



Andra AP-fonden
Second Swedish National Pension Fund - AP2

Half-year report

January 1st – June 30th 2002

The Second Swedish National Pension Fund/AP2 is a "buffer fund" within the Swedish National Pension system, entrusted with managing the pension assets of the Swedish people, with a view to generating maximum return at minimum risk.

The Second Swedish National Pension Fund, which is located in Gothenburg, started operations on January 1st 2001.



Financial uncertainty demands a long-term and focused approach

The return on the Fund's invested assets for the six months ending June 30th, adjusted for in-flow, amounted to **-9.3%**, in line with the Fund's reference index. Combined pension assets under the Fund's management

amounted to **SEK 124.3 billion** at the close of this period. At the start of

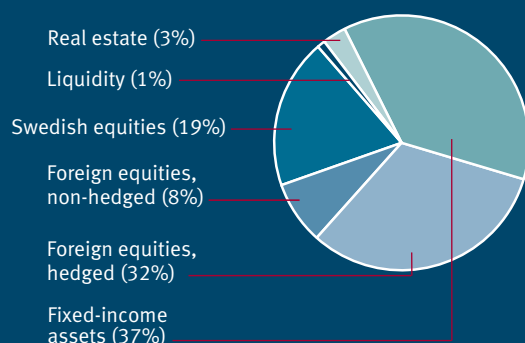
the year, the worth of these assets was estimated at **SEK 133.5 billion**. This decline in value is largely unrealised. Value growth in the various classes of asset

varies sharply, reflecting the development on global capital markets. Fixed-income instruments

have demonstrated the best overall performance. The Fund has surpassed its reference

index with respect to foreign equities, hedged as well as non-hedged. The performance of the Swedish equities portfolio, however, was below reference index.

Portfolio as per June 30th 2002 (%)



The portfolio assets referred to in this report are allocated exposures. In addition to booked market 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 market values.



Fund capital by class of asset

| Amounts in SEK billion | June 30 th 2002 | June 30 th 2001 | Dec. 31 st 2001 |
|--|-------------------------------|-------------------------------|-------------------------------|
| Swedish equities | 23.5 | 28.6 | 26.2 |
| Foreign equities, hedged | 39.5 | 16.9 | 40.7 |
| Foreign equities, non-hedged | 9.6 | 17.8 | 13.2 |
| Fixed-income assets, incl. liquidity | 47.1 | 64.5 | 48.6 |
| Real estate, incl. alternative investments | 4.6 | 4.6 | 4.7 |

- The Fund's fixed-income portfolio developed in parity with the market and generated a return of 2.5%. Its estimated worth, including liquidity, amounted to SEK 47.1 billion on June 30th 2002.
- The hedged portfolio of global equities generated a negative return of -11.3%, amounting to SEK 39.5 billion by the end of the period. During the same period, the non-hedged portfolio noted a negative return of -19.6%, with an allocated exposure of SEK 9.6 billion. The difference derives from the increase in the value of the krona during the first half.
- The return on the portfolio of Swedish equities amounted to -22.9%. By the close of the first six months, the portfolio of Swedish equities was worth SEK 23.5 billion. In the telecom sector, the decline in the value of the Ericsson share has played a particularly decisive role in exacerbating this negative trend.
- The Second Swedish National Pension Fund/AP2's investments in unlisted real estate holdings, consisting of a 25-percent stake in AP-Fastigheter and a 33-percent stake in Norrporten, have performed well. Their combined worth is estimated at SEK 4.5 billion, including a convertible subordinated loan.
- Business area Alternative Investments (unlisted equities managed via funds) is still in the build-up phase, and several investment opportunities are currently being evaluated. As at June 30th 2002, these assets were valued at SEK 73 million.
- As a significant institutional investor, the Second Swedish National Pension Fund/AP2 reviews its corporate governance policy on a continuous basis, to focus and clarify the Fund's position and response in relation to corporate governance issues.
- During the spring, the Fund has partially revised its investment strategy. Among other things, this creates opportunities to increase the Fund's relative holdings in small and medium-sized companies, mainly in Sweden but also on the global market. The current portfolio will be adjusted gradually in compliance with this new investment strategy.

Considerable market uncertainty affects first half earnings

The result of the Second Swedish National Pension Fund/AP2's asset management activities during the

first half of 2002 was negative, reflecting the sharp decline on both Swedish and international stock markets. The decline of almost 22 percentage units that the Swedish stock market noted by the close of the period had an especially negative impact on the growth of the Fund's capital. The Fund's management performance in Swedish equities, as against index, is unsatisfactory. In contrast, development of the portfolio of global equities has exceeded the reference index, which has gone some way to improving the relative return on investment.

