



Tredje AP-fonden

## Positive portfolio growth and strong active returns

### Interim report 1 January – 30 June 2009

Turbulence on global financial markets and continued falls in equity prices marked the first two months of the year. A recovery on world equity markets and falling credit and liquidity risk premiums in the remaining four months saw AP3's portfolio post an overall gain for the six months ended 30 June.

- Net income was SEK 9.4 (-17.9) billion, equal to a return of 5.3% (-8.0) before expenses and 5.2% (-8.0) after expenses.
- Fund capital stood at SEK 188.6 billion at 30 June, an increase of SEK 7.6 billion from 1 January.
- Total active return was 1.3% of market-listed assets during the first six months, representing a contribution of SEK 1.8 billion.
- Real return for the past five years amount to 2.2 % per year. For the six months ended 30 June, real return was 4.8%.
- AP3 has generated total returns of SEK 35.1 billion since inception in 2001. Fund capital, including net flows to and from the Swedish Social Insurance Agency, has risen by SEK 54.6 billion. A longstanding net inflow became an outflow in the six months ended 30 June as pension disbursements exceeding paid-in contributions.



## STATEMENT BY THE CEO

Our mission of delivering strong returns on pension capital to provide maximum benefit to the pension system was severely tested in 2008. The dramatic fall in the value of the AP-fund's assets, combined with low growth in pension assets, means the pension system's built-in stabilisation mechanism will be activated in 2010. In concrete terms, this means that pensions and pension entitlements will not be indexed upwards in line with wage growth.

The capital generated by the AP funds will now be used to bridge the gap between pension contributions and disbursements. From 2001 to 2008 the AP funds recorded net growth in their pension assets due to favourable demographics. This year has seen the first net outflow since the new pension system was introduced. There was nothing strange about this: the AP funds are buffer funds whose role is to manage surpluses and cover deficits in the pay-as-you-go pension system. But because the AP funds also form part of the pension system's aggregate asset base, net outflows mean the funds' contributions to the system will be lower than the investment returns they generate. This makes it likely that the system will take longer to return to balance so that pension entitlements and pensions can be indexed in line with inflation.

It was against this background and the high-risk conditions prevailing on financial markets at the start of the year that we adopted a relatively cautious strategy. We looked for new investments in sub-markets offering relatively favourable returns in relation to risk. We completed a significant diversification of the real estate portfolio via our investment in Hemsö Fastigheter, an owner of public buildings. We also continued to seek higher exposure in high-yield fixed income products like senior bank loans and convertible bonds. We made no new private equity investments because we were above the statutory limit of 5% exposure at the start of the year. We decided not to reduce this exposure by selling holdings on the grounds that doing so might jeopardise significant asset values. Private equity exposure has since declined to within the 5% limit because of an increase in value of the total portfolio and also in response to a strengthening of the Swedish krona and the fact that private equity valuations, which are subject to a time lag of one month, were negative.

The government's annual review on the AP funds noted that the funds had fallen short of their active return targets and recommended an operational review. We had already decided to make market exposure (beta) independent of active positions (alpha) to optimise risk diversification, and this strategy was fully operational by the end of 2008. We adopted relatively strict risk budgeting initially in alpha management and reduced the number of external equity mandates on the beta management side. However, we saw no reason to review our decision in the beta fixed income portfolio to retain a significant weight in non-liquid bonds by holding these mainly government bonds to maturity as we knew that the drop in bond prices sustained in 2008 would be recouped as long as the issuers survive. Much of this recovery happened in six months ended 30 June. We generated an active return of SEK 1.8 billion during the period and since inception in 2001 have recorded a cumulative net return of SEK 1.1 billion. This illustrates the difficulty of drawing too many conclusions from a single year – a point we made to the government during its annual review.

Expenses in relation to assets under management rose during the six months compared to the same period last year, largely due to the decrease in the value of the portfolio. The Canadian benchmarking institute CEM's annual review shows that our operations are competitive and that costs are below average among global pension funds. However, cost monitoring and control remains a high priority. A cost-effectiveness programme is currently under way involving a range

of measures to reduce operating, asset management and transaction costs. We are considering the possibility of scaling back external management. Internal management offers tighter risk control, scope for faster risk adjustment and lower costs. The cost-saving measures that we have introduced so far will be seen gradually in income. We are also working with AP1, AP2 and AP4 to identify possible efficiency measures through increased cooperation.

