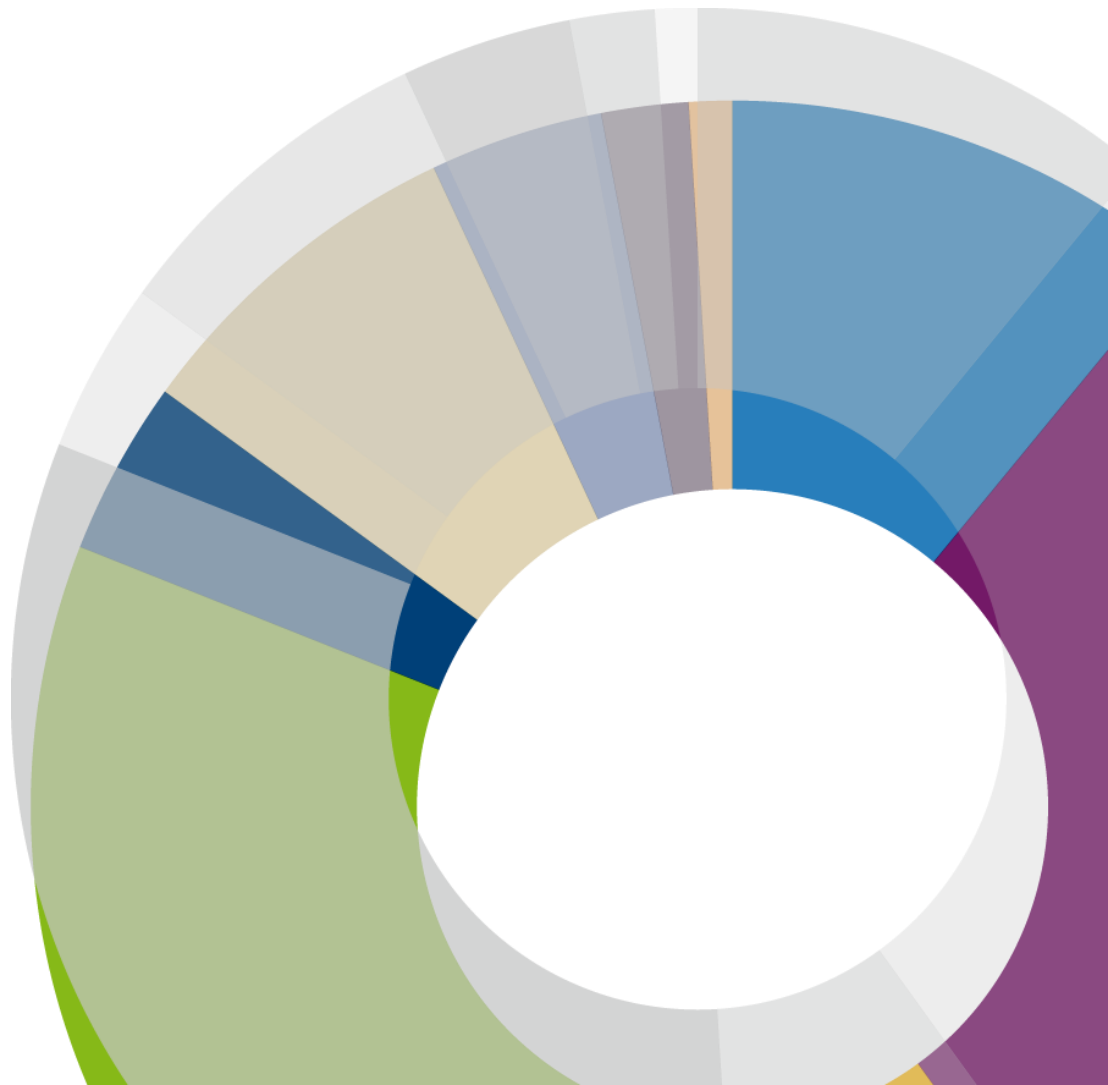


# Half-year report January 1 – June 30 2016



## Well diversified portfolio generates results

The Fund\* posted a total return of 3.7 percent, excluding costs, for the first half of 2016. Relative to benchmark index, return was -0.7 percent, excluding alternative investments and costs. Fund capital increased by a net of SEK 7.4 billion to SEK 308 billion by June 30 2016.

