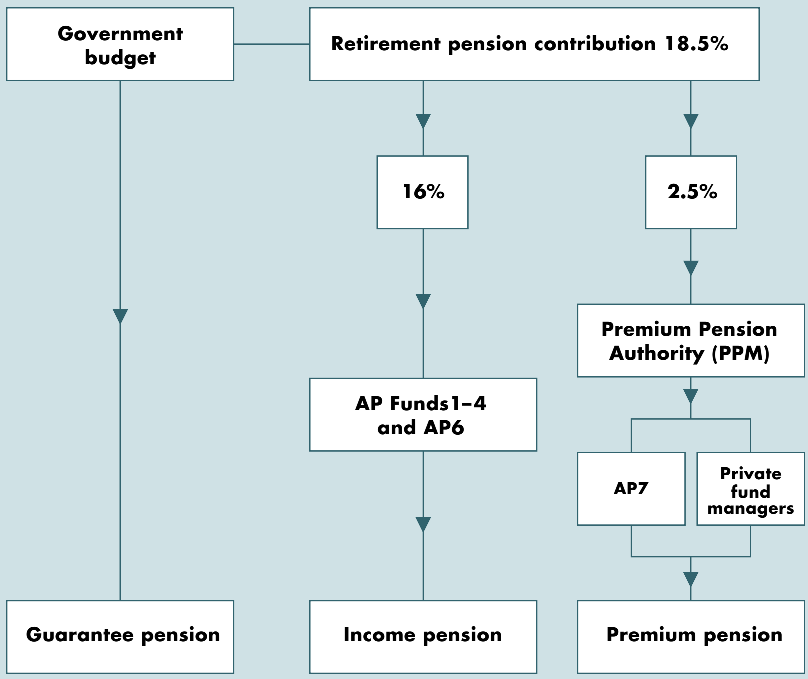
FJÄRDE AP-FONDEN

Annual Report 2006

The Fourth Swedish National Pension Fund (AP4) is one of five buffer funds in the national pension system. Together with the capital of AP1, AP2, AP3 and AP6, AP4's fund capital is used to offset temporary fluctuations in pension system contributions and disbursements. The objective of the buffer funds is to invest capital to generate optimum returns for the long-term health of the pension system, which includes the income pension, guarantee pension (formerly ATPO) and premium pension. At present, AP4 has some SEK 200.5 billion of Sweden's state pension assets under management.

The Swedish pension system has two components: a pay-as-you-go element and a premium-funded element. The pay-as-you-go system is based on current pension disbursements being financed by guarantee pension contributions from people in work, at a rate of 16% of salary. Pension disbursements in the premium-funded system are based on the individual's own allocated funds, which accrue from the premium pension contribution (2.5% of salary). The premium reserve is managed by private fund managers and the Seventh National Pension Fund and is accordingly not further described in this report. The income pension system's most vital asset thus consists of projected future contributions, while the assets of the buffer funds correspond to some 10% of the total pension commitment.



To ensure the financial stability of the income pension system, disbursed pensions are adjusted through a balancing procedure if assets fall below liabilities. The greatest threat to the value of pensions in the next 20–30 years is that the labour force activity rate may decline, while the greatest long-term risk will arise upon unfavourable demographic trends expressed as a low birth rate or low net immigration. There are additional risks in the form of low returns on the buffer funds and low economic growth.

Investment goals

The overriding objective of AP1, AP2, AP3 and AP4 is to manage fund capital so that it provides the best possible benefits to the national pension system. AP6 has a specialised mandate to invest a minor portion of the pension system's funded capital in the venture capital market (the private equity market).

Investment rules

The Riksdag (the Swedish parliament), drew up new investment rules for AP1, AP2, AP3 and AP4 in conjunction with the reorganisation of the funds. The rules came into effect on 1 January 2001 and are identical for each of the four funds. The investment rules allow the funds to invest in most asset classes other than commodities.

- The funds may invest in all listed and liquid securities traded in the capital market.
- At least 30% of fund assets must be invested in fixed income securities with low credit and liquidity risk.
- A maximum of 40% of fund assets may be exposed to currency risk.
- A maximum of 10% of fund assets may be exposed to a single issuer or group of issuers with mutual links.
- Equities held in listed Swedish companies may not exceed 2% of total market capitalisation.
- The fund may own shares corresponding to no more than 10% of voting rights in any single listed company.
- No more than 5% of fund assets may be invested in unlisted securities. Such investments must be made indirectly via venture capital firms or the equivalent.
- At least 10% of fund assets must be managed by external asset managers.

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INFORMATION

For further information, please visit the AP4 website at www.ap4.se. The following publications are available online:

- Annual and interim reports from recent years
- AP4's key public documents

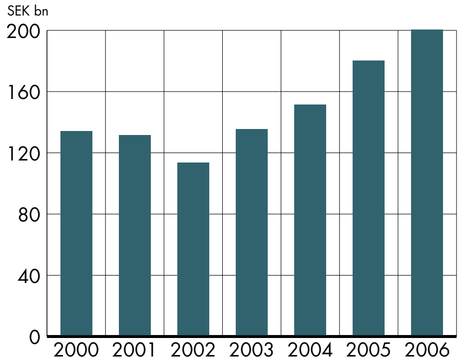
Annual reports and other reports may be also be ordered directly from the Fund.

Further information about the national pension system is available online from the Swedish National Social Insurance Agency at, *www.forsakringskassan.se*

2006 IN BRIEF

- Net profit at market value was SEK 18.8 (25.8) billion.
- Calculated at market value and including transfers, fund capital rose during the year from SEK 180.1 billion to SEK 200.5 billion.
- The Fund's high weight in equities and the favourable market climate resulted in a total return on investment assets of 10.5% (16.9), substantially outperforming AP4's long-term target of an annual real return of 4.5%.
- The return on the global equity portfolio was 13.4% and provided a contribution of SEK 10.0 billion to absolute return.
- The Swedish equity portfolio generated an impressive return of 25.7% and a contribution of SEK 8.4 billion to fund performance.
- Fixed income management generated a return of 0.6% attributable to rising interest rates in a low rate environment, contributing SEK 0.4 billion to fund performance.
- Currency exposure at 31 December 2006 was 15.1% (10.1).
- Operating costs were unchanged from the previous year and totalled SEK 133 million, equivalent to 0.07% (0.08) of average fund capital.

Market value of AP4's fund capital at 31 December (2000–2006)



Fund capital is growing.

Contributions to Fund performance 2006

	Weights in strategic portfolio %	Contribution to absolute return % points	Contribution to net profit SEK bn	Contribution to relative return % points
Global equities*	42.0	5.6	10.0	–0.1
Swedish equities	19.0	4.7	8.4	–0.4
Fixed income assets*	37.0	0.3	0.4	0.0
Real estate	2.0	0.7	1.3	0.0
Currencies	–	–0.9	–1.5	–0.2
active management	–	–0.1	–0.2	–0.1
Tactical asset allocation	–	0.1	0.2	0.1
Total	**100.0**	**10.5**	**18.8**	**–0.6**

** Including full hedging.*

High equity component and bull market generated strong absolute return (see page 27).

LETTER FROM THE PRESIDENT

As I sum up the financial year of 2006 for the Fourth Swedish National Pension Fund, the key message is that the Fund generated a strong real return for the fourth consecutive year. Total return on investment was 10.5%, contributing to growth in Fund capital from SEK 180 billion to SEK 200 billion by the end of the year. The Fund has delivered average annual returns of 4.8% for the last six years, well above the annual inflation rate of 1.5% during the same period. In recent years AP4 and the other buffer funds have thus attained their overriding objective: to benefit the public pension system.

Trends in recent years show with great clarity that buffer fund asset management should be evaluated over longer time horizons. We have limited scope to implement major changes to the portfolio structure. The buffer funds must identify strategies that hold up over time, not only for isolated years. The buffer funds were severely criticised early in the decade for being overweight in equities, which contributed to poor performance – in the short-term. But viewed over the entire period, that is, from the date reorganisation took effect in January 2001 through year-end 2006, the buffer funds have achieved their goal of strong real absolute returns by a good margin.

SUCCESSFUL CURRENCY DECISION

The impact of selecting the right asset structure, or allocation, can be exemplified with AP4's decision in late 2005 to reduce currency exposure. Our analysis unambiguously showed that the Swedish krona was severely undervalued. On that basis, currency exposure in the Fund's strategic portfolio was halved, from 20% to 10%. As of year-end 2006, the decision had contributed SEK 1.25 billion, or almost 0.7 percentage points, to absolute return. This illustrates how important it is that long-term financial institutions also approach allocation from the medium-term perspective. AP4 intends to devote additional resources to strategic allocation processes.

Despite AP4's fine performance in 2006, there are a few setbacks to report. The Fund's efforts to outperform the benchmark index have yet to bear fruit, for instance. The underperformance in 2006 was 0.6 percentage points compared to the returns indexed management would have achieved. This is of course unsatisfactory. There are several explanations for the problem, including that the Fund's underexposure to small-cap and medium-cap stocks in Sweden had adverse effect on performance. Action has been taken to prevent future major profit fluctuations rooted in this "small-cap effect." My primary tasks in my first few years as the new President of AP4 will be to sharpen focus on medium-term allocation and improve active asset management performance.

MUTUAL DEPENDENCY

AP4's long-term capacity to deliver strong returns and benefit the pension system is not a function solely of our own efforts. Returns are dependent on several external factors over which the Fund has little control, but where we and other long-term shareholders can influence developments in a favourable direction. A few examples:

Generating satisfactory returns requires more than profitable, well-managed companies. Another fundamental prerequisite is that the global securities markets are efficient and fill their primary functions not only as marketplaces, but also as facilitators of effective capital provision.

Fears have emerged in recent years that the new regulations facing todays´s developed stock markets – like the Sarbanes Oxley Act in the United States and the Code of Corporate Governance in Sweden – have become so burdensome and so costly that market listing no longer seems appealing to many companies.

The regulatory sceptics have also been able to use the rapid growth in the private equity sector to support their arguments. Remuneration levels are often considerably higher in that sector – and those involved do not have to defend their pay in public. Claims are also made that companies in the private equity sector can take a more long-term approach, since management teams do not have to work towards meeting the short-term expectations of the market, quarter after quarter. In this respect, institutional investors like AP4 are accused of promoting this brand of quarterly capitalism.

It is utterly crucial to long-term investors like AP4 that the entire capital market functions, in the broad sense of the word. In efficient market economies, companies will both be floated and taken off the stock exchange – quite simply, two sides of the same coin. It would be considerably more difficult for private equity to operate in the absence of efficient stock markets. I am also convinced that it can sometimes do companies good to be delisted for a time, only to return in a later phase to the stock market in a more efficient and perhaps reorganised state. There are several good examples of this.

Mats Andersson
new President of AP4 as of 1 January 2007

DIVERSE OWNERSHIP

Diverse ownership is actually a prerequisite for an efficient market economy. An institution of the nature of AP4 enjoys favourable conditions for acting as a long-term financial shareholder. The Fund has been one of the largest shareholders on the Stockholm Stock Exchange for more than 30 years. AP4 is precluded from being an active, industrial shareholder of the kind Investor and Industrivärden represent. But the Fund is now devoting considerable effort to fulfilling its financial ownership role, in part through our dedicated and responsible activities on nominating committees. Often in partnership with other financial institutions, AP4 is also committed to establishing and developing the regulatory framework surrounding Swedish listed companies.