Executive pay came under the spotlight during the spring. In April the government revised its July 2008 guidelines on employment conditions for senior executives of government-owned enterprises and also introduced special guidelines for the AP funds. The new guidelines cover remuneration of AP fund employees and how the AP funds should act as investors. Moreover, the European Commission issued a recommendation for senior executives of listed companies and a recommendation for remuneration in the financial sector, with both recommendations to be effective in all European Union member states from 1 January 2010. AP3 will review the corporate governance policy in the light of its experiences so far, the government's guidelines and the impact of the EU recommendations on corporate governance in Sweden.

We are an increasingly prominent player in the field of environmental and social responsibility, and here it is vital to remain faithful to a systematic work process. So far in 2009, the AP funds' Ethical Council has achieved success in various dialogues with companies and has also seen some of the initiatives that it has supported bear fruit in terms of proactive responses from the companies concerned.

*Kerstin Hessius, CEO*

## FUND CAPITAL

AP3 reported a return of 5.3% before expenses and 5.2% after expenses for the six months ended 30 June. This amounted to SEK 9.4 billion after expenses.

Fund capital stood at SEK 188.6 billion at 30 June, an increase of SEK 7.6 billion from 31 December 2008. Total return since inception in 2001 stands at SEK 35.1 billion, equal to an annual average of 2.5%. Adjusted for inflation, this represents a real annual return of 0.9%, which is below the 4% target. The primary reason for this shortfall is that AP3's first nine years have seen two financial crises – the dotcom bubble of 2001-2003 and the financial crisis of 2008. Fund capital, including net inflows and outflows, has risen by SEK 54.6 billion since 2001.

Change in fund capital, SEK million	Jan-June 2009	Jan-Dec 2008
Fund capital at 1 Jan	181,024	224,897
Pension contributions	25,247	50,785
Pension disbursements	-26,872	-49,802
Administration fee to Swedish Social Insurance Agency	-115	-152
Transfers from phase-out funds	0	53
Net income for the period	9,358	- 44,757
<b>Total fund capital at end of period</b>	<b>188,642</b>	<b>181,024</b>

## EXPENSES

Operating expenses for the first half were SEK 75 million, of which SEK 46 million were staff costs. An additional SEK 69 million of commission expenses was expensed in the income statement and consisted of fixed commissions for external mandates, agreed commissions for private equity funds, and custody account expenses. Total expenses (operating expenses plus commission expenses) totalled 0.16% of assets under management on an annualised basis. The equivalent figure for AP3's internal expenses (operating expenses) was 0.08%.

## MARKET OVERVIEW

The sharp slump in world financial markets during the autumn quickly fed through to the real economy. The first months of the year saw continued turbulence on fixed income and equity markets across the globe. National governments introduced a raft of stimulus measures, central banks cut interest rates to historic lows and a more positive mood emerged on the markets during the second quarter.

Equity markets fluctuated sharply during the first six months, with the S&P 500 falling by around 25% until early March and then a rapid recovery taking hold as market volatility eased. The Swedish equity market rose by 20% and the US equity market posted a gain of just under 2% in the six months ended 30 June. The Swedish krona also experienced sharp swings during the period, falling to a low of SEK 9 against the dollar and SEK 11.70 against the euro in early March. By 30 June, however, the krona was slightly stronger than at the start of the year at close to SEK 8 against the dollar and almost SEK 11 against the euro.