Based on a rolling twelve-month perspective, the Fund's combined return on investment amounted to -10.2%, exceeding the return on investment noted by the Fund's reference index, which generated a return of -11.6% for the same period.

The decline in the value of the Fund's capital assets is largely unrealised, due to the fact that the Fund's extremely long-term investment strategy allows for a degree of "hibernation" in responding to short-term dips in the market. Unlike many other institutional investors, subject to pressures such as consolidation demands, the Second Swedish National Pension Fund/AP2 has avoided having to realise the current decline in the market worth of its assets. The Fund's long-term approach and its balanced portfolio of different classes of asset make comparisons with other fund managers and life insurance companies largely irrelevant.

The potential impact of a single very weak year on stock markets should be seen in terms of the Fund's extremely long-term investment horizon. Assuming that the long-term development of international capital markets reflects the historical trends noted over the past hundred years, current market developments are expected to have only a limited impact on Fund disbursements to the national pension system, which are likely to be needed as of 2010.

The economic trend

Economic growth in the OECD region noted an upturn during the first half of 2002. Corporate and household expectations of economic growth developed faster than expected during the winter and spring, especially in the USA. The adjustment in inventories which had been the main cause of the earlier slowdown in the

Change in reference portfolio

| % of total portfolio | Share in % June 30 th 2002 | Future share in % | Exposure Dec. 31 st 2001 | Exposure June 30 th 2002 |
|--|--|----------------------|--|--|
| Swedish equities | 20 | 20 | 20 | 19 |
| Foreign equities, hedged | 30 | 32 | 30 | 32 |
| Foreign equities, non-hedged | 10 | 6 | 10 | 8 |
| Equities on growth markets, non-hedged | — | 2 | — | — |
| Swedish nominal fixed-income instruments | ¹⁾ | 16 | 37 ²⁾ | 38 ²⁾ |
| Swedish real fixed-income instruments | ¹⁾ | 5 | — | — |
| Foreign nominal fixed-income instruments | — | 16 | — | — |
| Real estate | ¹⁾ | 3 | 3 | 3 |

1) Total framework = 40%

2) Total fixed-income, including disposable liquid funds.

The composition of the new reference index is being revised and will be presented after New Year 2003.

global economy was a significant contributory factor to this later recovery. The sharp rate of decline in corporate investment during 2001 has now gradually slowed, and households are continuing to increase their rate of consumption by around 2%.

An important factor behind this recovery was the massive eco-political stimulus provided during 2001 in the form of low real interest rates and an expansive financial policy. A more optimistic view of growth in the global economy has developed during the first six months of the year. In mid-August, a broad representative panel of economic analysts estimated that GNP growth throughout the world would gradually accelerate to almost 2% in 2002 and close to 3% in 2003.

The downturn in the global economy has also left its mark on the Swedish economy. Growth in Sweden's economy has nevertheless been sustained at a relatively high level. The Bank of Sweden was also one of the first central banks to raise interest rates during the first half of the year. During this period, the Swedish krona has also strengthened in response to political signals concerning Sweden's possible eventual membership of the EMU.

A recovery seems to be around the corner. Nevertheless, this upturn is still fragile, with signs of a slowdown in the rate of growth towards the end of the second half. Consumer demand remains decisive to such a recovery, as does corporate demand for investment products in the second half. The sharp downturn on global stock markets during the summer has increased the risk of a weaker recovery by the major economies.

The decline of global stock markets continued during the first six months of the year. A broad index such as MSCI World fell by 12.1% during the first half. The corresponding decline on the Stockholm stock market index (SIXRX) was 21.9%. Bond interest rates at the close of the first six months were at approximately the same levels as at the start of the year. Expectations that the central banks would raise their rates were replaced by the possibility of new reductions in interest rates during the autumn.

Stock markets continued to be driven by the long-term reassessment of technology sectors which has continued since March 2000. This applies first and foremost to those sectors that noted a major decline in mar-

ket rates during the first half, while other sections of the stock market have suffered less dramatic declines. At the same time, the news from many exchange-listed companies has remained negative concerning the short-term earnings trend. During the first six months of the year, the accountancy scandals in the USA have undermined confidence in the stock market and further fuelled uncertainty surrounding corporate profits. Furthermore, many investors are increasingly sceptical about the expectations of an upswing in profits forecast by analysts for the second half of 2002 and in 2003.