AP4's corporate governance mandate is primarily oriented towards working via nominating committees for the companies in which the Fund is an important shareholder. The main task of the nominating committee is to prepare items for the election and remuneration agenda for the annual general meeting. We are progressively gaining experience in this area while broadening and deepening networks, which I hope will lead to better boards of directors and thus promote the development of Swedish listed companies.

Prior to the current financial year, AP4 adjusted the internal performance target from a 0.7 percentage points to 0.5 percentage points excess return a year. This should not be considered an expression of reduced ambition, but rather as an adaptation to reality. An annual excess return target of 0.5 percentage points currently equates to a cash amount of SEK 1 billion. The board of directors has also formulated a long-term requirement for real total return. The annual target has been set at 4.5% and was based on parameters including the aim to avoid automatic balancing, that is, the downward adjustment of pensions.

Efforts to enhance asset management at AP4 are still in progress. I am convinced that successful asset management organisations are created by constantly seeking out ways and means to improve. In such a process, having a stable, close-knit organisation to rely on is vital. For that reason, I feel at ease taking over responsibility for the Fourth Swedish National Pension Fund after Thomas Halvorsen, who in his 24 years with the Fund and 14 years as President truly built just such an organisation.

Stockholm, February 2007

Mats Andersson

A CONVERSATION WITH THE FORMER PRESIDENT

Thomas Halvorsen, who first joined AP4 back in 1983 and was appointed President in 1993, stepped down at the end of 2006. Financial journalist **Torun Nilsson** interviews Mr Halvorsen about the extraordinary development of the financial markets during his tenure at AP4.

Thomas Halvorsen, president 1993–2006

You have witnessed a unique period of financial revolution and burgeoning fund power. You have done so as the chief executive for the first major Swedish equity fund. But when you started in the equity markets in 1976, it was anything but hot. How did you end up there?

I had been trading stocks quite a bit for my student union at Uppsala University, actually quite successfully. But certainly, equities were considered outmoded back then. I will never forget how my future boss at Handelsbanken and first mentor, Bengt Nyberg, asked during my employment interview: "Do you believe there is any future for the Swedish equity market, Mr Halvorsen?" My mouth went dry, but I pulled myself together and answered something about how Sweden was despite everything a market economy, and so there must be a hub. His question was actually relevant. An insurance company at the time was considering quitting investment in Swedish equities.

But you got the job?

Yes, and I was soon given the job of writing the bank's market letters and updating two-year earnings forecasts for about a hundred listed companies. There were really not many of us working with that kind of thing back then. When I joined the Swedish Society of Financial Analysts in 1977 I was something like member number 65. Today the membership is around 1,700.

And then?

AP4's chief executive Sten Wikander phoned me in 1983 and asked whether I would like to head up the Research Department. It was a fascinating, thoroughly enjoyable time. Sten was a superb teacher and had carefully considered views on a wide range of issues. I was put in the middle of things right from the start. I became number two at the Fund in 1984, when I had operational responsibility and presented investment issues to the board.

"I think the Swedish financial market works well in most respects. There are distinct boundaries drawn between shareholders, the board and management."

He was the one who triggered your interest in corporate governance, is that so?

Yes, I came into contact with corporate governance almost immediately. AP4 and a few other institutions spearheaded by Skanska carried out the so-called midnight raid against Jan Stenbeck at Sandvik within a week or two after I started at the Fund. (Editor's note: Stenbeck had just carried out a startling internal transaction in his corporate group to settle an inheritance dispute.)

Wikander was extremely interested in corporate governance. His approach was an intellectual one based on his experience as CFO at Volvo. After a few more corporate scandals at Bahco, ABV and so on, he wrote Sweden's first corporate governance policy in 1986. Much of it still holds up today. But the difficult thing is implementing a corporate governance policy, not writing one.

But you were able to do that as the new President of the Fund in 1993. Tell us about it!

Our baptism by fire came with the Volvo/Renault affair of 1993. Late that autumn, Volvo chairman Pehr G. Gyllenhammer and the majority of the board resigned after Volvo management revolted against the merger with Renault. AP4 was the largest Swedish shareholder with nearly ten percent of the votes and I became chairman of a group of representatives of the nine principal Swedish shareholders who were charged with sorting out a new board. It was a demanding task. We met every day for several weeks and it was nearly Christmas before I could call a press conference to introduce the new Volvo board with Bert-Olof Svanholm at the helm. That Christmas I did not buy a single present and spent the holiday mainly sleeping.

That proved to be the starting point for organised institutional corporate governance, right?

Yes, we continued working together thereafter, especially the very largest institutions. Investor's CEO Claes Dahlbäck also played a key role. He brought in certain international values and he clearly understood that the Wallenbergs needed allies. He allowed us to participate in nominating processes in the Wallenberg arena.

What do you think of voting rights differences, one of the foundations of traditional Swedish shareholder power and a hot topic in Swedish corporate governance circles for the past ten years?

I have no objections. I think it is important that as many interesting companies as possible are traded on the stock market and I believe entrepreneurs like the owners of H&M would never have listed the company if the family had not been able to secure power by means of the voting rights difference. I also believe that, like all other agreements, ownership agreements are made to be kept.

The only argument against voting rights differences that may be valid is that they might preserve ownership structures and slow down changes for the better. But an old fundamentalist like me can always rebut this by saying that a long-term approach is really not such a bad thing.

You have been responsible for AP4's portfolio for more than 20 years and it has performed well. A total of five billion kronor has been contributed since the fund started and it has grown to two hundred billion kronor and outperformed the index. How did you do it?

In broad terms, one can say that management of the Swedish equity portfolio was very successful in the 1980s and early 1990s. The portfolio was essentially Swedish back then and the Fund took large positions.

As the Fund was one of the biggest players in the market, we were compelled to act long-term. Skiing a special slalom was out of the question – we had to put our efforts into the Super G. We focused on research and the 30 or 40 largest companies, visiting a great many of them. I emphasized focus on the three M's to our analysts. First and foremost, Management, that is, business concept, strategy, board and executive management. Next, Markets, the company's long-term market outlook. Finally Money, crunching the numbers. The Fund had a low turnover rate for the portfolio, an average of ten years. That succeeded very well, although I have to admit it was certainly easier to beat the market back then.

H&M, Astra and Pharmacia are among the Fund's greatest hits. How did you find the stocks?

The Fund had already become a major shareholder in H&M back in the 1970s when Sten Wikander took over as President. But I always maintained substantial overweight in the share. In my opinion, Stefan Persson has consistently been the most capable executive in the market. He successfully refined the business concept, upgraded the brand and carried out a triumphant foreign expansion.

I have always supported the pharmaceutical companies because they are in a long-term business and Sweden produces such internationally prominent research. The Fund has been overweight in those equities throughout my era.

You were involved in selling Astra and Pharmacia abroad. How did that feel?

It is always sad when Swedish companies move, of course. In the Astra case, the location of the head office was the thorniest issue when the merger was discussed. But, and more's the pity, I am convinced we are going to see progressively fewer head offices in Sweden as the economy becomes more open. Global economies of scale become so imperative. But in Astra's case, the merger with Zeneca actually led to the research department being moved to Sweden. The Pharmacia case was a real mess on the other hand because both principal shareholders (Editor's note, the Swedish state and Volvo) wanted to sell. As a result, corporate governance was poor.

You were among those who never invested in Refaat el-Sayed's Fermenta. Why was that?

We did not understand Fermenta's accounts and Refaat could not provide satisfactory answers to our questions.

AP4 was a pioneer in private equity, tell us about that.

Sten Wikander began investing in unlisted companies as early as 1981. The first investment was Andersons, a construction and property company that later went on to be listed. We wanted to expand the supply of venture capital in Sweden and were involved in starting the first Swedish venture capital firm, Four Seasons. We were quite successful and did a service to the market by developing the infrastructure for unlisted companies. The Fund eventually had more than 20 private equity holdings. But the investments in private equities proved arduous in relation to the returns they generated, especially during the banking crisis of the early 1990s. Nowadays the Fund is permitted to gain exposure to private equity only indirectly through venture capital firms, a rule I actually support. It is difficult to combine that brand of asset management with the ordinary kind.

You were also involved in launching the successful HealthCap funds, the first in 1996. How did that come about?
Björn Odlander and Peder Fredrikson came to me and asked for support and ideas. Starting an operation of that kind from the ground up is not entirely unproblematic for two private individuals, of course. AP4 decided to invest from the outset and was the largest investor in the first two funds.

The performance of the Swedish equity portfolio has declined since the buffer funds were split up in 2001. Why?
Following the split we had to sharply expand the organisation to handle commercial paper, currencies and global equities. We increased staff from nine to fifty in a year and a half. The financial market was still booming and we had a hard time finding a head of equities. Once we found a capable individual, he soon left to start his own asset management firm. That was not good. Another problem is that small cap stocks have delivered such strong market performance. We invest primarily in large cap stocks. The small cap effect has entailed a couple of percentage points a year since the fund was split up.

Why hasn't the Fund bought small cap stocks?
We have tried, but covering all companies demands too many resources.

Has the investment philosophy changed?
Not fundamentally. My idea was to combine good old-fashioned fundamental analysis with quantitative methods. The difference is that the investment universe has grown to 273 companies in our benchmark index. But with the stubbornness of a drunkard, I insist it is still the same business it used to be.

You did not jump on the IT bandwagon in the late 1990s. Surely that implies you would have come through in better shape than many others if the split had not been implemented in 2001? After all, the crash was hardest for IT and telecoms.
Relatively speaking, we would have. But in absolute terms, performance would have been worse without the split, as it reduced our weight in equities. Remember, the market kept on falling until October 2002.

Why did all four of the new buffer funds invest heavily in the stock market in 2001, in the midst of the crash?
When you have four competing funds with the same fundamental view, i.e. that equities always generate the best long-term returns, it becomes nigh on impossible not to enter the market relatively quickly. The only way is to go against the market. But timing that kind of decision is one of the most difficult things in the world to do. It is almost impossible to garner support in a group for that kind of decision. It takes deep convictions to make bold moves like that.

What is the most striking difference between today's market and the one you started out in?
When I started in the 1970s, optimism was low and valuations likewise. Companies were cash-poor and financing was the paramount problem. Venture capital provision was inadequate and inefficient. I remember when Volvo was going to carry out a new issue of a little over 200 million kronor in 1978. Bengt Nyberg was ill and I had to attend a meeting in his place between Volvo and the big banks discussing whether the Swedish stock market could handle such a large amount. The Swedish venture capital market was an isolated island at the time. Today, everything is linked. Venture capital provision is global.

What do you think of the current financial market?
I think the Swedish financial market works well in most respects. The Swedish Companies Act is on the forefront from an international perspective. There are distinct boundaries drawn between shareholders, the board and management. The Code of Corporate Governance is well thought-out. The various roles have been carved out in greater detail. And Sweden has a favourable mix of old power centres, alert institutional owners and challengers like hedge funds and venture capitalists.