- The Second AP Fund's assets under management totalled SEK 308.0 (306.5) billion on June 30 2016, against which net outflows to the national pension system were charged in an amount of SEK -3.2 (-2.4) billion.
- The Fund posted a first-half net result of SEK 10.6 (15.0) billion.
- The Fund's return on the total portfolio was 3.7 (5.2) percent, excluding commission and operating expenses. Including these costs, the portfolio generated a return of 3.6 (5.1) percent.
- The relative return on the portfolio of quoted assets, excluding alternative investments and costs, amounted to -0.7 (0.2) percent.
- Operating expenses in terms of asset management costs continued to be low, remaining unchanged at 0.07 (0.07) percent for the period.
- Over the past ten years, the Fund has generated a return on invested assets of 80.7 percent, excluding costs, corresponding to an average annual return of 6.1 percent. Less inflation, this is equivalent to an annual real return of 5.0 percent.
- Since its inception in 2001, the Fund has generated an overall return of SEK 185.9 billion, corresponding to an average annual return of 5.5 percent, including costs.
- The Fund's level of currency exposure was 33 (30) percent.
- During the first half of 2016, the Fund implemented one of the largest real-estate transactions ever carried out in Sweden when, together with the Sixth AP Fund, all joint holdings in Norrporten were sold to Castellum for SEK 14 billion.

### Key ratios

	Jan-June 2016	Jan-June 2015	Jan-Dec 2015
Fund capital carried forward, SEK m	308 010	306 510	300 624
Net result for the period, SEK m	10 602	15 020	11 661
Net payments to the national pension system, SEK m	-3 216	-2 417	-4 944
Fund capital brought forward, SEK m	300 624	293 907	293 907
Asset management costs, operating expenses, %	0.07	0.07	0.07
Asset management costs, incl. commission expenses, %	0.16	0.18	0.18
Return on total portfolio after costs, %	3.6	5.1	4.0
Annualized return after commission and operating expenses, 5.0 years, %	8.3	10.3	8.0
Annualized return after commission and operating expenses, 10.0 years, %	5.9	6.8	5.7

\*The Second AP Fund is officially translated as the Second Swedish National Pension Fund. 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 same period of time preceding year.

## Chief Executive's review

Turbulence affecting financial markets is something to which we are growing fairly accustomed. However, it has been some considerable time since we saw anything like the dramatic swings experienced towards the end of June in conjunction with Brexit. The British referendum increased the degree of financial uncertainty in the world, affecting a number of factors, including interest rates and stock yields.

Despite this turbulence, we achieved a net return of 3.7 percent for the half year, and our total portfolio actually rose in value even during the final turbulent week in June. The ability to generate a stable return even during uncertain times is mainly attributable to the well diversified nature of our portfolio, both in terms of asset class and markets. We have confidence in our agreed asset management strategy and stick to it, even when things get difficult. Our long-term and well diversified approach is a key factor in the Fund's success and important contributor to its strong growth.

The exceptionally low current rates of interest naturally have an impact on the Fund's return on invested assets, since we are subject to investment regulations that require us to invest at least 30 percent of our capital assets in fixed-interest securities. This means that, should current interest levels be extended over a longer period, the Fund's prospects of achieving a satisfactory future return will consequently be limited.

Returning to the topic of investment regulations, we sold our interests in Nordic Capital funds V, VI and VII during the first half. The decision to implement these divestments and review the private-equity portfolio derived partly from the fact that we have the five-percent limit placed on our investments in unquoted assets.

During the period, we implemented one of the largest real-estate transactions ever carried out in Sweden when, together with the Sixth Swedish National Pension (AP) Fund, we sold all our joint holdings in Norrporten to Castellum for SEK 14 billion. We came to the conclusion that the time was right to sell our respective interests in Norrporten, thereby realizing a considerable gain, to the benefit of Sweden's pensioners. This transaction also means that the Fund can move a step further in implementing our asset management strategy, enabling us to gradually increase the level of our real-estate investments in other markets.