Asset management

The Fund's in-house team, in cooperation with external partners, manages assets that consist mainly of Swedish and foreign equities and fixed-income portfolios. The actual composition of the assets that comprise the portfolio is determined by a "strategic reference portfolio", approved annually by the Board of Directors, which is formulated to satisfy the Fund's long-term commitments. The performance of the strategic reference portfolio is compared on a continuous basis against the fixed reference index. The objective is to generate an annual surplus yield of 0.5% over the long term, relative to the reference portfolio, based on an investment horizon of about ten years.

The Board of Directors bases the composition of the reference portfolio on an annually revised ALM (Asset Liability Modelling) study, which is used to estimate how the assets on which future pension commitments rely can best be built up, at limited risk.

Based on data generated by the ALM study conducted in the spring of 2002, the Board of Directors has decided to modify and refine the portfolio. Compared with its predecessor, the new reference portfolio features global diversification of the bond portfolio and an increase in the relative share of corporate bonds. In a move to reduce the Swedish equities portfolio's dependence on stocks in a few large companies, the classes of asset that comprise Swedish equities have been divided up, with a view to increasing the relative proportion of equities held in small and medium-sized companies. Added to this, new classes of asset such as equities in growth markets and real estate have been defined in a slightly different way from earlier.

Return in relation to index, January–June 2002

Second AP Fund

Reference index

| | | | |
|------------------------------|---------|--------------------------------------|---------|
| Total return | – 9.3% | Total index ¹⁾ | – 9.3% |
| Swedish equities | – 22.9% | SIXRX | – 21.9% |
| Foreign equities, hedged | – 11.3% | MSCI World Local | – 12.1% |
| Foreign equities, non-hedged | – 19.6% | MSCI World | – 20.3% |
| Fixed-income instruments | + 2.5% | SHB fixed-income index ²⁾ | + 2.6% |

1) Consists of SIXRX 20%, MSCI World Local (hedged) 30%, fixed-income index 40% and MSCI World (non-hedged) 10%.

2) Consists of 45% NomGovt, 23% SHB T-Bill, 12% SHM Mortgage, 15% Real Estate Govt and 5% SHB Corporate.

Key events of the first half

The establishment of the Second Swedish National Pension Fund/AP2 was initiated in autumn 2000 and has been conducted in several and to some extent parallel stages. At year-end 2001 this process had been completed.

During spring 2002, the Swedish Government submitted its customary performance report on the Swedish National Pension Funds for consideration by the Swedish Parliament. Among other things, the report notes that one year is too limited a period to permit correct evaluation of the Funds' performance. The Swedish Government cites five years as a suitable evaluation period. The report also notes that although the transactions of the First, Second, Third and Fourth Swedish National Pension Funds did affect the exchange rate of the Swedish krona in 2001, the effects were only limited.

During the spring, the Second Swedish National Pension Fund/AP2, in its role as a major shareholder in several Swedish companies, has invested considerable resources in addressing questions that fall within the "corporate governance" framework. The evaluation of various forms of incentive programme and the adoption of a clear standpoint in connection with a number of decisions by Annual General Meetings has been a frequent aspect of this work. During the spring, the Fund has participated in close to 50 AGMs.

Also during the spring, the Fund completed international negotiations to procure the services of a global custodian and cash management bank. It had to be able to meet the Fund's and its external partners' support and service requirements on every geographic market in which the Fund is active. The final phase of these negotiations involved a thorough evaluation of 11 internationally active banks, three of which were Swedish. The final choice fell on State Street Bank & Trust Company, which will serve as the Second Swedish National Pension Fund/AP2's custodian bank for the next two years.

During the autumn, the Fund will adopt a similar approach when evaluating and procuring the services of external investment managers for various commissions within the equities and fixed-income sectors.

Financial review

The Fund noted a negative return on invested assets of –9.3% for the first half of 2002, a result mirrored by the Fund's reference index.

The net inflow of liquid funds during the period amounted to SEK 4 billion, of which SEK 1.2 billion was in the form of inflows from the National Social Insurance Board (RFV). The remainder of this net inflow was in the form of dividends from "special funds", managed respectively by the First and Fourth Swedish National Pension Funds.

Dividends received totalled SEK 1.2 billion.

The negative return of SEK –877 million on foreign exchange transactions is the net result of realised foreign exchange gains amounting to SEK 1.4 billion, less unrealised net foreign exchange losses of SEK 2.3 billion.

The Fund's reported liquidity of more than SEK 7 billion includes liquid funds earmarked as collateral for positions taken in derivative instruments.