What we might need is to allocate more resources, especially to the Swedish Financial Supervisory Authority, for

"I believe the buffer funds need a different type of assessment. A five-year perspective was introduced last year alongside the one-year perspective. That was an important step in the right direction, considering that the buffer funds' mandate to benefit the Swedish pension system is truly long-term."

monitoring market players. But self-regulation also needs to be further enhanced.

What do you think of raiders like Christer Gardell?

He seems to have done well, although I found his behaviour questionable in the Skandia deal, the only professional context in which I have encountered him.

How are traditional shareholders like the Wallenberg family going to be able to compete with Fund capital in the long term?

They have to have the best executives, remember, M as in Management. It is no surprise that their venture capital firm EQT has gained such a prominent role. That depends on the capacity of the venture capital firms to reward people, after all. Just look at the networks venture capital firms have.

If the incentive system is so important, how will entrepreneurial businesses be able to thrive in the stock market?

There is a risk that listed companies will be bled of management skills because executives are rewarded so richly by the venture capital firms. I would like to see executives in Sweden become heroes instead of whipping-boys. It is they who lay the foundation for our prosperity and if more people understood that, we would not have to engage in political debate about their pay.

Do you see any other problems with the financial market?

Perhaps not a problem, but I am concerned about the rapid development of the art of financial engineering and the burgeoning flora of financial instruments.

The stock market has become extremely short-sighted and index-oriented. Investors have started chasing points instead of playing longer trends. That is not a good thing – the very purpose of the market is to allocate capital. Venture capital should be inexpensive for solid companies and vice versa. That requires a long-term approach.

There are probably other risks associated with all these new instruments. Turnover in the derivatives market is sky-high and counterparty risks are much greater than before. What might happen in a situation of severe financial turmoil? I would very much like to see standardised international regulations here. The trend is being spurred on by the major international investment banks, who are devising increasingly sophisticated financial solutions.

Why are you letting the investment banks drive you to this?

If you take the optimistic view, you might say that the new instruments are streamlining the market and are a source of additional returns. For instance, the Fund has a successful fixed income and currency management team who are good at cashing in on this.

From the pessimist's standpoint, you could point the finger at reduced transparency. Perhaps we investors are being fooled by something that is not worth the price. But I am not the man to determine whether or not that is the case.

Finally, do you have any advice you would like to take this opportunity to share?

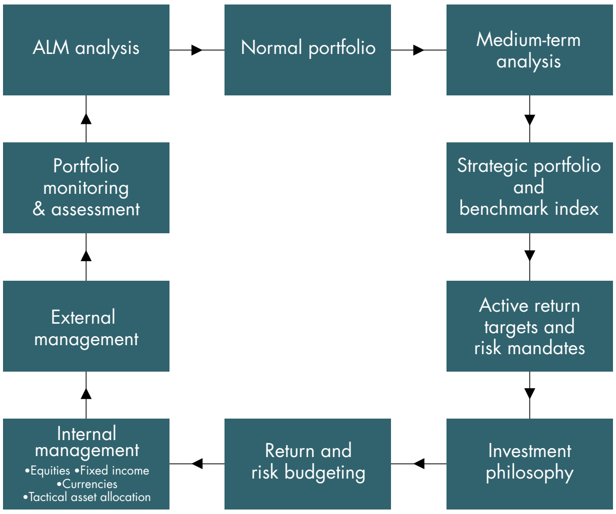
I believe the buffer funds need a different type of assessment. As the system is designed now, it reinforces similarities, contrary to intentions when the four competing funds were created. The funds should also be compared to other investors, such as the best of the life assurance providers. That would stimulate better asset management. There is a tendency for monitoring to concentrate entirely on the short-term and the negative, which are covered extensively by the media. That kind of assessment does no good to any organisation. A five-year perspective was introduced last year alongside the one-year perspective. That was an important step in the right direction, considering that the buffer funds' mandate to benefit the Swedish pension system is truly long-term.

STRATEGIC INVESTMENT AT AP4

MANDATE AND OBJECTIVES

Buffer fund operations are governed by the Swedish National Pension Funds Act. Under the law, the funds shall ”manage fund assets to generate maximum utility to the insurance scheme for earnings-related pensions” and “the overall risk level in fund investments shall be low.” The travaux préparatoires specify “risk and return shall be interpreted in terms of disbursed pensions.” AP4’s interpretation of this mandate is that its primary objective is to maximise projected total future pensions with the proviso that there must be little risk for low pensions in connection with adverse trends in financial markets or the Swedish economy. For a more detailed account of the Fund’s objectives function, please see the section entitled “In-depth ALM analysis” on page 14.

Asset management process



Structure of AP4’s asset management process.

MAIN COMPONENTS OF THE INVESTMENT PROCESS

Investment is a three-step process at AP4. The first step involves Asset Liability Modelling (ALM), which is the analysis of the pension system’s commitments and assets to determine which combination of buffer fund assets best fulfils the long-term (40 years) objectives.The chosen asset mix thus determines AP4’s long-term normal portfolio. The normal portfolio is significant partly as the link between the investment process and the buffer funds’ role in the pension system and partly because the majority of the Fund’s returns and risks are dependent on the normal portfolio mix. The normal portfolio is discussed in the section entitled “In-depth ALM analysis” on page 14.

The normal portfolio is based on a 40-year investment horizon and long-term forecasts for risk and return. The Fund believes still better returns can be achieved by adjusting the asset mix in a second step – medium-term allocation – to medium-term forecast trends in the financial markets. This allocation forms the strategic portfolio, which is also the benchmark index for active asset management. The medium-term analysis may be, but does not have to be, based on ALM studies of the pension system’s assets and commitments. A process was begun during the year to further refine the models and analyses upon which medium-term allocation is based.

The third step in the process is active asset management, whose purpose is to further enhance returns by means of current market forecasts and a relatively short investment horizon. Active asset management is governed by excess return targets and risk mandates relative to the strategic portfolio. At this point, we also decide which management mandates will be internal and which will be entrusted to external managers.

STRATEGIC PORTFOLIO

The deviation of the strategic portfolio from the long-term normal portfolio reflects the Fund’s assessment of how the returns and risks of various assets will differ over the next three to five years from the long-term equilibrium values on which ALM analysis is based. In part because medium-term analysis is still in the build-up phase, there were only relatively limited deviations between the current strategic portfolio and the long-term normal portfolio at 1 January 2007, except with regard to the equity component.

One finding of this year’s ALM analysis was that the equity component of the long-term normal portfolio should be 65%. The Fund does not believe it would be appropriate to increase the current equity weight of 61% in the strategic portfolio at this time. Accordingly, it is 4 percentage points below the equity component of the long-term normal portfolio. Currency exposure for the strategic portfolio was 15% at the end of 2006, which was 5 percentage points lower than currency exposure in the normal portfolio. The board of directors also decided in December 2005 that emerging market equities should make up 3% of the normal portfolio, but the Fund has determined that the price of emerging market equities should decline relative to the price of global equities in developed markets before it will be appropriate to implement the decision. Finally, the Fund has chosen not to invest in Japanese debt securities or British long-term bonds from the medium-term perspective.

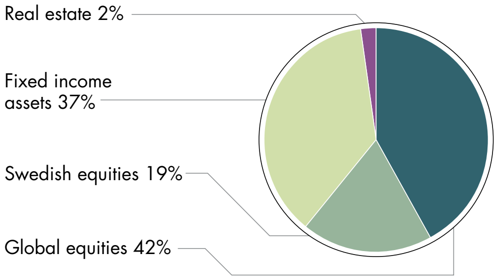
At year-end 2006, the strategic portfolio was structured as follows: 61% equities (42% global developed market equities and 19% Swedish), 37% fixed income assets and 2% real estate (see chart at right). The reference index for the fixed income portfolio was made up of 54% government securities and 46% investment grade corporate bonds.

In late 2005, the Fund concluded that the Swedish krona was undervalued from the medium-term perspective and reduced strategic currency exposure from 20% to 10%. The krona strengthened during the course of 2006 as predicted and the Fund decided to increase currency exposure again, to 15% in the first step in December 2006. Currency exposures at year-end 2005 and 2006 are shown on the chart below.

The return on the strategic portfolio plays another important role as the benchmark norm for Fund management, meaning the strategic portfolio and its components constitute the benchmark index for the Fund. The asset classes in the strategic portfolio are represented by the following indices: MSCI World (hedged) for global equities, SIX Return Index for Swedish equities and Merrill Lynch GBI (hedged) and Handelsbanken Markets Bond Index for global and Swedish bonds, respectively.

The Fund has decided to switch the reference index for global equities as of 1 January 2007 from MSCI World Total Net Return – whose returns are subject to the maximum withholding tax applicable to international institutional investors – to MSCI World Total Gross Return, whose returns are exempt from withholding tax. The change was made possible when the Ministry of Finance secured full tax exemption for capital investments by Swedish pension funds as

Strategic portfolio 2006



High weight in equities.

of October 2006 in connection with renegotiation of the double taxation treaty with the United States. Fund returns are subject to withholding tax on equities from many other countries though, which as a whole is expected to reduce returns on global equities by about 0.1 percentage points per year.

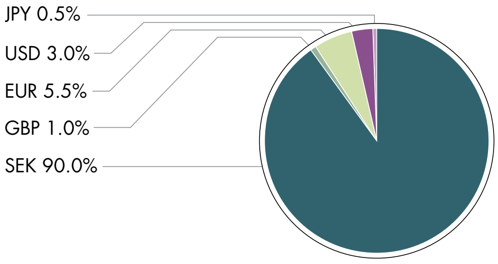
With the exception of active tactical asset allocation and active currency management, AP4's active asset management operations are index-related: risk and return are subject to targets that are measured and assessed relative to the benchmark index.

RETURN TARGETS AND RISK MANDATES

Partly in response to adverse management outcomes in recent years, the AP4 board of directors has stipulated a slightly lower return target than for the preceding year. The following return targets and risk mandates apply for 2007:

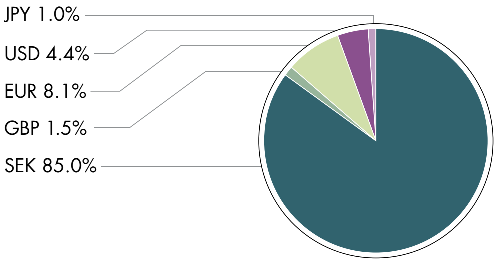
Over a two-year period, AP4 shall achieve a total return that exceeds return on the strategic portfolio by 1.0 percentage points, corresponding to annual active return of 0.5 percentage points or about SEK 1 billion per year given

Currency exposure under 2006 strategy



Currency exposure was reduced from 20% to 10% in late 2005…

Currency exposure under 2007 strategy



…and increased to 15% when the krona strengthened in late 2006.