## PORTFOLIO PERFORMANCE

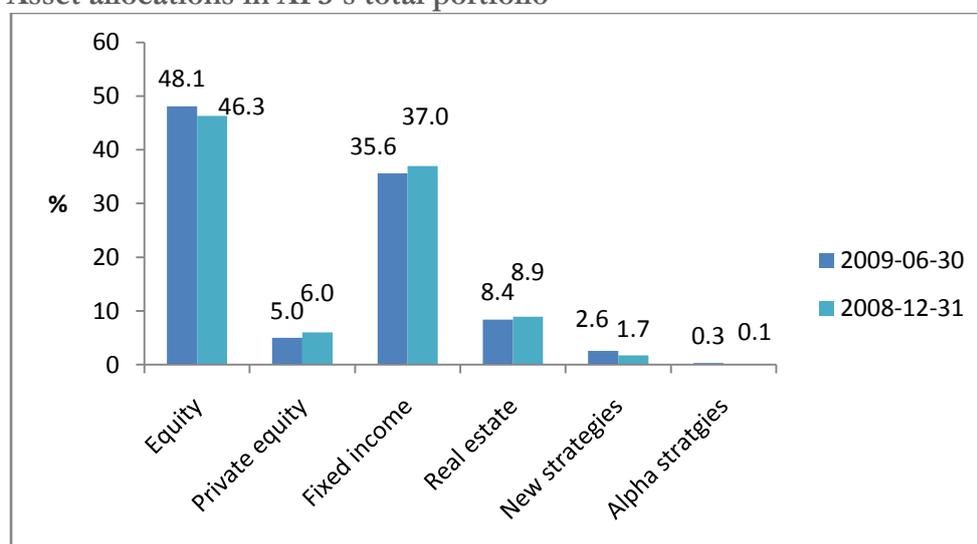
### Listed equities

AP3's equity portfolio generated a return of 9.5% during the first six months. As almost half of the AP3 portfolio consists of market-listed equities, stock market performance is the prime driver of investment returns.

Falling risk premiums during the spring had a favourable impact on the fixed income portfolio and helped lift it to a return of 4.1% for the period. The fixed income portfolio accounted for 35.6% of total assets at 30 June.

Active management was successful with a total active return of 1.3% for market-listed assets during the first six months, representing a contribution of SEK 1.8 billion. Alpha strategies generated more than SEK 700 million of this figure, with the beta group – which manages liquid equities, fixed income assets and foreign exchange – accounting for the remainder. These successes were largely due to the extensive restructuring carried out in 2008.

### Asset allocations in AP3's total portfolio



AP3 portfolio at 30 June 2009 <sup>(1)</sup>	Total return %	Of which active return %	Contribution to total return%
Equities <sup>(2) (3)</sup>	9.5	-0.5	4.2
Fixed income <sup>(2) (3)</sup>	4.1	2.3	1.5
Alpha strategies	-	0.5	0.4
<b>Listed equities</b>	<b>7.7</b>	<b>1.3</b>	<b>6.1</b>
Real estate	-1.3		-0.2
Private equity	-16.9		-1.1
Private equity	25.4		0.5
<b>Alternative investments</b>	<b>-3.1</b>		<b>-0.9</b>
<b>Total AP3 portfolio</b>	<b>5.3</b>		<b>5.3</b>

1) Cash used for position-taking in forwards has been divided among the relevant asset categories.

2) Returns on foreign equities and fixed income assets include currency hedges.

3) From 2009, strategic positions are included in equity and fixed income investments on the grounds that they are taken to adjust levels of risk and return in the portfolio.

## Alternative investments

The alternative investments portfolio comprises real estate, private equity and new strategies. Alternative investments accounted for 16% of the AP3 portfolio at the end of June 2009. Alternative investments contributed -0.9 percentage points to overall return.

AP3s real estate portfolio generated a negative return of 1.3% for the first six months ended 30 June. During the second quarter AP3 acquired a 50% equity interest in Hemsö, a subsidiary of property management company Kungsleden. Hemsö specialises in owning and managing public buildings such as old-age people's homes, schools and healthcare facilities. The transaction, announced in a press release on 22 December 2008, was conditional on approval from the competition authority and financing arrangements being kept. These conditions were duly met and the sale price was based on a property value of SEK 14.6 billion.

The private equity portfolio fell in value during the period, while listed equities gained ground, a combination of circumstances that saw AP3's private equity holdings fall to 5% of the total portfolio. Return on private equity for the first six months was -16.9%.

We signed no new private equity commitments during the period due to the fact that we were waiting for our holdings to return within the 5% limit. Reporting of these investments is subject to a time lag of three months and thus reflects the performance of the real economy in the first quarter of 2009. The reported value of AP3's private equity holdings at 30 June is based on the value at 31 March adjusted for inflows and outflows during the second quarter. We have applied this valuation model consistently since inception. The sensitivity analysis below shows the effect on AP3's private equity portfolio of changes in the MSCI listed equities index. The analysis indicates scope for a write-up of the portfolio as of 30 June, though no such write-up has taken place.

