

**INTERIM REPORT JANUARY – JUNE 2016**



## JANUARY – JUNE HIGHLIGHTS

- Net investment income for the first six months of 2016 was SEK 10.6 billion (14.3).
- Return after expenses was 3.5 per cent (5.0).
- Measured over the last ten-year period, average real return was 4.8 per cent (5.3), which is above the Fund's long-term target of 4.0 per cent real return after expenses measured over rolling ten-year periods.
- Net assets rose by SEK 7.3 billion (11.9) to SEK 297.5 billion.
- Första AP-fonden invested in Resonance Industrial Water Infrastructure Limited, which focuses on financing water purification and water recycling for industrial use on a global basis.
- During the period the Fund transferred SEK 3.2 billion (2.4) to the Swedish Pensions Agency.
- The Fund's administrative expenses decreased, amounting to SEK 215 million (253), equalling 0.15 per cent (0.17) annualised of assets under management.
- Per Nordberg stepped down from the Board on 19 May. As of 1 July, Urban Hansson Brusewitz became a member of the Board.

	Jan–Jun 16	Jan–Jun 15	Jan–Dec 15
Closing net assets	<b>SEK 297.5 bn</b>	SEK 295.7 bn	SEK 290.2 bn
Net investment income for the period	<b>SEK 10.6 bn</b>	SEK 14.3 bn	SEK 11.3 bn
Net flow to the pension system	SEK -3.2 bn	SEK -2.4 bn	SEK -4.9 bn
Opening net assets	SEK 290.2 bn	SEK 283.8 bn	SEK 283.8 bn
Expense ratio Operating expenses	0.06 %	0.06 %	0.06 %
Expense ratio inc. Commission expenses	0.15 %	0.17 %	0.17 %
Return after expenses	3.5 %	5.0 %	4.0 %
Real return after expenses	2.8 %	4.9 %	3.9 %

Annualised return after expenses 5.0 years	8.1 %
Annualised return after expenses 10.0 years	5.9 %

Real annualised return after expenses 10.0 years	<b>4.8 %</b>
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Första AP-fonden is one of five funds that manage buffer capital in the Swedish national income pension system and are governed by the Swedish National Pension Funds Act (2000:192) – the AP funds. For other information regarding Första AP-fonden, please refer to the Fund's website, [www.ap1.se](http://www.ap1.se). All values in this report are expressed in Swedish kronor. Millions of kronor are abbreviated as SEKm, and billions of kronor are abbreviated as SEKbn. Figures in brackets denote the corresponding figures for the period January–June 2015, unless otherwise indicated. The basis of tables and charts is the Fund's own data unless an alternative source is provided.

### Accounting and valuation policies

This interim report was prepared in accordance with the accounting and valuation policies jointly prepared by the AP Funds. These are summarised in the 2015 annual report. The January – June report has not been reviewed by the Fund's auditors.



## SOLID RETURN WITH A WELL-DIVERSIFIED PORTFOLIO



Första AP-fonden's return for the first six months of the year was 3.5 per cent after expenses. Net assets increased by SEK 7.3 billion to SEK 297.5 billion. Real return after expenses for the past ten years is 4.8 per cent, which is above the Fund's long-term target.

The Fund's well-diversified portfolio has performed well thanks to a high share of capital in alternative investments. The risk parity portfolio (within alternative strategies), the low-volatility portfolio and real estate performed particularly well. Hedge funds, high yields, infrastructure and private equity funds also performed better than our investments in equity and bond markets. For a long time, Första AP-fonden has consciously been increasing the share of unlisted investments, often called alternative investments, in order to create a more robust portfolio which correlates to a lesser extent with equity markets over time. This type of asset management is generally more costly than for listed securities,

and requires its own specific expertise. It is therefore positive that our expenses as a share of capital are now declining, which contributes positively to net investment income, despite the fact that we are increasing our number of employees. It is mainly commission expenses that are declining thanks to more cost-efficient management structures, and the fact that we are increasing the share of internally managed assets.