Active return targets and risk mandates, from Jan 2007

	Weight, %	Deviation mandate, % points	Benchmark and reference index	Outperformance target per year, % points	Active risk guideline, %
Global equity portfolio*	42	+10/–10	MSCI World DGI (SEK)*	0.7	4.4
Swedish equity portfolio*	19	+10/–10	SIX Return Index	0.7	6.0
Fixed income portfolio	37	+10/–7	Handelsbanken Markets Bond Index/ Merrill Lynch GBI (SEK)*	0.4	2.0
Active currency management	–	+5/–5	Tailored import basket index	0.1	0.5
Tactical asset allocation	–	+4/–4		0.1	0.6
Real estate	2	+1/–1	Return on holding in AP Fastigheter Holding AB	–	–
Investment assets	**100**		**Index weighted as per strategic portfolio**	**0.5**	**4.0**

* = Total deviation mandate for equities +8/–10

* = Hedged in SEK

the current value of funds under management. Active risk (risk relative to the benchmark index) for the entire portfolio shall not exceed 4.0%. The board has stipulated deviation mandates from strategic portfolio asset weights of +8/–10 percentage points for equities, +10/–7 percentage points for fixed income assets and +1/–1 percentage points for real estate (see chart above).

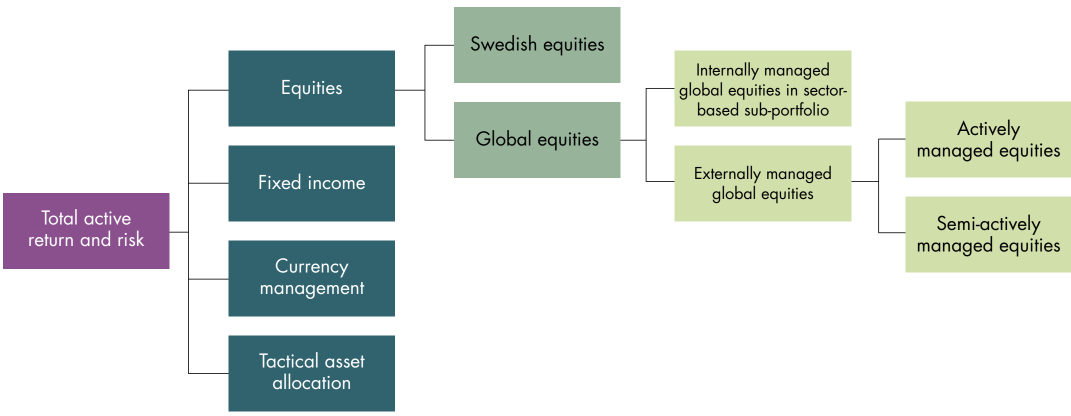
These targets and mandates form the basis for the excess return targets and risk mandates that the Fund sets for its asset management operations. Active risk is spread relatively evenly to ensure diversification of risk among managers and portfolios. The table at the foot of the page shows a schematic distribution of return contributions and active risk.

The internally managed global equity mandate refers to European and American equities divided into ten sector-based equity mandates and one sector allocation mandate. Three of the sector portfolios are index-linked. Analysis and position taking are based on internal company and equity analysis using a common analysis model to facilitate consistent management across our portfolios. The sector mix for internally managed global equities is shown on the chart on the next page.

Equities from Japan and other developed industrial countries in Asia and the Pacific Rim are managed in three actively managed external mandates. The Fund also has three semi-actively managed external mandates for European and American equities and one externally actively managed global equity mandate, although the latter is being liquidated.

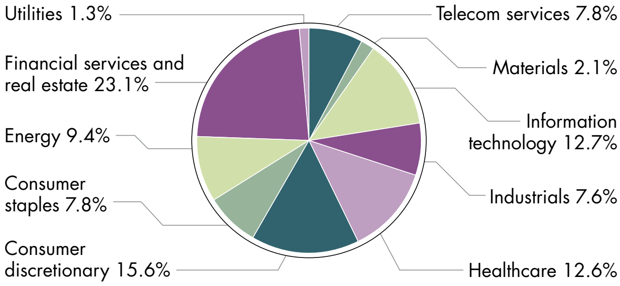
Swedish equities are managed internally in two separate portfolios, an actively managed portfolio of mainly large-cap equities with SIXRX60 as the reference index and a more passive portfolio comprising other companies in the SIX Return Index as the reference index. Management of Swedish and global equities is closely linked because managers of the global sector portfolios provide analytical

Return and active risk by portfolio



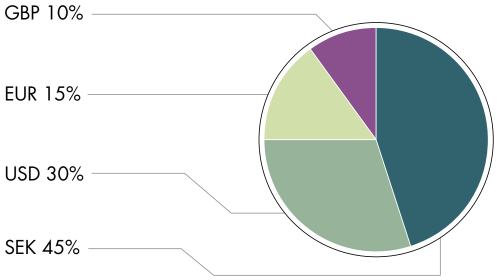
Distribution of performance contributions and active risk in sub-portfolios

Internally managed global equities per sector



The financial services and real estate sector is highly significant.

Currency distribution of fixed income portfolio in the reference index, 2007



High weight in domestic currency, but lower than most Swedish asset managers.

support to the Swedish equity portfolio manager. As of 2007, the return target for the Swedish and global equity mandates is to outperform the reference indices by 0.7 percentage points.

Fixed income assets are managed in an internally managed global portfolio of Swedish and global securities. The currency distribution of the reference index is shown on the chart above. Though valued against a single comprehensive return target and risk mandate, management by the fixed income team is spread across five risk classes: duration, other yield curve, country spread, swap spread and other credit spread, with relatively even distribution of risk among these classes. The aim is to diversify active risk across a large number of weakly correlated positions to achieve a higher information ratio (diversifying to eliminate much of the risk while maintaining good returns). The target for fixed income management is to outperform the reference index by 0.4 percentage points.

Currency management is divided between a strategic component and an active component. The strategic management side aims to ensure that total currency exposure of the Fund – as opposed to the exposure arising from active currency management – is in line with the strategic currency exposure target. Active currency management focuses mainly on markets in which AP4 has fixed income operations and seeks to maximise absolute return within the given risk mandate. The annual return target is 0.1% of total Fund investment assets of approximately SEK 200 million.

Tactical asset allocation also has two components: passive management and active management. Passive management aims to minimise differences in asset allocations between the Fund and the strategic portfolio. Active allocation works exclusively with derivatives – primarily equity index futures and interest rate futures – in various markets. Here again, the absolute return target is 0.1% of the total market value of investment assets.

IN-DEPTH ALM ANALYSIS

NEW OBJECTIVES FUNCTION

The purpose of Asset Liability Modelling (ALM) is the overall analysis of pension system assets and liabilities. The objective, as required by the legal directive (see page 10), is to design the long-term asset mix – the normal portfolio – that provides maximum utility to pension beneficiaries. The Fund believes that attempting to further define the legal requirements using a formula would be useful towards that end. A significant part of the ALM process in 2006 was devoted to establishing such a function.

As the Fund interprets the law, the formula should accommodate a balance between maximising expected pensions and limiting the risk of low pensions. The formula should thus reflect the risk aversion of pension beneficiaries and the Riksdag. Aimed at achieving intergenerational neutrality, the formula should also encourage even distribution from year to year.

The Fund analysed various alternatives before selecting a relatively simple utility function with constant relative risk aversion based on the real average pension (adjusted to CPI) for each year. The function appears as follows:

$$E\left[U_{2006-2045}\right] = \sum_{j=1}^{N} \frac{\sum_{t=2006}^{2045} \frac{\overline{RP_{t,j}}^{1-\theta}}{1-\theta}}{N}$$

Where:

$E\left[U_{2006-2045}\right]$ = Expected utility of pensions disbursed 2006–2045

$\overline{RP_{t,j}}$ = Average real pension for year t and scenario j

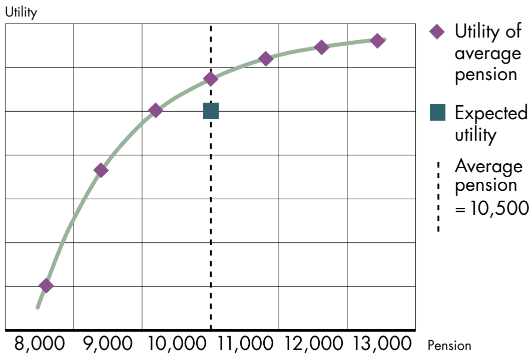
θ = Risk aversion

N = Number of scenarios in AP4 ALM simulations for every mix considered for the normal portfolio

The goal is thus to identify the normal portfolio that maximises the expected utility of average real pensions for the next 40 years, which includes achieving a balance between average outcomes and outcomes in the worst-case scenarios. This is illustrated in the chart at the top of the next column, showing seven pension outcomes in a single year and the expected utility of each.

The chart illustrates two key characteristics of the formula. First, the utility loss is greater in absolute terms when pensions are lowered by SEK 1,000, for instance, than the utility gain when pensions are increased by the same amount. Secondly, the expected utility of all seven possible outcomes (large blue square) is lower than the utility of the average pension of SEK 10,500. The formula thus assigns greater importance to avoiding poor pension outcomes than to achieving high pensions by over-investing in risky assets; that is, it reflects the risk aversion of pension beneficiaries. The intensity of that aversion then becomes a significant question. Unfortunately, there are no good methods for objectively determining the risk aversion of the average pension beneficiary – or for that matter of the AP4 board of directors. After various deliberations the Fund has settled on a range implying relatively high risk aversion, of between 7 and 10.

The utility function



Expected utility of pension disbursements in various scenarios.

FUTURE SURPLUSES IN THE PENSION SYSTEM

Model simulations show that when conditions are favourable, very large surpluses may arise in the pension system during the latter part of the analysis period. Under current regulations, these surpluses cannot be used to increase pension disbursements. Among other things, the five-party agreement on the pension system is based on the principle that all funds should be retained in the system, it thus seems unrealistic to base an analysis of trends for the next 40 years on the presumption that potential large surpluses will not be distributed to pension beneficiaries. For that reason and in contrast to analyses in prior years, the ALM analysis for 2006 assumes implementation of the proposals in the government committee report SOU 2005:105 “Distribution of surpluses in the earnings-related pension system.” According to the committee’s proposal, if the balance figure exceeds 1.1, pensions should be increased by the quotient between the current balance figure and 1.1. Thereby, the portion of any surplus that pushes the balance figure over 1.1 will be distributed to pension beneficiaries and thus considered in our formula.

Whether or not surpluses are included in the formula is critically important to composing the normal portfolio. In respect of equities and other asset classes with high expected return and high risk, the best outcomes have no impact on pensions and thus do not affect the formula when analyses are based on current regulations. The result is that pension beneficiaries' utility from investments in equities, for example, is underestimated and the equity weight in the normal portfolio becomes too low. This distortion is prevented when it is assumed that pension system surpluses will be distributed to beneficiaries.

RISK AND RETURN FORECASTS

Asset selection is based on an assessment of long-term expected returns and variations in return for individual asset classes and historical co-variation of returns among asset classes. These assessments are shown in the following table.

Asset class	Forecast annual:	
	Return, %[1]	Risk, %[1]
Listed assets		
Global equities, developed markets	7.55	16.80
Swedish equities	7.75	23.00
Global equities, emerging markets	8.55	24.45
Government coupon bonds	5.15	6.35
Corporate coupon bonds with credit rating of BBB or higher	5.55	7.10
Corporate coupon bonds with credit rating lower than BBB (High Yield)	7.45	12.80
Index-linked bonds	5.00	4.50
Hedge funds	7.00	10.35
Unlisted assets		
Real estate	6.55	9.95
Private equities[2]	–	–

1) Hedged return.

2) The lack of historical data precluded inclusion of private equity in the model simulation and the portfolio weight for this asset class is thus decided on other grounds.