The Fund's result for the period amounted to SEK –13.3 billion. Unrealised changes in value account for SEK –10.6 billion of this amount. These changes in value pertain to the Fund's holdings in listed equities and fixed-income securities.

At the close of the six months ending June 30th 2002, 7.7% of Fund assets were exposed in foreign currency. This currency exposure, which mirrors index, applies also to the foreign share portfolio, consisting mainly of positions in US dollars, euros and sterling.

Growth trends for different classes of asset

Swedish equities

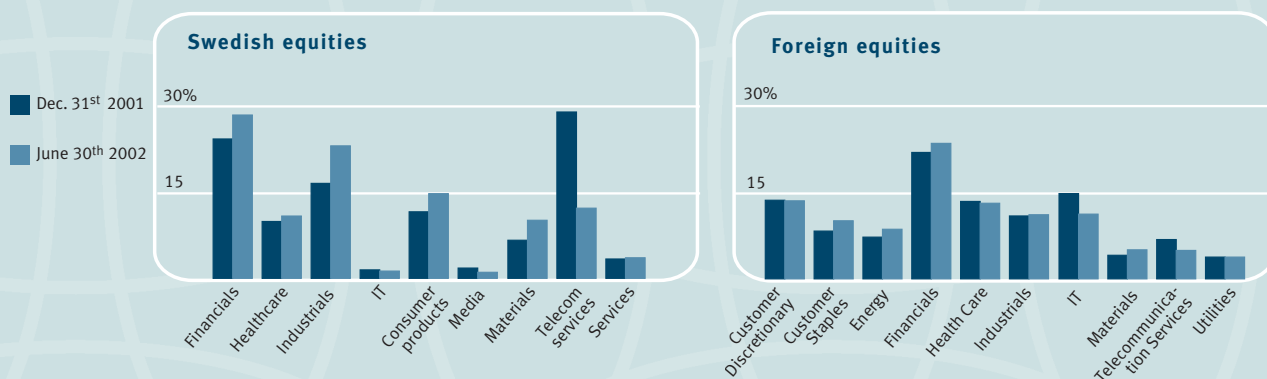
At the start of the year, the portfolio of Swedish equities was valued at SEK 26.2 billion. By the close of the first half, its worth had fallen to SEK 23.5 billion. This decline is largely attributable to the sharp fall in share prices noted by the Swedish stock market dur-



The potential impact of a single very weak year on stock markets should be seen in terms of the Fund's extremely long-term investment horizon.



Distribution of Second AP2 Fund shareholdings by sector



ing the report period, which resulted in a negative return of -22.9%. The SIXRX index noted a -21.9% decline during the same period.

The negative deviation from index may be partially explained by index-related over-exposure in a few capital intensive equities in the telecom and finance sectors.

The Fund's five largest Swedish holdings in terms of market worth as per June 30th 2002 were its shares in H&M (8.2%), AstraZeneca (7.5%), Nordea (6.5%), Ericsson (5.2%) and SCA (5.0%).

Foreign equities

The combined worth of the foreign equities portfolio was SEK 53.9 billion at the start of the year.

By the close of the first half, the portfolio was worth SEK 49.1 billion.

The return on the portfolio of non-hedged foreign equities amounted to -19.6% for the period, compared with the MSCI World Index, which noted -20.3% for the same period.

The hedged portion, which accounts for the greater part of the Fund's foreign equities portfolio, generated a return of -11.3% during the period, compared with the -12.1% noted by the MSCI World Local Index.

The Fund had no shares in US telecom operator Worldcom, when the company sought protection from its creditors under Chapter 11.

At the close of the report period, the Fund's five largest holdings in foreign companies were in General Electric (2.0%), Exxon Mobil (1.9%), Microsoft (1.7%), Pfizer Inc. (1.5%) and Citigroup (1.4%).

Fixed-income assets

The market value of the Fund's fixed-income portfolio as per June 30th, excluding liquid funds, was slightly more than SEK 46.3 billion, more or less equivalent to its market value at year-end 2001.

During the first half, the Fund's fixed-income and bond portfolio was diversified and now consists of a significantly greater number of instruments than earlier, when treasury bills were the predominant class of asset. In addition to nominal and real treasury bills, the portfolio now contains a substantial portion of housing bonds and Swedish corporate bonds. The return on the fixed income portfolio was 2.5% for the period, while the reference index for the same period noted a return of 2.6%.