The global growth trend was relatively stable in the first half of the year. The US economy is increasingly exhibiting clear signs of being in the late stage of the business cycle, with low and declining unemployment and rising inflation. The EMU and Japan, however, face major structural challenges and the battle against deflation has top priority. The Chinese economy has shifted down a gear, and the current vital transformation from investment-led to consumer-led growth poses a risk to the global trend. Commodity-sensitive emerging markets are noting some improvement, with imbalances between supply and demand on the major commodity markets gradually decreasing. At the end of June, the UK voted for a Brexit – to leave the EU. Reactions on the financial markets were as expected, with major initial downturns and a sharp weakening of the GBP. We expect markets to remain volatile in the autumn.

I am concerned about the current investment climate, with major structural threats, high valuation levels and central banks competing to weaken their currencies through extremely low interest rates and quantitative measures. This type of environment is a hotbed for asset bubbles. In that case, exercising caution and having realistic expectations of return are paramount. We expect relatively moderate return in the long term, meaning that reaching our long-term return target will be a challenge.

### Sustainability

As the international environment changes, it is important that we continue to develop our processes for how we make and follow-up on our investments. At the end of last year, we renewed our sustainability vision and strategy.

Through our investments and shareholder activism, our wish is to be part of the solution to the world's global challenges. With increasingly tight resources, using them efficiently is key to taking on these challenges. While this is of course about the climate issue, there are many other areas that are important to sustainable development and long-term value creation. The carbon footprint of our equity portfolio is already low, and we find it necessary to take a broader view beyond the climate issue alone. We have therefore chosen to focus on resource efficiency. By that, we mean the responsible use of financial capital, natural resources and human capital. We are now working to implement the strategy in all of our investments.

An example is the review of our successful low-volatility strategy, which is expected to generate return on a par with the equity market over time, but at lower risk and with lower fluctuations in return. However, as a rule the strategy is linked to investments in certain CO<sub>2</sub>-intensive companies. We are therefore investigating how the strategy can be made more resource-efficient, not merely focusing on carbon footprint, but also the use of water and other natural resources.

Another part of the strategy is about making dedicated sustainability investments with a focus on resource efficiency. One such initial investment was made in Resonance Industrial Water Infrastructure Fund – a company that helps industries around the world to finance, modernise and run water purification facilities. The tremendous need in this area is underscored by the fact that existing facilities are often very old, and that around 80 per cent of water reserves in China are considered polluted.

## Engaged owner

For us, as an engaged owner with a long-term focus, it is important that the companies we own are well-managed. We are therefore engaged in corporate governance, both abroad and in Sweden, and have decided to increase our resources in this area. Our ambition includes voting at more foreign AGMs and engaging in dialogue with more companies.

As usual, at the Swedish AGMs in the spring, there was wide support between boards and shareholders. In Swedbank, however, a series of events led us to lose confidence in the bank's chairman. Together with other shareholders, in the end we obtained a better board than the initial proposals of the nomination committee.

A long-term approach, engagement and cost-efficiency are important guiding principles in our continued work to generate solid return for present and future pensioners.

Stockholm, July 2016

Johan Magnusson, CEO

## FUND PERFORMANCE IN JANUARY–JUNE 2016

**Första AP-fonden's net investment income for January – June 2016 was SEK 10.6 billion (14.3), giving a return after expenses of 3.5 per cent (5.0).**

Measured over the last ten-year period, return after expenses was 5.9 per cent. In real terms, this equals 4.8 per cent. The outcome means that the Fund has overshot its target of 4.0 per cent real return since it was introduced. The Fund has contributed SEK 138.6 billion to the pension system over the ten-year period.

In the first six months of 2016, the Fund transferred SEK 3.2 billion (2.4) to the pension system to cover the deficit in pension contributions in relation to pension disbursements. Since 2009, the Fund has contributed SEK 33.1 billion to cover the deficit in pension disbursements.

### Asset allocation

In the first six months of 2016, Första AP-fonden had an exposure of around 33.6 per cent to listed equities, 27.0 per cent to fixed income assets and 40.1 per cent to alternative investments such as real estate, private equity funds, hedge funds and infrastructure.

### Sustainable value creation

Första AP-fonden's entire asset management is steeped in its ambition to generate long-term sustainable value growth. This includes, in accordance with the mandate from Swedish Parliament, taking ethics and the environment

into consideration in investment decisions. It also encompasses working actively with shareholder activism in existing holdings to steer them towards sustainable business. In all asset classes, sustainability is taken into consideration in investment decisions.