Sensitivity analysis for private equity 30 June 2009	Valuation in final accounts at 2009-06-30	Adjusted to MSCI <sup>(1)</sup> , 100% effect	Adjusted to MSCI <sup>(1)</sup> , 50% effect
Market value, SEK million	9,438	11,675	10,557
Adjustment market value, %		23.7%	11.8%
Adjustment market value, SEK million		2,237	1,118
Return, %	-16.9%	5.1%	-5.9%
Share of fund capital, %	5.0%	6.1%	5.6%

<sup>(1)</sup> MSCI relates to small cap equities in Europe and the US weighted according to regional exposure in the AP3 private equity portfolio.

AP3's portfolio of new strategies includes life science equities, insurance-related securities, secured bank loans and agricultural land. New strategies, which are in the construction phase, are aimed at diversifying the portfolio. During the first six months this portfolio delivered a return of 25.4%.

## CURRENCY MANAGEMENT

Currency exposure was 17.3% at 30 June and was mainly in US dollars and sterling.

## CORPORATE GOVERNANCE

AP3 voted at 50 Swedish annual general meetings and approximately 200 foreign AGMs. Our

external managers also voted at many AGMs on our behalf. Prior to the 2008 AGM season, we held nomination committee seats at Bergvik Skog, BioInvent, Enea, Karo Bio and Karolinska Development. A more detailed report on our AGM-related governance activities from July 2008 to June 2009 is available on the website at [www.ap3.se](http://www.ap3.se).

AP3 has a joint Ethical Council with AP1, AP2 and AP4 to promote environmental and socially responsible business practice at foreign companies. The Council's annual report and list of companies that it engaged in dialogue was published in April 2009 and is available for download from [www.ethicalcouncil.com](http://www.ethicalcouncil.com).

## **EMPLOYEES**

The staff headcount was 54 on 30 June 2009, up by 4 since the start of the year. The increase reflected our recruitment of new staff to replace employees who left us in 2008 and an expansion of internal management capacity.

## **BOARD OF DIRECTORS**

Non-executive director Karin Kronstam left the board at her own request. The government has yet to appoint a replacement.

## **SUBSEQUENT EVENTS**

The recovery on Swedish and global equity markets continued after 30 June and had a positive effect on AP3's portfolio returns.

## **FURTHER INFORMATION**

Tables and lists of AP3's holdings are available on our website.

## **NEXT REPORTING DATE**

The full-year financial statements and annual report for 2009 will be published in February 2010.

## **ACCOUNTING POLICIES**

This interim report was prepared in compliance with the accounting and valuation principles jointly developed and approved by the AP funds. These are presented in the 2008 annual report on page 49 under Note 1.

The interim report has not been reviewed by AP3's auditors.

*Stockholm, 28 August 2009*

*Kerstin Hessius*  
CEO

## Income statement

### Revenue, SEK million

	Jan-June 2009	Jan-June 2009	Jan-Dec 2008
Net interest income	421	1,315	4,266
Dividends received	1,779	2,664	3,666
Net income from listed shares and units	6,816	-18,044	-51,540
Net income from unlisted shares and units	-2,209	-527	-2,507
Net income from interest-bearing assets	2 805	508	266
Net income from derivative securities	-661	-3,249	-1,465
Net income from currencies	551	-446	2,837
Net commission expenses	-69	-66	-143
<b>Total operating income</b>	<b>9,433</b>	<b>-17,845</b>	<b>-44,620</b>

### Operating expenses

Staff costs	46	49	89
Other administrative expenses	29	23	48
<b>Total operating expenses</b>	<b>75</b>	<b>72</b>	<b>137</b>
<b>Net income for the period</b>	<b>9,358</b>	<b>-17,917</b>	<b>-44,757</b>

## Balance sheet

### Assets, SEK million

	2009-06-30	2008-06-30	2008-12-31
Shares and units,			
Listed	94,024	109,228	89,130
Unlisted	17,271	13,287	16,406
Bonds and interest-bearing assets	71,769	80,473	84,304
Derivatives	4,238	2,750	3,117
Cash and cash equivalents	2,555	3,301	2,607
Other assets	8,029	1,154	838
Prepaid expenses and accrued income	1,322	1,510	1,636
<b>Total assets</b>	<b>199,208</b>	<b>211,703</b>	<b>198,038</b>

### Fund capital and liabilities

Liabilities			
Derivatives	2,041	1,734	15,696
Other liabilities	8,436	2,246	1,209
Deferred income and accrued expenses	89	102	109
<b>Total liabilities</b>	<b>10,566</b>	<b>4,082</b>	<b>17,014</b>