Liquidity

The Fund's liquid assets consist of collateral for positions held in derivatives, allocated liquidity and disposable liquidity, to a declared value of SEK 7.3 billion.

Alternative investments

The Fund's holdings in the asset class Alternative Investments (unlisted funds) are being built up.

The Second Swedish National Pension Fund/AP2 will explore opportunities for expanding investment in this class of asset during 2002.

Real estate

The Fund's real-estate exposure consists partly of a participation in the portfolio of listed shares, and partly of substantial holdings in the unlisted real-estate companies AP-Fastigheter (25%) and Norrporten (33.3%). In spite of the uncertain economic climate, the Fund's investments in the unlisted real-estate sector show solid growth. At the close of the report period, the real estate portfolio was worth SEK 4.5 billion.

Management costs and personnel

Management costs for the Second Swedish National Pension Fund/AP2 for the six months ending June 30th 2002 amounted to SEK 96 million. This corresponds to 0.07% of the total value of assets under management during the report period.

During the period, the number of staff increased from 28 to 35.

The Fund's assets are managed both in-house and through cooperation with external partners. Since its inauguration, the Fund has pursued a strategy that has involved external management of a substantial proportion of its assets. As per June 30th 2002, assets totalling SEK 57.7 billion were under management by external investment managers, corresponding to 46% of total assets under management.

Gothenburg, August 26 2002

Lars Idermark
CEO

Income statement

| Amounts in SEK million | June 30 th 2002 | June 30 th 2001 | Dec. 31 st 2001 |
|-------------------------------------|----------------------------|----------------------------|----------------------------|
| Operating income | | | |
| Dividends received | 1 196 | 622 | 823 |
| Net interest income | 1 493 | 2 043 | 3 775 |
| Net capital loss | -4 349 | - 818 | -3 918 |
| Exchange profit/loss, net | -877 | 1 364 | 899 |
| Unrealised change in value | -10 635 | - 6 880 | -6 397 |
| Total operating income | -13 172 | - 3 669 | -4 818 |
| Operating expenses | | | |
| External asset management costs | -26 | -23 | -47 |
| Personnel costs | -26 | - 6 | -22 |
| Other costs | -44 | - 51 | -118 |
| Total operating expenses | -96 | - 80 | -187 |
| Net profit/loss for the year | -13 268 | - 3 749 | -5 005 |

Balance sheet

| Amounts in SEK million | June 30 th 2002 | June 30 th 2001 | Dec. 31 st 2001 |
|--|----------------------------|----------------------------|----------------------------|
| ASSETS | | | |
| Investment assets | | | |
| Shares and participations | | | |
| Listed | 60 392 | 63 394 | 77 743 |
| Unlisted | 3 953 | 4 048 | 4 139 |
| Bonds and other fixed income securities | 49 332 | 62 755 | 48 172 |
| Derivatives | 5 660 | 38 | 585 |
| Total investment assets | 119 337 | 130 235 | 130 639 |
| Receivables and other assets | | | |
| Cash and bank balances | 7 307 | 1 274 | 1 916 |
| Other assets | 53 | 80 | 43 |
| Prepaid expenses and accrued income | 1 125 | 1 079 | 1 193 |
| Total receivables and other assets | 8 485 | 2 433 | 3 152 |
| TOTAL ASSETS | 127 822 | 132 668 | 133 791 |
| FUND CAPITAL AND LIABILITIES | | | |
| Fund capital | | | |
| Fund capital at start of year | 133 493 | 133 975 | 133 975 |
| Net disbursements to the National Pension Scheme | 1 163 | 1 697 | 3 062 |
| Reimbursement from "special funds" management | 2 876 | 456 | 1 461 |
| Net profit/loss for the period | -13 268 | -3 749 | -5 005 |
| Total fund capital | 124 264 | 132 379 | 133 493 |
| Liabilities | | | |
| Derivatives | 3 258 | 210 | 217 |
| Other liabilities | 116 | 57 | 48 |
| Prepaid income and accrued expenses | 184 | 22 | 33 |
| Total current liabilities | 3 558 | 289 | 298 |
| TOTAL FUND CAPITAL AND LIABILITIES | 127 822 | 132 668 | 133 791 |

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

Next report:

The financial results for the full twelve months ending December 31st 2002 will be presented in a year-end report of unaudited annual earnings, scheduled for publication in February 2003. The annual report for the financial year 2002 will be published in the spring of 2003.

The lighthouse shown on the cover is Vacker Lighthouse, which stands at Tjurpannan in the county of Bohuslän.

Photo: Tommy Johansson.