### Equities

At the end of June, Första AP-fonden's equity portfolio was valued at SEK 96.3 billion, broken down into 40 per cent in foreign developed countries, 24 per cent in emerging markets and 36 per cent in Sweden. Swedish equities and equities in foreign developed countries are managed internally at the Fund, with a focus on large and medium-sized companies. Emerging markets and small caps are dealt with by external managers. Besides in the equity portfolio, the Fund has listed equities reported under other assets in the Systematic Strategies sub-portfolio.

The equity portfolio displayed a negative performance in the first six months of the year. Allocation to Swedish equities and developed countries contributed negatively, while emerging markets performed positively. The return of the equity portfolio in the first six months was -1.7 per cent, equalling SEK -1.4 billion.

### Net investment income for January – June 2016 before expenses in local currency

Asset class	Contribution, SEKbn	Contribution, %	Portfolio return, %
Equities	-1.4	-0.5	-1.7
Sweden	-1.8	-0.6	-5.5
Developed countries	-0.9	-0.3	-2.4
Emerging markets (in USD)	1.2	0.4	5.7
Fixed income securities	2.1	0.7	2.6
Real estate	2.5	0.8	7.9
Infrastructure	0.3	0.1	4.0
Hedge funds	0.7	0.2	4.7
Private equity funds	0.4	0.1	2.6
High yield	0.4	0.1	4.2
Alternative strategies	1.6	0.5	12.8
Systematic strategies	1.8	0.6	9.6
Special investments	-0.2	-0.1	-6.7
Allocation, cash, foreign exchange	2.6	0.9	0.9
<b>Total</b>	<b>10.8</b>	<b>3.6</b>	<b>3.6</b>

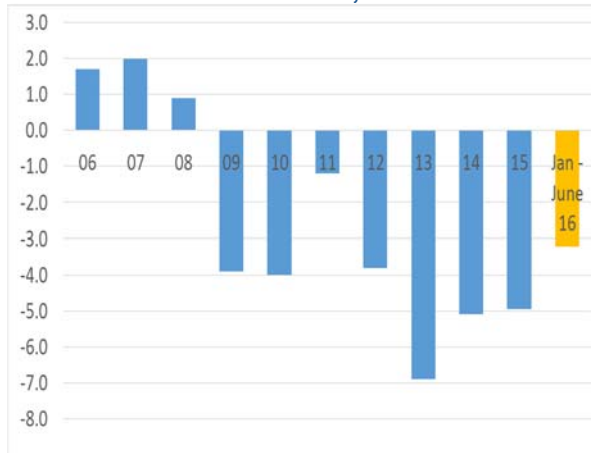
Return after exp. 2006 – June 2016, %



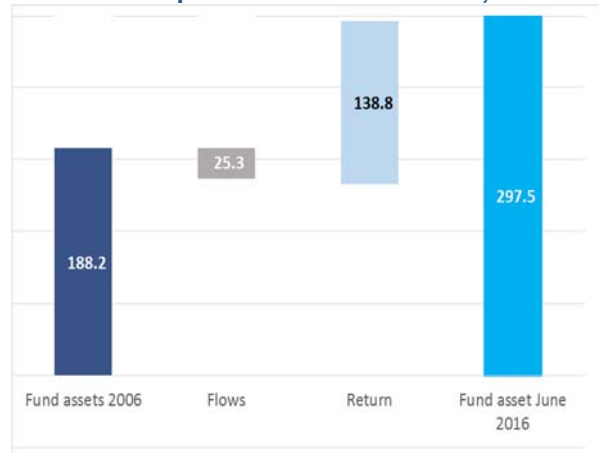
Return %, Jan–Jun 2016



Net flows 2006 – June 2016, SEKbn



Asset development 2006 – June 2016, SEKbn



### Fixed income securities and foreign exchange

Första AP-fonden’s fixed income portfolio was valued at SEK 80.2 billion at the end of June, equalling 27.0 per cent of net assets. Adding to this is also fixed income securities of 3.8 per cent within other asset classes. According to the applicable definition in the AP Funds Act, the share of safe bonds is thus 30.8 per cent. The majority is invested in foreign securities. Första AP-fonden’s fixed income portfolio consists of nominal government bonds, credit bonds and real bonds.