### **Sustainability**

Over the past six months, we have continued with our long-term commitment to integrate sustainability in all we do. This has included a decision to allocate one percent of the Fund's total strategic portfolio to 'green bonds'. Marking a strategically important stance, this will further strengthen our efforts in promoting sustainability. The Fund has previously invested in 'green' and 'social impact' bonds, which are managed as part of the existing bond portfolio. Currently, Fund investments in green bonds total SEK 4.5 billion.

### *Climate*

During the report period, we further reduced our financial risk in fossil energy by divesting holdings in an additional eleven coal companies, as well as eight oil-and-gas corporations. In total, the Fund has divested its interests in 23 coal companies and 15 oil-and-gas corporations.

When analysing the financial implications of climate risks, the Fund starts by determining whether the climate risks that companies face have been factored into their market value. Our analysis of fossil-energy companies and of the energy sector, conducted at the end of last year, arose out of the Fund's commitment to address ethical and environmental issues without compromising the overall aim of generating a high return on invested assets. Consequently, both analyses applied a financial perspective. Divesting our interests in these companies will help secure the Fund's long-term return.

In the early spring, the Asset Owners Disclosure Project ranked the Second AP Fund eighth in the world for the way we manage climate risks associated with the Fund's portfolio investments. It is pleasing that our long-term efforts have been recognized, especially in light of the fact that it marks an improvement since last year, when the Fund was ranked eleventh.

### *Diversity*

To increase access to capital for women entrepreneurs, we have decided to invest USD 30 million in the Women Entrepreneurs' Opportunity Facility, which is a partnership initiative between the Goldman Sachs 10,000 Women programme and the International Finance Corporation (IFC). The funding facility amounts to USD 600 million. It aims to promote lending in emerging economies by helping to bridge the global credit gap experienced by small and medium enterprises (SMEs) owned by women, offering 100,000 women entrepreneurs the opportunity to develop their companies.

This is a small but important investment for us, in light of our conviction that women in emerging economies are an underutilized resource that can make a positive contribution to growth, and thereby to corporate growth and increased prosperity. Women are often subject to less favourable conditions of employment, have lower incomes and lack access to the capital needed to grow their businesses. Furthermore, they are often prevented from owning or inheriting land and other assets. These are challenges we wish to help resolve, while also making a smart investment in purely financial terms.

### *Agriculture in Brazil*

We have attracted a certain amount of criticism in connection with our agricultural investments in Brazil, which has included accusations of contributing to 'land grabbing'. We naturally take such criticism very seriously and strive consistently to ensure that our investments are managed in a sustainable manner. As for the accusation of 'land grabbing', I should like to stress that the Fund does NOT engage in such activity. The agricultural investments made by the Second AP Fund pertain to large-scale farms with clearly established proprietary rights acquired by equal parties.

During the year, to further increase transparency concerning the way farms in which we have invested are managed, we initiated and implemented a number of third-party audits of tenant farmer operations on our agricultural estates in Brazil. These audits review compliance with the companies' own policies, the PRI's Guidance for Responsible Investment in Farmland – and national legislation. The results will be published in our forthcoming Sustainability and Corporate Governance Report.

It is pleasing that sustainability issues are gaining increasing prominence on the agendas both of society at large and of individual sectors such as companies, special interest groups, investors and consumers. As to how each and every one can best contribute, this naturally varies according to our different roles. In the case of the Second AP Fund, as manager of a portion of the Swedish people's pension 'buffer', this commitment is defined by the terms of the task assigned us by Sweden's Parliament. That Sweden's AP Funds are in many respects considered to offer an international archetype in their approach to sustainability may be partly attributable to the broad nature of the task assigned them, enabling them to develop in harmony with society's overall development.

### **Female representation on corporate boards is accelerating**

The Second AP Fund has been measuring the percentage of women on the boards and executive managements of companies quoted on Nasdaq Stockholm since 2003. This year marked the first time that the proportion of female board members exceeded 30 percent, while women accounted for more than 20 percent of executive managements. Excluding CEOs (according to the EU's calculation model), the proportion of female directors on the boards of primary quoted companies on Nasdaq Stockholm is 33.6 percent. No less than 44.9 percent of newly elected board members are women, and the pace of change has picked up significantly in the past three years. No country in the world, without actual legislation, has such a high percentage of female board members as Sweden. This has not been due solely to the threat of legislation, but because owners and nomination committees have increasingly utilized existing competence on the market. I believe in the power of self-regulation and feel it would be a pity to legislate the introduction of quotas.