### Fund capital

Fund capital at 1 Jan	181,024	224,897	224,897
Net payments to/from the pension system	-1,740	628	831
Transfers from special asset management and phase-out funds	0	13	53
Net income for the period	9,358	-17,917	-44,757
<b>Total fund capital</b>	<b>188,642</b>	<b>207,621</b>	<b>181,024</b>
<b>Total fund capital and liabilities</b>	<b>199,208</b>	<b>211,703</b>	<b>198,038</b>

## Summary 2001 – June 2009

		Jan- June 2009	2008	2007	2006	2005	Annual 2001- 2009	Annual <sup>2)</sup> 2007- 2009
<b>Income and inflows</b>								
<b>SEK billion</b>								
Net flows to/from the pension system		-1.7	0.9	2.0	1.6	2.9		
Net income		9.4	-44.8	10.7	18.6	28.8		
<b>Fund capital at 31 Dec</b>		188.6	181.0	224.9	212.2	192.0		
<b>Returns and expenses</b>								
<b>total portfolio,</b>								
<b>%</b>								
Return before expenses		5.3	-19.7	5.1	9.7	17.9		
Operating expenses		0.08	0.07	0.06	0.06	0.07		
Commission expenses		0.08	0.07	0.07	0.08	0.09		
Return after expenses		5.2	-19.8	5.0	9.5	17.7	2.5	
Inflation		0.39	0.90	3.45	1.63	0.82	1.6	
Real return after expenses		4.8	-20.5	1.5	7.8	16.7	0.9	
<b>SEK billion</b>								
Return after commission expenses		9.4	-44.6	10.8	18.7	28.9	4.1	
Operating expenses		0.1	0.2	0.1	0.1	0.1	0.2	
Return after expenses		9.4	-44.8	10.7	18.6	28.8	3.9	
<b>Return and risk</b>								
Return %	Portfolio	8.3	-21.9	4.1	8.9	17.3		-4.9
	Index	7.0	-20.5	4.4	9.1	16.1		-4.6
	Active	1.3	-1.4	-0.3	-0.2	1.2		-0.3
Risk (standard deviation) %	Portfolio	12.3	16.6	7.3	6.3	4.5		12.7
	Index	12.2	16.6	7.2	6.1	4.3		12.6
	Active	0.8	0.8	0.5	0.5	0.5		0.7
Information ratio		3.3	neg	neg	neg	2.2		neg
Sharpe ratio		1.3	neg	0.1	1.1	3.4		neg
<b>Currency exposure</b>								
% of total portfolio		17.3	13.8	9.0 <sup>(1)</sup>	9.0 <sup>(1)</sup>	14.7 <sup>(1)</sup>		
<b>External management</b>								
% of total portfolio		39.4	38.8	39.9	40.4	45.3		
<b>Asset management expenses</b>								
% of assets under management								
Operating expenses		0.08 <sup>(2)</sup>	0.07	0.06	0.06	0.07		
Operating expenses + commission expenses		0.16 <sup>(2)</sup>	0.14	0.13	0.14	0.16		

	Jan- June 2009	2008	2007	2006	2005
<b>Market value per asset class</b>					
SEK billion	188.6	181.0	224.9	212.2	192.0
Swedish equities <sup>(3)</sup>	21.5	17.9	24.0	26.8	30.7
Foreign equities <sup>(3)</sup>	69.6	66.0	93.5	88.8	80.2
Nominal Swedish fixed income	13.8	13.7	13.6	18.0	25.6
Nominal foreign fixed income	39.5	39.2	59.3	44.5	42.5
Index-linked Swedish fixed income	4.7	5.4	7.4	12.0	6.7
Index-linked foreign fixed income	9.5	8.7	11.3	10.4	1.9
Swedish and foreign private equity <sup>(3)</sup>	9.4	10.8	9.5	6.4	
Real estate (incl. timberland)) <sup>(4)</sup>	15.9	16.2	6.4	5.5	4.4
New strategies <sup>(5)</sup>	4.8	3.1			
<b>Number of employees</b>					
	54	50	51	50	48

(1) Excluding exposure through SEK-listed companies with a foreign domicile.

(2) Expenses converted to annualised rates.

(3) Swedish and foreign equities include listed equities and private equity prior to 2006. As of 2006, listed equities and private equity are reported separately.

(4) Private equity includes listed life science holdings prior to 2008. As of 2008, these holdings are included in alternative strategies.