Return on the Fund’s fixed income portfolio was 2.6 per cent, equalling SEK 2.1 billion before expenses for January – June 2016.

### Real estate

Första AP-fonden’s real estate holding was valued at SEK 33.6 billion at the end of June, equalling 11.3 per cent of net assets. These are mainly focused on running return from rent payments, and to a lesser extent on investments with expected value appreciation as the main return component.

The value of the portfolio increased thanks to value growth in the existing holding, and through supplementary investments in wholly or partially owned companies. The return of the real estate portfolio in the first six months of 2016 was 7.9 per cent, equalling SEK 2.5 billion.

## Hedge funds

Första AP-fonden's hedge fund portfolio was valued at SEK 14.5 billion at the end of June, equalling 4.9 per cent of net assets.

Investments in hedge funds are designed to tone down the effects of sharp price volatility in the rest of the portfolio. In the first half of 2016, the hedge fund portfolio showed a return of 4.7 per cent, equalling SEK 0.7 billion.

## Private equity funds

Första AP-fonden's investments in private equity funds amount to SEK 15.1 billion, equalling 5.1 per cent of net assets. Hence, Första AP-fonden has marginally exceeded the 5.0 per cent restriction. An action plan has been prepared to address this. The Fund invests globally in private equity funds through external managers. Return on this asset class is expected to be higher than for listed equities over time. The return of the private equity portfolio in the first six months of 2016 was 2.6 per cent, equalling SEK 0.4 billion.

## Infrastructure

The Fund's investments in infrastructure amount to SEK 8.8 billion, equalling 3.0 per cent of net assets. At the end of the six-month period, the Fund invested in Resonance Industrial Water Infrastructure Limited, which focuses on financing water purification and water recycling for industrial use on a global basis. Return on the infrastructure portfolio for the first six months of 2016 was 4.0 per cent, equalling SEK 0.3 billion.

## High yield

Första AP-fonden's high yield investments amount to SEK 10.9 billion, equalling 3.7 per cent of net assets. In the high-yield portfolio, investments are made in non-investment grade, high yield bonds. The return of the high yield portfolio in the first six months of 2016 was 4.2 per cent, equalling SEK 0.4 billion.

## Alternative strategies

Första AP-fonden's alternative strategies portfolio amounts to SEK 14.9 billion, equalling 5.0 per cent of net assets. Alternative strategies includes a risk parity portfolio with the purpose of limiting macroeconomic risks without renouncing return opportunities and a

portfolio consisting of alternative beta strategies designed to systematically obtain risk premiums. The return of alternative strategies in the first six months was 12.8 per cent, equalling SEK 1.6 billion.

## Systematic strategies

Första AP-fonden's systematic strategies portfolio amounts to SEK 18.6 billion, equalling 6.3 per cent of net assets. Systematic strategies currently only include investments in equities with low volatility in developed countries. The return of systematic strategies in the first six months was 9.6 per cent, equalling SEK 1.8 billion.

## Special investments

Första AP-fonden's special investments portfolio amounts to SEK 2.9 billion, equalling 1.0 per cent of net assets. Special investments include the Fund's new investment areas, such as agriculture and real estate investments on new markets. The return of special investments in the first six months was -6.7 per cent, equalling SEK -0.2 billion.

## Others

The Fund's expenses are broken down into operating expenses and commission expenses. In the first six months of 2016, operating expenses were SEK 93 million (90).

Commission expenses, which encompass fixed management fees and custodian bank fees, were SEK 122 million (163) in the period. The Fund's total expenses amounted to SEK 215 million (253), equalling an annualised expense level of 0.15 per cent (0.17) in relation to the average value of net assets.

On 30 June 2016, Första AP-fonden had 60 employees (53).

## Events after the close of the reporting period

The referendum in the UK regarding leaving the EU has affected asset values. The valuation of Första AP-fonden's real estate holding in the UK was performed prior to the referendum, and has not affected the values used in this report. The Fund's share in Cityhold is 25 per cent and is valued at SEK 3.5 billion in this report. Just over half of the value of Cityhold's properties are in the UK.