### **Looking ahead**

The political climate in Great Britain is likely to remain turbulent during the autumn. There is also a risk that the imminent US presidential election could have an impact on financial markets. Clearly, there are still plenty of unanswered questions. I am nevertheless confident that the Second AP Fund continues to be well equipped to face the future. Our focus must always be to do our very best for today's and tomorrow's pensioners!

Eva Halvarsson  
CEO

## Asset class and portfolio performance

### Turbulent six months

During the first half, the financial markets experienced considerable anxiety and volatility. Following the strong finish of the preceding year, a mood of uncertainty and gloom started to spread as early as the first weeks in January. The sharply declining price of oil cast doubt over the strength of global demand, while the threat of recession was considered increasingly likely. Worry about the prospect of a sharp downturn in the Chinese economy, which had already led to dramatic market fluctuations in August 2015, contributed to falling interest rates and share prices in many countries. Low oil prices and weak Chinese demand for raw materials, which in turn triggered a decline in commodity prices, contributed to a very low level of global inflation. Expectations of continued monetary stimulation by central banks (QE), which were realized both in the Eurozone and Japan, generated worries that the global banking system might be facing declining profitability. Reflecting these worries, global equities experienced a fall in value of as much as ten percent by early February.

Better global macroeconomic data and indications that the Chinese policymakers had introduced additional monetary stimuli to prevent their economy from slowing too suddenly eventually persuaded the market to abandon its pessimistic outlook. The Federal Reserve's intimation that global uncertainty might impact on the rate at which quantitative easing could be phased out also served to improve the mood and, by the end of February, the stock market had regained much of the year's earlier losses. Nevertheless, it was early April before the stock prices quoted on Nasdaq Stockholm returned to their December 2015 levels.

In May, economic indicators suggested that fears for the global economy might have been exaggerated. European growth staged a steady recovery and of the US labour market continued to improve. Although the global industrial economy remained weak, there were signs of improvement. The service sector was strong across the globe. Many of the fears cited during the first quarter seemed increasingly unjustified.

Even though Swedish financial markets were affected by global developments, the Swedish economy performed extremely well, if at a somewhat slower tempo compared to its very strong performance during the final quarter of 2015. The high level of demand generated hopes that Swedish central bank's inflation forecasts would be realized and that a gradual discontinuation of quantitative easing might be started towards the end of the year.

However, the first six months of the year ended as they began, featuring a notably nervous market, with falling interest rates and share prices. Initially, signs of a weaker US labour market fuelled anxiety about prospects of weak global growth. Anticipated increases in the US base lending rate were postponed yet again. The unexpected outcome of the British referendum on membership of the EU caused considerable anxiety, triggering a sharp decline in interest rates, especially marked in Sweden. During the last few days of June, however, the markets deemed the risk that the referendum would lead to a systemic crisis as low, and stocks staged a partial recovery.

### Half-year result

The impact of falling interest rates, the relatively poor performance of the stock market and the effect of a weakened Swedish krona significantly affected the half-year result, which was partially offset by the Fund's hedging policy. Emerging markets contributed strongly to the Fund's portfolio, both in terms of equities and fixed-income securities.

Total returns on the Fund's portfolios of Swedish and foreign equities were -5.1 and 4.2 percent respectively. Emerging-market equities saw a 6.7 percent increase in market worth. Swedish fixed-income securities generated a return of 2.5 percent, foreign government securities 6.6 percent, foreign credits 7.2 percent and emerging-market bonds 13.4 percent. The Fund's alternative investments, comprising domestic Chinese equities, unquoted real estate, private equity funds, alternative risk premiums and alternative credits, generated a return of 5.5 percent.

The relative result was negative, -71 basis points. This underperformance was largely attributable to the market turbulence of June.