The assumed annual inflation rate is 2.25% and a real annual increase of 1.8% is expected for the income index, which is the basis for upwards adjustment of pension system liabilities.

THE NORMAL PORTFOLIO MIX

This year's ALM process shows that optimum goal attainment is achieved with a still higher - above 70% - weight of equities than indicated in prior analyses. The equity component of the optimal portfolio was increased because, as said, we assume that surpluses in the system will be distributed to pension beneficiaries, in contrast to prior studies. The equity component in the normal portfolio is however restricted by the legal requirement that at least 30% of Fund assets must be invested in low-risk fixed income assets. The equity component is also limited by the investment of 2 percentage points in real estate and the assumption that 3 percentage points should be available as a margin, in part to manage the drift in asset class weights. The conclusion is that the equity weight in the normal portfolio should be 65%.

The outcome begs the question of whether the legal requirement to invest 30% of Fund assets in low-risk fixed income assets impairs returns for beneficiaries to such an extent that it should be reviewed or taken away altogether. The buffer funds' asset mixes should also be viewed in light of the fact that almost 90% of pension system assets are made up of the "contribution asset." An equity weight of 65% in the buffer funds thus equates to an equity component of about 8% of the pension system's total assets.

The ALM study also indicates that given the Fund's return and risk forecasts, optimum goal attainment is achieved with a Swedish equity component of about 8%. The forecast return for global equities from developed markets is 0.20 percentage points lower than for Swedish equities, due to hedging expenses. For the current Swedish equity component (19%) to be optimal, the study also shows a required return on Swedish equities that is about an additional 0.45 percentage points higher than the return on global equities. The Fund believes the higher assumed return for Swedish equities is justified by that Swedish equities have historically generated higher returns than global equities, which seems still to be the case, and by greater transparency and more open corporate governance in the Swedish equity market. The Fund has thus decided to maintain the Swedish equity component at 19% for the time being.

Investments in emerging markets are expected to generate higher returns, but also convey higher risk, than equities from developed markets. Based on those conditions, the result is that the normal portfolio should contain at least 5% equities from emerging markets. Nonetheless, the Fund has elected to limit the component in the normal portfolio to 3%, in part due to assessments that prices for emerging market equities are currently relatively high.

With regard to fixed income assets, the study findings indicated that AP4's normal portfolio should have a low weight in government bonds and a very high weight in investment grade (credit rating BBB or better) corporate bonds. Long-term, the Fund's fixed income portfolio should also have a very long duration. Index-linked bonds, on the other hand, have no favourable long-term impact on the portfolio, primarily because the expected return is lower than for nominal bonds.

Significant factors that could not be modelled in the simulations should be taken into account when the strategic portfolio is designed. One such factor is the limited supply of long duration corporate bonds. The duration of the normal portfolio has thus been set at approximately 4.5 years and the corporate bonds component to slightly less than half of fixed income assets.

According to a prior decision, the Fund may invest up to 2.5% of assets in unlisted equities. The build-up of the private equity portfolio has reached a phase where commitments have essentially reached the desired level, but actual investments are still growing. Private equity is included in the normal portfolio with the same weight for this asset class as for the current total portfolio.

The ALM study also indicates that other studied asset classes (real estate, high yield bonds and hedge funds) should be included in the normal portfolio and real estate should have a higher weight than previously, but the Fund believes further analysis and deliberations are required before any such decisions can be taken. Accordingly, the normal portfolio mix is as shown in the following table.

Normal portfolio mix by asset class

Asset class	Mix, %
Global equities, developed markets	42.4
Swedish equities	19.0
Global equities, emerging markets	3.0
Total listed equities	**64.4**
Government bonds	18.4
Corporate bonds	14.6
Total fixed income	**33.0**
Total liquid assets	**97.4**
Private equities	**0.6**
Real estate	**2.0**
Total	**100.0**

AP4 has chosen a long-term currency exposure to ensure that currency returns offset the effects of exchange rate fluctuations on inflation and thus on the debit side of the public pension system. Based on available studies of the impact of exchange rates on inflation, the Fund believes this should be achieved by hedging the underlying exposure in the securities portfolio to the extent that total currency exposure corresponds to two thirds of the share of imports of total consumption, while maintaining a currency mix that corresponds to the currency mix of imports. Currencies are managed in clusters to limit the costs and complexity of hedging, wherein a major currency from the exposure perspective represents several minor currencies. In accordance with these principles, the Fund has determined the currency exposure for the normal portfolio as shown in the following table:

Currency mix for the normal portfolio

Total currency exposure in the normal portfolio	20%
Mix between currency blocks	Weight, %
USD (incl. HKD, NZD, SGD and currencies from developing countries)	30
EUR (incl. DKK and NOK)	55
JPY	5
GBP	10

ACTIVE TACTICAL ASSET ALLOCATION

TACTICAL ASSET ALLOCATION

Tactical asset allocation is a relatively new area of operations at AP4. The first section of the investment philosophy was drafted and the portfolio structure designed in early 2005. Active allocation decisions have been taken since May 2005. The goal is to create a qualified allocation department that can be expected to make a significant contribution to Fund performance. In addition to an active mandate, activities include managing drift in the Fund's underlying portfolios.

Active allocation decisions are implemented in an overlay portfolio and all positions are taken with derivatives. The performance target for the active allocation portfolio is 0.1% of the value of total portfolio assets per year, roughly SEK 200 million. Maximum active risk ex-ante is 0.6% annualised, calculated on the basis of the total portfolio.

The Fund's investment model focuses on cyclical market timing, sentiment and relative assessment among asset classes and markets. The investment horizon is six to twelve months. Opportunities to add value using the model are highly dependent on the ability to predict turning points in the economic trend, capacity to interpret the level of risk aversion in financial markets and access to relevant and continually updated information.

Attempting to predict turning points and momentum in economic trends and take advantage of historical connections between economic trends and the financial markets provides guidance in selecting the level of risk and timing allocation decisions. The Fund uses both externally and internally designed indicators for growth and production. The allocation department also makes its own growth forecasts and performs daily monitoring and analysis of new economic statistics.

Unrealistic optimism or pessimism about future market trends arises from time to time. In times of excessive optimism, the market becomes sensitive to negative surprises, while excessively pessimistic sentiment makes the market sensitive to positive surprises. Allocation decisions are based on input including a judgement of the investment community's appetite for risk and current expectations regarding financial market trends. The Fund uses a number of indicators for this purpose. Assessment of asset classes and markets are other key components of the investment process. As far as possible, the Fund makes its own forecasts of earnings trends in the major equity markets. This is a recently initiated project that will be further developed in future years.

Based on expected earnings growth and assessment of possible revaluation potential, target prices for each equity market are estimated for six to twelve months ahead. Short and long-term interest rate trends over the next six to twelve month are assessed using a Taylor model and based on the allocation department's forecasts for growth and inflation. The Fund also estimates trend-based earnings levels for various markets and calculates key ratios on those levels to estimate the risks in current earnings levels.

The disciplined use of the investment model is a prerequisite for successful tactical asset allocation. New and relevant information has an immediate impact on the indicators in the decision-making model. Changes in the indicators are added directly into conclusions and position taking and the decision-making model is continually developed. Models that prove inadequate are discarded. The Fund intends to more extensively develop its own models and indicators in future years.

At present, the Fund takes positions among equity indices, long-term government bonds and money market investments in developed markets. In future years, the allocation department will be increasing the number of strategies and markets with a view to increasing expected returns and decreasing risks.

The first phase will include positions in emerging markets and sectors. Other strategies will be added in tandem with further reinforcement to the tactical asset allocation department.

Active tactical asset allocation has outperformed its performance targets from the outset with limited risk utilisation and thus generated a very high information ratio.

AP4 AS AN ACTIVE SHAREHOLDER

AP4 is engaged in corporate governance on various levels. The most significant issues of 2006 are described below.

PROCESSES PRIOR TO GENERAL MEETINGS

Corporate governance issues are still increasing in scope for financial institutions, mainly as a consequence of the growing numbers of Swedish listed companies that have elected to comply with the Swedish Code of Corporate Governance (the Code). The impact of this development on AP4 has been that three senior executives are now deeply involved in corporate governance for much of the year, especially since nominating processes are tending to become more comprehensive. As in prior years, AP4 entrusts its corporate analysts and occasionally individual directors to represent the Fund at certain general meetings.

AP4 was represented on 19 nominating committees during the 2006 AGM season. That number increased in 2007, when AP4 will be a member of 27 nominating committees, including five chairmanships. Robur, SEB Funds and Skandia Liv have substantially larger Swedish equity portfolios than AP4 and are accordingly represented on more nominating committees, but AP4 has far and away the highest number of mandates among the buffer funds.

Nominating processes often vary substantially as the companies' situations differ in key respects. Sometimes a great many meetings are required, interspersed with interviews of former and potential directors; in other cases one or two meetings may suffice in a well-managed company with an efficient board and a principal shareholder with a distinct and long-term approach.

As the name indicates, a nominating committee is a preparatory body for the annual general meeting, not a separate body under Swedish commercial law or a kind of governing body. The purpose of the nominating committee is to draft some of the key decision items for the meeting to ensure it runs smoothly.

Resolutions are usually passed at annual general meetings by a large majority and time-consuming roll calls are required only in rare and exceptional cases. The media have sometimes interpreted this to imply that Swedish financial institutions uncritically rubber-stamp the proposals of principal shareholders regarding stock-related incentive programmes and increases in board remuneration. But that is not the case! Institutional capital has definitely advanced the positions vis-à-vis principal shareholders in the last ten years. What the critics do not see are the confidential discussions that take place among nominating committees. During these discussions – which in respect of incentive programmes are usually extended to a wider group of shareholders – proposals by the principal shareholder often undergo material changes.

The Code has given nominating committees a more distinct and significant role. AP4's overall assessment thus far is: A promising start – despite scant human resources on the institutional side. Current processes are effective and there is broad corporate acceptance for these processes. Finally, there is rapidly accruing knowledge capital among Swedish financial institutions as to how the processes should be managed.

During its first year of implementation, the Code has naturally received both criticism and praise. Much of the criticism has involved opinions that the rules are far too detailed, which has caused general meetings to become protracted and burdened by formal requirements.

Board chairmen for the vast majority of Swedish listed companies have implemented processes for evaluating board activities, which AP4 believes is one of the most important contributions of the Code when it comes to continually improving the corporate governance of Swedish companies. While board evaluation has been in progress in Sweden for several years, the Code has meant that the process has developed much faster than would otherwise have been the case.

PARTICIPATION AT GENERAL MEETINGS

The AGM is the principal forum for shareholders. AP4 aims primarily to attend and exercise voting rights at general meetings for companies in which the Fund owns a significant holding. In 2006 we were represented at 45 general meetings, including extraordinary general meetings.

Nominating committee involvement has generally meant we have played a more prominent role at the general meeting, either as a proposer of motions and/or to report and answer questions about the nominating committee's work.

AP4 was more actively involved in general meetings in 2006 in other respects as well. The Fund submitted an explanation of vote at the Ericsson meeting, which was recorded in the minutes of the meeting. The Fund voted in favour of the proposal, which included an increase in the chairman's remuneration to SEK 3.75 million. In the explanation of this vote, AP4 maintained that Ericsson is in many respects a highly unusual company on the Stockholm Stock Exchange. Accordingly, the Fund argued the level of remuneration at Ericsson cannot serve as a yardstick for other Swedish listed companies.