## TEN-YEAR OVERVIEW

	Jan–Jun 2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Net investment income and inflow, SEKbn											
Closing net assets	297.5	290.2	283.8	252.5	233.7	213.3	218.8	202.3	171.6	218.8	207.1
Net flow from the pension system	-3.2	-4.9	-5.1	-6.9	-3.8	-1.2	-4.0	-3.9	0.9	2.0	1.7
Net investment income for the year	10.6	11.3	36.4	25.7	24.2	-4.2	20.5	34.6	-48	9.7	18.2
<b>Return, expenses and risk, %</b>											
Return before expenses	3.6	4.1	14.8	11.3	11.4	-1.7	10.3	20.4	-21.7	4.8	9.8
Operating expenses, annualised, % of AUM	0.06	0.06	0.07	0.07	0.08	0.07	0.08	0.10	0.09	0.08	0.08
Commission expenses, annualised, % of AUM	0.08	0.11	0.10	0.07	0.06	0.05	0.05	0.06	0.07	0.07	0.07
Return after expenses	3.5	4.0	14.6	11.2	11.3	-1.9	10.2	20.2	-21.9	4.6	9.6
Inflation	0.7	0.05									
Real return	2.8	3.9									
Net investment income and expenses in total portfolio, SEKbn											
Net investment income before expenses	10.8	11.8	36.9	26.0	24.5	-4.0	20.8	34.9	-47.7	9.8	18.4
Operating expenses, SEKbn	-0.2	-0.5	-0.5	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Exposure, %											
Equities	33.6	34.7	48.9	49.2	47.4	49.2	60.3	58.6	54.6	59.2	59.8
Sweden	11.8	12.3	11.6	12.0	11.4	12.6	15.7	13.8	11.2	0	0
Developed countries	13.7	14.4	27.1	27.5	25.0	25.3	0	0	0	0	0
Emerging markets	8.0	8.0	10.1	9.7	11.0	11.4	0.0	0.0	0.0	0.0	0.0
Fixed income securities <sup>2</sup>	29.4	30.2	30.9	31.2	36.4	40.9	32.5	34.7	40.1	39.2	37.8
– of which in other assets	2.5	2.3	3.3	1.5							
Cash	-0.6	-0.1	-1.1	-0.7							
Real estate	11.3	11.1	8.8	8.8	7.7	5.6	5.0	3.4	4.0	2.3	2.5
Infrastructure	3.0	2.9									
Hedge funds	4.9	4.8	5.9	4.9	4.3	0.2	0.3				
Private equity funds	5.1	5.0	4.4	3.3	3.2	2.8	2.0	1.7	1.4	0.7	
High yield	3.7	2.9									
Alternative strategies	5.0	4.4									
Systematic strategies	6.3	5.2	5.6	4.8	0.7	0.6	0.7				
Special investments	1.0	1.1									
Foreign exchange	25.7	31.3	35.1	29.2	27.4	21.3	24	21.6	22.2	18.2	16
Risk											
Risk <sup>1</sup>	7.7	8.1	5.4	5	5.9	8.9	7.4	9.7	16.6	7.7	6.8
Sharpe ratio	1.0	0.5	2.6	2.1	1.9	neg.	1.1	2.0	neg.	0.1	1
External management, %											
Share of total portfolio at 31 Dec <sup>3</sup>	32.0	31.0	34.6	37.1	39.3	41.4	43.7	42.4	39.7	36.0	34.2

1) Standard deviation annualised, nominal return before expenses

2) Including the parts of Cash – bank balances – that are included in safe bonds, the Fund's share of safe bonds was 30.8 per cent at 30 June 2016. Besides bank balances, Cash also consists of unrealised changes in value on the Fund's derivative positions.