### Changes in the portfolio

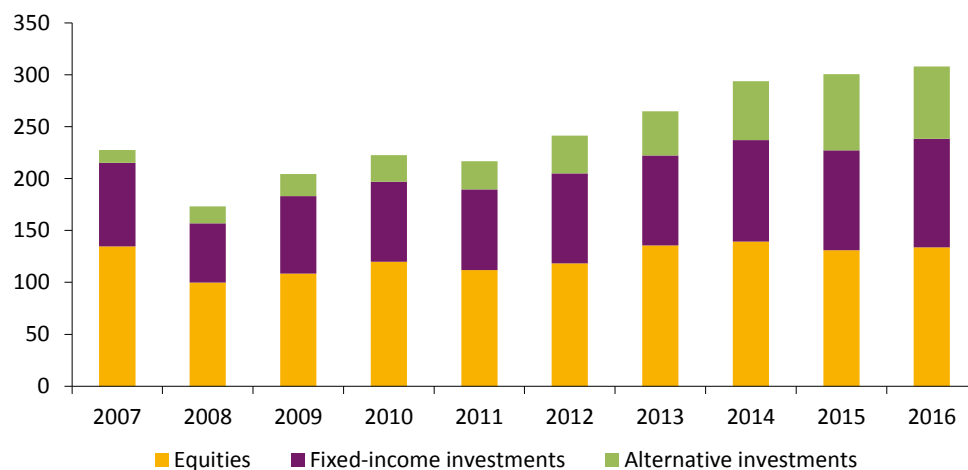
During the report period, the Fund conducted the successful sale of unquoted Swedish real-estate company Norrporten. One percentage unit of the Fund's strategic portfolio was allocated to its exposure in green bonds. To reduce the interest-rate risk in Swedish kronor, the Fund reduced its allocation in Swedish bonds by three percent, mainly to the benefit of global credits. The exchange hedging of unquoted assets was revised, to ensure a better match with the underlying FX risks.

**Composition of strategic portfolio, share of portfolio and return, June 30 2016**

Asset class	Strategic portfolio, %	Share of portfolio, %	Market worth, SEK bn	Absolute return, %	Relative return, %	Active risk ex post *, %
Equities, Swedish	10.0	9.8	30.2	-5.1	-2.2	2.1
Equities, developed markets	22.5	22.5	69.1	4.2	0.4	0.5
Equities, emerging markets	11.0	11.0	34.5	6.7	-0.2	0.8
Fixed-income, Swedish securities	13.0	12.5	38.4	2.5	-0.5	0.3
Fixed-income, foreign green bonds**	1.0	1.0	3.0	4.0	-0.1	-
Fixed-income, foreign government bonds	4.0	4.0	12.2	6.6	-0.1	0.5
Fixed-income, foreign credits	10.5	10.4	31.9	7.2	0.2	0.3
Fixed-income, emerging markets securities	6.0	6.2	19.0	13.4	-0.2	1.1
<b>Total listed assets, excluding alternative investments, commission and operating expenses</b>				<b>3.1</b>	<b>-0.7</b>	<b>0.4</b>
Alternative investments	22.0	22.6	69.7	5.5		
<b>Total Fund capital, excluding commission fees and operating expenses</b>	<b>100</b>	<b>100</b>	<b>308.0</b>	<b>3.7</b>		

\* Historical outcome, 12 months rolling.

\*\* Return since start, April 6 2016.

**Fund capital growth, 2007 – June 30 2016, SEK bn**


# Income statement and balance sheet

## Income statement

SEK million	Jan-June 2016	Jan-June 2015	Jan-Dec 2015
<b>Operating income</b>			
Net interest income	1 005	1 089	1 897
Dividends received	4 505	3 991	5 458
Net result, listed equities & participations	-2 370	7 795	3 608
Net result, non-listed equities & participations	955	1 555	3 934
Net result, fixed-income assets	3 558	-1 489	-3 033
Net result, derivative instruments	-405	-249	-62
Net result, exchange gain/loss	3 591	2 598	392
Commission expenses, net	-128	-165	-321
<b>Total operating income</b>	<b>10 711</b>	<b>15 125</b>	<b>11 873</b>
<b>Operating expenses</b>			
Personnel expenses	-65	-63	-126
Other administration expenses	-44	-42	-86
<b>Total operating expenses</b>	<b>-109</b>	<b>-105</b>	<b>-212</b>
<b>NET RESULT FOR THE PERIOD</b>	<b>10 602</b>	<b>15 020</b>	<b>11 661</b>