AP4 also posed critical questions to the principal shareholder at the Electrolux meeting, where a unanimous nominating committee proposed increasing board remuneration by 25% at the individual level – even though the board's financial accountability would be tangibly reduced after the imminent dividend to shareholders in the subsidiary Husqvarna, which represented about half the worth of the group.

JOINT SHAREHOLDER INITIATIVES

The Fund was active in the Association of Institutional Shareholders (AIS) during the year, an organisation formed by financial institutions in 2003 to strengthen and develop self-regulation in the Swedish equity market.

Another joint shareholder initiative was taken in late 2006 when the largest financial institutions in Sweden – which manage Swedish equities worth more than SEK 500 billion and equal to more than 15% of the total capitalisation of the Stockholm Stock Exchange – jointly authored a highly critical opinion. The opinion was preceded by a joint opinion piece in Dagens Nyheter under the headline "Legal loophole may cost savers billions."

The background to the exchange was the softening of regulations on takeovers of listed companies in recent years. This was not brought about by regulatory changes, but rather by creative financial advisers and buyers who have found a loophole in the law enabling circumvention of the "90% rule" in connection with takeovers. Merger regulations that require only a two thirds majority at a single general meeting make this possible.

The institutions presumed that the Riksdag would close this legal loophole. In the 2005 annual report, the President of AP4 wrote, "acquiring a company should be no easier or cheaper on the Stockholm Stock Exchange than on the large international bourses." It was therefore highly unexpected when a proposal referred for consideration to the Council on Legislation recommended that the loophole should be left in place and for all intents and purposes be widened, rather than closed. Something that until now has been a sharply criticised evasion would become an entirely legitimate principle.

The scathing opinion of the AIS, submitted in December 2006, makes it clear that the proposal would mean that more than 10% of outstanding shares could be acquired through forced sale. This contravenes both Swedish and European law. The institutions also pointed out that forced acquisitions supported by merger regulations will result in considerably lower bid premiums. As a result, large values will be transferred from existing shareholders to the bidders, the AIS warned. The opinion concluded with general thoughts on how regulations for merger and forced redemption should be drafted in the future.

The Ministry of Justice indicated in January 2007 that the Swedish government is going to strengthen protection of minority interests and reinstate the 90% rule for cash bids. In parallel, the government announced that it will be appointing a committee to carry out a fast-track study of how sound mergers can be facilitated without leading to regulatory misuse by listed companies.

SPECIAL SHAREHOLDER INITIATIVES

The four buffer funds initiated a partnership in 2006 concerning the special responsibility of the funds to implement environmental and ethical considerations in capital management. The objective of the partnership is to equip the buffer funds to more efficiently detect and more energetically prevent and react to ethical violations by companies in which the funds invest. The common ethical principles are expressed in the international conventions ratified by Sweden, such as ILO's core conventions and the UN Declaration on Human Rights. Toward that end, the First to Fourth Swedish National Pension Funds formed a joint Ethics Council in autumn 2006.

ethical council
A COLLABORATION BETWEEN FIRST–FOURTH AP-FUND

In cooperation with outside experts, the Ethics Council will be systematically reviewing the equity portfolios of the four buffer funds to identify and audit violations against international conventions. When violations are discovered, the Ethics Council will initiate dialogue with the company to ensure that action is taken to prevent further infringements. In these dialogues, the Ethics Council will endeavour to interact with the growing number of international pension funds that have similar ethical principles. The UN's new partnership forum for funds that have signed the Principles of Responsible Investment (PRI) will be an important channel for this joint effort.

In future years, the Ethics Council will provide an account of its work in an annual report.

SPECIAL CASES

Every year usually features at least one case requiring extraordinary efforts by major shareholders. Two corporate events stand out in 2006 for AP4: the resolution of the Skandia deal and the hostile takeover bid for the healthcare company Capio.

The resolution of the very long and drawn-out attempt to buy the life assurance provider Skandia was one of the signal events in Swedish corporate governance in 2006. The outcome was that South African Old Mutual successfully acquired an interest of more than 90% in the oldest company traded on the Stockholm Stock Exchange without having to pay the customary bid premium, despite the board's rejection of the bid and despite that the lion's share of Swedish financial institutions supported the board majority, albeit without backing up such moral support with new capital for the purchase of additional shares in Skandia.

There are many lessons to be learnt from the Skandia case study from the shareholder, board and management perspectives. AP4 welcomes the initiative taken by the Stockholm School of Economics to document and analyse what happened and has therefore decided to provide co-funding for the project.

The bid for the healthcare company Capio by two venture capital firms, Apax and Nordic Capital, was another signal event. With an interest of slightly more than 5%, AP4 was one of Capio's principal owners. The share price had developed well from a long-term perspective, but had suffered a severe setback in connection with the general market downturn in the spring. An unsupported buy-out offer on Capio came from Apax and Nordic Capital a couple of months after the price crash, a bid that seemed at first to entail a favourable takeover premium, but which was soon perceived as very meagre, at least compared to the stock's price earlier in the year.

The stock market was sceptical about the bid's chances of success, which became evident when the share was immediately traded above the bid level. One reason for this was that the Capio board immediately rejected the bid as too low and later worked openly to encourage competing bids. Another was that a few of Capio's largest shareholders, spearheaded by AP2 and AP4, made no secret of their dislike of the bid. One means employed in the criticism was a letter from the largest institutional shareholders to the Swedish Stock Market Council, which emphasised that the takeover bid on Capio was another example of growing regulatory misuse where bidders are attempting to use merger regulations in their bid conditions to push through bids at a much lower acceptance rate than under customary forced redemption rules, which stipulate at least 90%.

The bid for Capio was increased somewhat, or by about 9%, after a long and drawn-out process. The bid entailed a premium of about 25% compared to the average price six months prior to the original offer. The adjustment, by which Capio was valued at SEK 17 billion, was acceptable to the board and principal shareholders. The bid accordingly was successful and Capio was de-listed from the Stockholm Stock Exchange in mid-November.

BOARD REPRESENTATION

In contrast to many other financial institutions, the AP4 corporate governance policy allows the Fund to nominate, albeit on a restrictive basis, its own employees to non-executive directorships of listed companies. Former AP4 President Thomas Halvorsen has held seats on the boards of several companies over the years and is currently a director of Beijer Alma. The Fund's new President Mats Andersson is a director for KMT, a listed engineering company.

MACROECONOMIC REVIEW 2006

Global economic performance remained strong in 2006. At the end of the third quarter, annual GDP growth in OECD countries was 3.0% compared to the corresponding quarter in 2005. Despite indications that the growth rate may have cooled slightly in the fourth quarter, the growth rate among the OECD countries has clearly remained stable at about 3.0% for the third consecutive year.

Global economic growth was progressively redistributed during the year. Continued policy rate hikes in the United States had an adverse impact on the US economy. The housing market in particular was severely weakened, with direct and indirect impact on consumption and investments. The European economy, on the other hand, continued to recover and both household consumption and corporate investments increased at an accelerating rate during the year. Strong performance in the Japanese economy also endured.

Growth advanced at a brisk pace in non-OECD countries. As in prior years, China made a substantial contribution to global economic activity. As a group, countries outside the OECD may be expected to have contributed 1.5 percentage points to global economic growth in 2006. As in 2005, this indicates estimated global growth of 4.5% in 2006.

The industrial economy was robust in the first half, but leading indicators for industrial production, such as the OECD's leading indicators and ISM (the national supply managers' index in the United States), fell progressively in the second half. Relatively extensive inventory build-up was noted in the final months of the year in the US and Japanese economies.

The price of oil was volatile, rising in total from US$59 to US$64 a barrel by year-end. The increase expressed as a percentage was thus considerably less than in prior years. Prices for a number of base metals like zinc, nickel and copper also rose steeply in 2006.

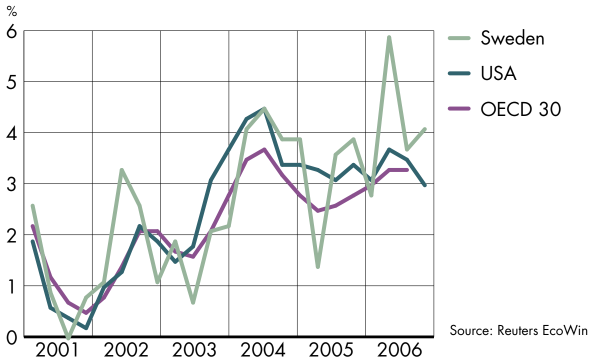
AP4 expects the weakening of the US economy to continue and believes the global industrial economy is on the verge of a downturn. Our overall assessment is that the global economic growth rate will wane slightly in 2007.

FIXED INCOME AND CURRENCIES

Despite tighter monetary policies from the central banks, the global bond markets were characterised by sustained low long-term yields and flatter yield curves during the year.

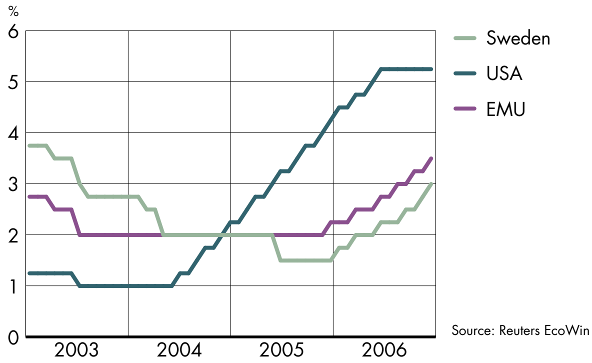
The US Federal Reserve began the year with a continuation of the gradual tightening cycle commenced in 2004. US economic growth was strong early in the year and inflation rose slightly. Consequently, there was a considerable increase in long and short-term rates in the US in the first half of the year, pulling rates up in other parts of the world as well. As indicators of a stronger economy in Europe and Japan became increasingly clear, central banks began tightening monetary policy in those parts of the world. The European Central Bank and the Swedish Riksbank raised their base rates several times in the first half, starting in early December 2005 and January 2006 respectively. The Bank of Japan and the Bank of England raised their respective base rates starting in the summer. There were signs as early as summer that growth in the US economy had started to flag. The slow-down was most obvious in the previously booming housing market. The bond market thus began discounting that the cycle of rate increases in the US was nearing its end

Annualised GDP growth, 2001–2006



Strong performance in the global economy.

Base rates, 2003–2006



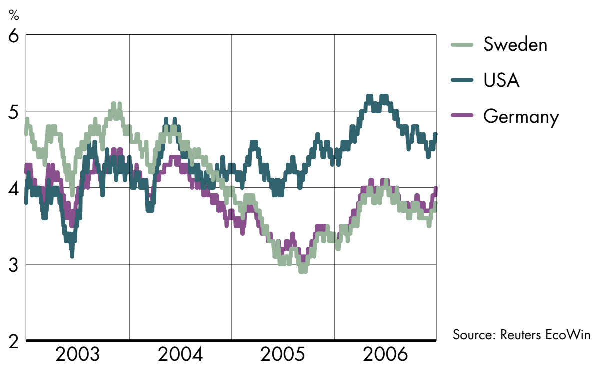
Rising base rates in 2006.

and US long-term yields started to fall. When growth further moderated later in the third quarter and the rise in inflation tapered off, the Federal Reserve clearly indicated less need for additional tightening. The bond market obviously began to expect the Federal Reserve may lower the base rate sometime in the first half of 2007. Long-term and short-term US rates ended the year at levels only moderately higher than those prevailing when the year began.