3) In accordance with a joint decision, the AP funds report wholly or partially owned real estate companies as being internally managed



## PORTFOLIO COMPOSITION

Asset class	30/06/2016			31/12/2015		
	Portfolio value SEKm	Holding %	Exposure %	Portfolio value SEKm	Holding %	Exposure %
Equities	96,334	32.4	33.6	95,632	32.9	34.7
Sweden	34,549	11.6	11.8	35,220	12.1	12.3
Developed countries	38,803	13.0	13.7	37,964	13.1	14.4
Emerging markets	22,983	7.7	8.0	22,449	7.7	8.0
Fixed income securities	80,221	27.0	27.0	80,986	27.9	27.9
Cash	1,731	0.6	-0.6	4,677	1.6	-0.1
<b>Total listed investments</b>	<b>178,287</b>	<b>59.9</b>		<b>181,295</b>	<b>62.5</b>	
Real estate	33,625	11.3	11.3	32,242	11.1	11.1
Infrastructure	8,785	3.0	3.0	8,466	2.9	2.9
Hedge funds	14,473	4.9	4.9	14,023	4.8	4.8
Private equity funds	15,137	5.1	5.1	14,608	5.0	5.0
High yield	10,867	3.7	3.7	8,536	2.9	2.9
Alternative strategies	14,858	5.0	5.0	12,691	4.4	4.4
Systematic strategies	18,600	6.3	6.3	15,210	5.2	5.2
Special investments	2,911	1.0	1.0	3,136	1.1	1.1
<b>Total portfolio</b>	<b>297,544</b>	<b>100.0</b>	<b>100.6</b>	<b>290,207</b>	<b>100.0</b>	<b>100.1</b>
Foreign exchange exposure	76,510		25.7	90,818		31.3

## FOREIGN EXCHANGE EXPOSURE

SEKm	USD	GBP	EUR	JPY	Others	Total
Net assets	136,158	13,975	35,197	2,466	24,387	212,183
Derivatives	-91,741	-15,016	-35,543	11,815	-5,188	-135,673
Foreign exchange exposure, 30 June 2016	44,417	-1,041	-346	14,281	19,199	76,510

## INCOME STATEMENT

SEKm	Jan–Jun 2016	Jan–Jun 2015	Jan–Dec 2015
Operating income			
Net interest income	327	720	1,371
Dividends received	4,267	3,454	5,388
Net gains/losses, listed shares and participations	-2,091	4,504	-1,481
Net gains/losses, unlisted shares and participations	2,698	2,240	4,391
Net gains/losses, fixed income assets	3,011	-734	-1,349
Net gains/losses, derivative instruments	-1,142	921	-144
Net gains/losses, foreign exchange movements	3,698	3,432	3,657
Commission expenses	-122	-163	-308
<b>Total operating income</b>	<b>10,646</b>	<b>14,374</b>	<b>11,525</b>
Operating expenses			
Personnel costs	-57	-58	-116
Other administrative expenses	-36	-32	-69
<b>Total operating expenses</b>	<b>-93</b>	<b>-90</b>	<b>-185</b>
Net investment income	10,553	14,284	11,340

## BALANCE SHEET

SEKm	30 Jun 16	30 Jun 15	31 Dec 15
Assets			
Shares and participations, Listed	128,774	131,472	123,667
Shares and participations, Unlisted <sup>1</sup>	70,727	63,642	67,788
Bonds and other fixed income assets	93,152	96,695	90,103
Derivatives	248	2,500	2,275
Cash and bank balances	5,585	2,170	6,420
Other assets	1,027	1,721	1,380
Prepaid expenses and accrued income	1,181	1,188	915
<b>Total assets</b>	<b>300,694</b>	<b>299,388</b>	<b>292,548</b>
Liabilities			
Derivatives	2,135	2,120	730
Other liabilities	985	1,544	1,566
Deferred income and accrued expenses	30	46	45
<b>Total liabilities</b>	<b>3,150</b>	<b>3,710</b>	<b>2,341</b>
Net assets			
Opening net assets	290,207	283,811	283,811
Net payments Swedish Pensions Agency	-3,216	-2,417	-4,944
Net investment income for the year	10,553	14,284	11,340
<b>Total net assets</b>	<b>297,544</b>	<b>295,678</b>	<b>290,207</b>
<b>Total liabilities and net assets</b>	<b>300,694</b>	<b>299,388</b>	<b>292,548</b>

1) The item unlisted shares and participations includes private equity funds in the amount of SEK 15.1 billion at 30/06/2016

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