## Balance sheet

SEK million	June 30 2016	June 30 2015	Dec 31 2015
<b>Assets</b>			
Equities and participations			
Listed	142 710	141 345	138 526
Non-listed	45 766	43 520	49 205
Bonds and other fixed-income assets	117 433	113 696	105 426
Derivative instruments	2 140	4 459	2 847
Cash and bank balances	4 227	3 838	3 991
Other assets	2 271	838	680
Prepaid costs and accrued income	1 664	1 348	1 678
<b>TOTAL ASSETS</b>	<b>316 211</b>	<b>309 044</b>	<b>302 353</b>
<b>Fund capital and liabilities</b>			
<b>Liabilities</b>			
Derivative instruments	5 496	1 480	1 297
Other liabilities	2 375	865	163
Deferred income and accrued expenses	330	189	269
<b>Total liabilities</b>	<b>8 201</b>	<b>2 534</b>	<b>1 729</b>
<b>Fund capital</b>			
Fund capital brought forward	300 624	293 907	293 907
Net payments to the national pension system	-3 216	-2 417	-4 944
Net result for the period	10 602	15 020	11 661
<b>Total Fund capital</b>	<b>308 010</b>	<b>306 510</b>	<b>300 624</b>
<b>TOTAL FUND CAPITAL AND LIABILITIES</b>	<b>316 211</b>	<b>309 044</b>	<b>302 353</b>

## Ten-year performance review

	June 30 2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
<b>Fund capital, flows and net result, SEK m</b>										
Fund capital	308 010	300 624	293 907	264 712	241 454	216 622	222 507	204 290	173 338	227 512
Net payments to the national pension system	-3 216	-4 944	-5 120	-6 880	-3 788	-1 240	-4 041	-3 906	831	991
Contribution from liquidation fund/special management fund	0	0	0	0	0	0	0	0	53	1 028
Net result for the period	10 602	11 661	34 315	30 138	28 620	-4 645	22 258	34 858	-55 058	8 718
<b>Return, %</b>										
Annual return on total portfolio, excl. commission and operating expenses	3.7	4.1	13.3	12.8	13.5	-1.9	11.2	20.6	-24.0	4.2
Annual return on total portfolio incl. commission and operating expenses	3.6	4.0	13.1	12.7	13.3	-2.1	11.0	20.3	-24.1	4.0
Relative return on quoted assets, excl. alternative investments, commission and operating expenses*	-0.7	0.9	0.5	0.4	1.1	-0.3	0.8	0.7	-1.8	-0.4
Annualized return after commission and operating expenses, 5.0 years	8.3	8.0	9.4	10.8	2.4	0.6	3.5	4.9	3.3	12.8
Annualized return after commission and operating expenses, 10.0 years	5.9	5.7	7.1	7.0	7.4	4.3	4.2			
<b>Risk, %</b>										
Active risk, ex. post	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.6	1.0	0.7
FX exposure	33	30	24	23	20	16	12	10	12	11
Share of external mandates	16	17	28	25	29	29	23	24	22	24
<b>Management costs as % of assets under management</b>										
Management cost operating expenses	0.07	0.07	0.07	0.07	0.07	0.07	0.08	0.08	0.08	0.06
Management cost incl. commission expenses	0.16	0.18	0.17	0.17	0.16	0.17	0.17	0.18	0.16	0.13
<b>No. of employees</b>										
	65	64	63	59	60	58	54	53	55	49

\*Relative return refers to the difference in return between a portfolio and its benchmark or reference index.



### **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 58 of the Second AP Fund's annual report for 2015.

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

### **Board of directors**

The board of the Second AP Fund remains unchanged, since the Swedish Government appointed no new members during the spring.

### **Next financial report**

The annual report and result for the financial year 2016 will be published in February 2017. A Sustainability and Corporate Governance Report will be published at the same time.

Gothenburg, August 23 2016

Eva Halvarsson  
CEO