The downturn in long-term US interest rates contributed to the decline in long-term bond yields in other countries in the second half of the year. Unlike the Federal Reserve however, European central banks continued increasing their base rates during this period and at the end of the year signalled that further rate increases were likely or at least entirely possible in 2007. There was thus no room for shorter term rates to fall and yield curves in Europe flattened out considerably. In tandem with higher base rates, continued structural demand for long-term bonds due to the need of pension funds and insurance companies to offset long-term commitments probably contributed to the flatter yield curves. One specific reason that affected the Swedish market is that the new center-right government has announced significant future privatisations of state-owned companies, which some analysts anticipate may lead to a shortage of long-term government bonds in forthcoming years.

After the strengthening of the US dollar in 2005 when US short-term rates were increased considerably more than in other countries and American companies reaped profits from abroad under a temporary tax relief scheme, the dollar weakened again in 2006. The main reason was the prospective narrowing of the difference between short-term rates in the US and interest rates in other countries. Expectations were

Ten-year government bond yields, 2003–2006



Declining bond yields in the United States.

clear by year-end 2006 that the weakening of the dollar would continue. Another currency that weakened in 2006 was the Japanese yen, in part a function of relatively low Japanese interest rates. Although the Bank of Japan has initiated a normalisation of short-term rates, they have indicated that the pace will be cautious and expectations for continued increases are low. Furthermore, there is still a substantial need for Japanese investors to diversify their assets to a larger weight in foreign assets, which probably had adverse impact on the yen in 2006.

The Swedish krona strengthened appreciably during the year, bolstered by the weaker US dollar and the Riksbank's distinct indications of a more austere monetary policy, thus in agreement with many other central banks. The trend was accentuated by the outstanding performance of the Swedish economy over the course of 2006.

EQUITIES

Global equity markets delivered strong performance for the fourth consecutive year in 2006. Leading indicators improved in the initial months of the year while corporate earnings trends produced positive surprises. This helped sustain the buoyancy of the market trend and whet investors' appetite for risk. More severe geopolitical unrest combined with some inflation and interest rate concern in the US led to a short-lived but forceful correction on world stock exchanges in May. The market recovered after late July and the trend once again pointed upwards, with progressively declining volatility.

The MSCI World DNI rose by 15.6% (15.8) in local currency terms in 2006. Among the global trend-setting markets, the US market rose by 14.7% (5.1) and the European by 19.1% (24.9). The global index was held back by the Japanese market, however, which delivered minimal growth of 7.3% (44.6) in 2006. Share prices in emerging markets climbed during the year and recorded a total upturn of 28.5% (35.3).

Buoyed by the strength and durability of the global economy, strong corporate earnings trends continued in 2006 and earnings forecasts were further adjusted upwards. Margins and cash flows are at historically high levels and listed companies are generally speaking in good financial shape. There was also a sustained rise in activity with regard to mergers, acquisitions and takeovers in world equity markets.

Oil prices were somewhat higher at the end of the year than at the outset, but record-high price levels were recorded in the second and third quarters. The prices of other raw materials, especially base metals, rose sharply in relation to 2005. As a result, energy and raw materials-related companies accounted for the strongest earnings growth in 2006 and equities in those sectors were among the share price victors, along with utilities and telecom services. Healthcare and information technology stocks were the weakest performers, but all sectors demonstrated positive price trends in 2006.

The Swedish stock market also performed well in 2006. The SIX Return Index rose by 28.1% (36.3) during the year.

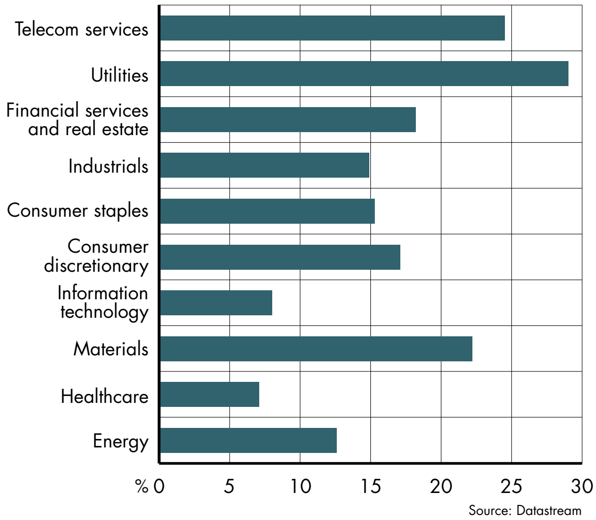
The year began with strong interim reports, optimistic statements from management and expectations for substantial extra dividends in conjunction with general meetings in the spring. Overall, this contributed to a very strong beginning to the year for the Swedish equity market, which had risen 16.2% by early May.

With the record-high dividends already paid out and accelerating global market nervousness, the Stockholm Stock Exchange declined almost 20% from mid-May until the market hit bottom on 13 July. Optimism returned in late summer and by mid-October the market was back to new year high levels.

As was the case last year, trends were strong for many companies with exposure to energy and the raw materials sector, both metals-related and petrochemical. Companies like ABB, Alfa Laval, SSAB and Boliden recorded share price upturns of 50 to 150% and outperformed the index by a wide margin. Ericsson, Nokia and AstraZeneca were the poorest performers among the largest companies traded on the Stockholm Stock Exchange. In other respects, 2006 was characterised by significant corporate deals. Takeover bids were made in the healthcare sector for Gambro and Capio, while the battle between heavy truck manufacturers MAN and Scania became front-page grist for the media mills in the autumn.

Signs that the US economy is cooling down are now apparent and worries about rising inflation and base rates have been soothed somewhat. Uncertainty remains as to the extent of the slowdown and the impact it will have on earnings trends. This uncertainty must be considered against the positive impact of strong corporate balance sheets and consistently good cash flows. AP4 expects earnings trends to remain strong over the short term. One risk is that expectations for earnings growth for the full year of 2007 are nevertheless too high and will inhibit future market development.

Sector trends, 2006 (MSCI World DNI)



The utilities sector was the best performer on the global index in 2006.

Equity markets, 2003–2006

Share price trends remain strong.

REPORT OF THE DIRECTORS

The Board of Directors and President of the Fourth Swedish National Pension Fund (AP4) present herewith the annual report for the financial year beginning 1 January 2006 and ending 31 December 2006, the Fund's 33rd year of operation and the sixth since the reorganisation of the Swedish pension system.

Accounting and valuation principles are described in a separate section.

REVIEW OF OPERATIONS IN 2006

AP4 generated a total return of 10.5% (16.9) in 2006, corresponding to a net profit of SEK 18.8 billion (25.8). This excellent result can be ascribed primarily to the Fund's strategic decision to maintain a high weight of 61% in equities, which allowed the Fund to benefit from the strong performance of equity markets during the year. Global equity markets produced a return of 15.6% in local currency terms, while the Swedish equity market posted a return of 28.1%. Since its inception on 31 December 2000 the Fund has recorded a return of 32.2% or 4.8% per year. This exceeds the growth of the personal income index, which is used to calculate the upwards adjustment of pension entitlements and pensions by 1.6 percentage points per year. The Fund has thus more than met its target of preserving the value of pensions.

In addition to the generally favourable impact of the high weight in equities, the decision to invest more than 30% of equity holdings in the Swedish market in 2006 also provided a strong contribution to Fund performance. Conversely, fixed income assets yielded only a marginal contribution, while currency exposure had negative impact on Fund performance due to the strengthening of the Swedish krona during the year. The negative currency effects were however severely limited by the favourable decision in December 2005 to halve the Fund's currency exposure from 20% to 10%. The contributions of each asset class to Fund performance are shown on the chart headed "Contributions to Fund performance 2006" on page 27.

Asset management underperformed the index by –0.6 (–0.1) percentage points. As in previous years, fixed income asset management and tactical asset allocation made a positive contribution relative to the index, but the Swedish and global equity portfolios fell short of their respective indices. Active currency management also generated a loss.

Again in 2006, AP4 and AP3 commissioned the Canadian firm Cost Effectiveness Management Inc. (CEM), a world leader in benchmarking for pension fund managers, to perform an in-depth study of costs and efficiency. CEM based its analysis on comparisons with some 20 pension funds of equivalent size and management strategies to the AP funds.

The CEM study showed that AP4's costs in 2005 were more than 10% below those of the benchmark group. The primary reasons were the Fund's lower management expenses per krona under external management and strategy of maintaining a relatively low share of assets under external management, which is on average costlier than internal management. AP4's costs for internally managed assets were on par with those of the benchmark group, while administrative expenses (including costs for Performance and Risk Control and custody accounts) were somewhat higher. The Fund sustained its cost-cutting measures in the latter part of 2006 and this efficiency drive will continue in 2007.

Absolute return, 2006

High equity component and bull market generated strong absolute return…

Relative return, 2006

…but asset management slightly underperformed the index.

SIGNIFICANT EVENTS

Asset management approaches

An unbiased stock-taking of options to improve fund performance was considered during the financial year. The options considered included new management approaches and financial instruments, as well as the introduction of additional cost centres. The objective was to generate stable income, in part through more clearly allocating risk to areas with high expected returns and in part by spreading risks to additional cost centres to attain greater diversification. Thus far, this exercise has resulted in greater consistency of expected active risk in equity management and between equity management and fixed income asset management. As of year-end 2006, currency managers were also given the opportunity to use currency options, while equity managers have started a project to extend investment opportunities to allow negative positions in individual equities. Aimed at enhancing risk management, the Swedish equity portfolio was split into two portfolios: an actively managed portfolio of mainly large cap equities for which the reference index is made up of companies on the SIX60 list and an index-tracking portfolio, for which other companies on the SIX Return Index make up the reference index.

With a view to streamlining analysis operations, a project was begun by portfolio managers to use quantitative screening methods (selecting the companies in the Fund's investment universe that should be subject to closer analysis).

A model was devised during the year for assessing asset classes based on factors including data on all companies in the global equity portfolio's reference index. The results derived from the model will be used as input information for medium-term strategic allocation. This will be integrated in 2007 with other analysis of returns for each asset class, and, based on the results of this project, the Fund's strategic portfolio will be composed. See also the section entitled "Investment strategy" on page 10.

The long-term objective for Fund operations was clarified with a formula, which was a key element in the year's ALM process. The analysis also resulted in a decision to implement a long-term normal portfolio alongside AP4's medium-term strategic portfolio, which, as before, is the benchmark index for active asset management. Other conceivable compositions for the long-term normal portfolio were also examined. The principal conclusion was that the Fund's long-term share of equities should be even higher than it is now. See pages 14–16 for a more detailed explanation of the ALM process.

Rationalisation and efficiency measures

The systematic re-examination from a cost perspective of all contracts to which AP4 is party that was begun in 2005 continued in 2006. The review concentrated on administrative and IT-related expenses and transaction fees for derivative products, which are included in the acquisition value for each instrument rather than being separately reported. These fees have been reduced, which is expected to generate additional income of more than SEK 17 million for 2006.

Other initiatives aimed at enhancing income were also implemented during the year. AP4 entered into an agreement with Institutional Shareholder Services to protect the Fund's interests as a passive party to class action suits involving equities traded on US stock exchanges. Such actions are becoming increasingly common and the Fund received settlements of more than SEK 3 million in 2006 referring to cases in 2005. The Fund has also commenced a programme for securities lending through Northern Trust, which is expected to generate substantial income.

The programme to streamline Fund administration continued during the financial year. Programme initiatives included outsourcing a large part of payroll administration.

Performance and Risk Control devoted much of the year to implementing a new system for evaluating risks and returns, Pearl, from the Dutch company Ortec. The expanded analysis options, primarily performance attribution, will be deployed gradually for the equity portfolios at the securities level, as well as for the fixed income and currency portfolios. Once the system has been fully implemented, the Fund will have a substantially better analysis tool as well as more efficient day-to-day operations and control.

Organisational changes and employees

Mats Andersson took over as President of the Fund as of 1 January 2007. Prior to joining AP4, he was head of asset management at Skandia Liv. The recruitment process was led by a board committee consisting of the chairman, deputy chairman and Kajsa Lindståhl. Mr Andersson's predecessor, Thomas Halvorsen, will be stepping down on 1 January 2007 after 24 years' service to the Fund. The average number of employees at the Fund in 2006 was 44 (46).

RETURN AND RISK

Market trends

Global economic growth remained robust in 2006 and was a key factor behind the sustained strong performance of equity markets. The MSCI World Index rose 15.6% (15.8) in local currency terms, 14.8% for North America and 19.1% for Europe, while growth in the Japanese market was considerably lower at 7.3%. Once again, it was a very good year for the Swedish equity market, which produced a total gain of 28.1% (36.3) despite the stronger krona. Measured in US dollars, total growth was an impressive 48.9%. Equity markets in emerging markets also performed strongly, generating growth of 28.5% for the MSCI Emerging Markets Index in local currency terms.

Central banks tightened their monetary policies in 2006, driving up short-term interest rates. In parallel, long-term rates rose moderately in the global bond markets, which led to a flattening of yield curves. Returns in fixed income markets were modest at best. Measured in local currency terms, the bond indices returned 3.7% in the US, –0.3 percent in the EMU area and 1.2% in Sweden.

In trade-weighted terms, the Swedish krona strengthened by 6.1% in 2006. In part, the upturn reflected the weakening

Return and risk

	Returns, %						Volatility, %	Active risk, %	Information ratio	Sharpe ratio	Beta value
	2006			2005			12 months	12 months	12 months	12 months	12 months
Asset class	Portfolio	Index	Relative	Portfolio	Index	Relative	Portfolio	Relative	Relative	Portfolio	Portfolio
Global equity portfolio*	13.4	13.7	–0.2	14.5	14.8	–0.2	9.1	1.2	neg	1.1	0.97
Internally managed	16.8	16.3	0.5	11.6	12.5	–0.9	11.4	1.9	0.3	1.2	0.96
Externally managed	11.7	13.5	–1.8	21.0	20.4	0.7	10.6	1.1	neg	0.7	0.99
Swedish equity portfolio	25.7	28.1	–2.4	34.1	36.3	–2.2	19.3	2.4	neg	1.2	1.03
Fixed income portfolio*	0.6	0.6	0.1	3.7	3.5	0.3	2.1	0.7	0.1	neg	1.01
Real estate	38.1	38.1	0.0	47.7	47.7	0.0	–	0.0	–	–	–
Investment assets**	10.5	11.1	–0.6	16.9	17.0	–0.1	7.1	0.8	neg	1.0	1.02
Investment assets including management expenses	10.4	11.1	–0.7	16.8	17.0	–0.2					
Listed investment assets	10.0	10.6	–0.5	16.4	16.5	–0.1					

* *Including full currency hedging.*

** *Including currencies and tactical allocation. Contributions from these asset classes are shown in Contributions to Fund performance.*

Percentages in the above tables are accurately rounded up or down individually and totals therefore do not always exactly correspond to the component figures.

of the US dollar, but was also attributable to the Riksbank's announcement of a more austere monetary policy and higher interest rates.

Growth was strong in the Swedish property market, which contributed to a return of 38.1% on the Fund's securities holdings in AP Fastigheter Holding AB.

The combined growth in the Fund's benchmark index was 11.1% (17.0) for the year.

Investment and return

The Fund's investment assets had a market value of SEK 200,621 million (180,168) at year-end. The portfolio was divided as follows: global equities 42.2% (42.2), Swedish equities 19.9% (20.0), fixed income assets 36.3% (36.4), real estate 2.3% (2.1) and cash, unrealised losses/gains from hedging, etc., –0.7% (–0.7). All investments refer to exposures including underlying values for derivatives, distributed by asset class.

Total return on investment assets was 10.5% (16.9) for the year, corresponding to –0.6% (–0.1) against the benchmark index. Return on investment assets after operating expenses was 10.4% (16.8).

Of the sub-portfolios, the global equity portfolio generated a return of 13.4% (14.5) including full currency hedging, an underperformance of –0.2 percentage points (–0.2) relative to the benchmark index.

The Swedish equity portfolio recorded a healthy return of 25.7% (34.1), although it still underperformed the benchmark index by –2.4 percentage points (–2.2). Return on fixed income assets was 0.6% (3.7) including hedging, outperforming the reference index by 0.1 percentage point (0.3). Returns from the Fund's real estate investments, which consist entirely of shares and notes receivable in AP Fastigheter Holding AB, amounted to 38.1% (47.7).

A complete chart showing returns and risk for investment assets is shown on the preceding page. The chart on page 28 shows the allocation and exposure of investment assets compared to the strategic portfolio.

Contributions to Fund performance

As shown below in "Contributions to Fund performance 2006", equity holdings contributed 10.3 percentage points of the total return of 10.6% on investments assets, of which Swedish equities accounted for 4.7 percentage points. Thus, equity investments generated SEK 18.4 billion (including 8.4 billion from Swedish equities) of net profit for the year of SEK 18.8 billion. Strategic currency exposure was reduced from 20% to 10% in December when the Fund assessed the Swedish krona as undervalued from the medium-term perspective. Accordingly, strategic currency exposure was 10% for most of 2006. As predicted, the Swedish krona strengthened against most currencies. The remaining currency exposure consequently made a negative contribution of –0.7 percentage points to the Fund's total return, corresponding to a reduction in profit of SEK 1.3 billion. Nevertheless, this was 0.6 percentage points or SEK 1.1 billion better than would have been the case if currency exposure had been maintained at 20%. At year-end, the Fund determined that the undervaluation of the krona upon which the decision was based to reduce currency exposure to 10% no longer fully applied and currency exposure was increased to 15% in mid-December.

Total investment returns underperformed the benchmark index by –0.6 percentage points (0.1). The relative contributions were an underperformance of –0.1 percentage points from global equities (where the main negative impact stemmed from the active external mandates) and an underperformance of –0.4 percentage points in Swedish equities. In addition, active tactical asset allocation outperformed the benchmark index by 0.1 percentage points and currency management generated a negative contribution of 0.2 percentage points.

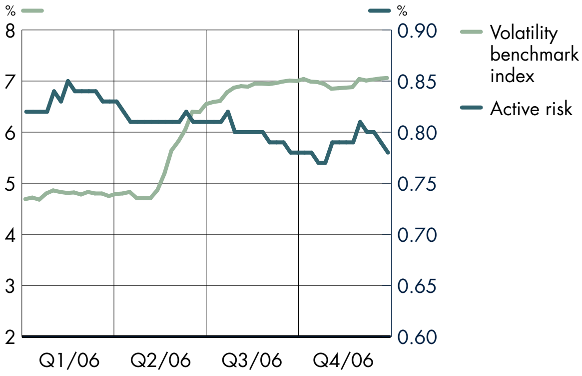
Contributions to Fund performance 2006

	Weights in strategic portfolio %	Contribution to absolute return % points	Contribution to net profit SEK bn	Contribution to relative return % points
Global equities*	42.0	5.6	10.0	–0.1
Swedish equities	19.0	4.7	8.4	–0.4
Fixed income asset*	37.0	0.3	0.4	0.0
Real estate	2.0	0.7	1.3	0.0
Currencies	–	–0.9	–1.5	–0.2
active management	–	–0.1	–0.2	–0.1
Tactical allocation	–	0.1	0.2	0.1
Total	**100.0**	**10.5**	**18.8**	**–0.6**

** Including full hedging.*

The contribution from currencies was affected by interest rate differences in currency forwards markets. For that reason and due to varying principles applied by external funds to calculate currency income, the currency contribution does not coincide with "Net income, foreign exchange" on the income statement.

Active risk and volatility, 2006



Declining active risk despite rising market volatility.

Risk

The risk level, measured as volatility, of AP4's investments averaged 7.1% (4.7) in 2006. Average active risk, measured retroactively, was 0.8% (0.8). The upswing in the Fund's average volatility during the year is partially attributable to the market uncertainty that arose in conjunction with the slump in world equity markets in May and June. Volatility thereafter subsided to levels only slightly higher than the average for 2005. Volatility in the fixed income portfolio was unchanged at 2.1% (1.9) during the year.

Active risk in global equities declined to 1.2% (1.2), but increased in Swedish equities to 2.4% (1.8). Active risk in the fixed income portfolio dropped to 0.7% (0.7), due to lower market volatility. See also the "Return and risk" chart on page 26.

INCOME IN 2006

AP4 reported a net profit of SEK 18,763 million (25,759) for 2006.

Operating income consisted of net interest income, dividends received, net income per asset class and net commission expenses for a total of SEK 18,896 million (25,892). Net income from listed shares and investments – consisting of gains from the sales of equities and unrealised changes in the value of remaining equity holdings – was the largest income item. Commission expenses, which amounted to SEK 75 million (87), comprised direct transaction costs such as fixed fees to external managers and custodian bank fees.

Allocation of investment assets

	31 Dec 2006		31 Dec 2005		31 Dec 2006
Asset class	Market value, SEK million	Exposure*, %	Market value, SEK million	Exposure*, %	Strategic portfolio, %
Global equity portfolio	80,778	42.2	76,813	42.2	42.0
Internally managed	46,500	25.2	43,322	23.6	-
Externally managed	34,278	17.1	33,491	18.6	-
Swedish equity portfolio	41,522	19.9	36,304	20.0	19.0
Fixed income portfolio	69,642	36.3	63,339	36.4	37.0
Real estate	4,628	2.3	3,842	2.1	2.0
Currencies/Tactical asset allocation/Cash**	4,051	–0.7	–130	–0.7	-
Investment assets	**200,621**	**100.00**	**180,168**	**100.0**	100.0

** Exposure includes the underlying value of derivatives for each asset class.*

*** Market value includes unrealised gains or losses on currency futures for hedging.*

Exposure and returns for external mandates in 2006

Asset class	Type of management	Region	Benchmark index*	Portfolio manager	Market value at 31 Dec, SEK million	Return, %	Return on index, %	Relative return, % points
Equities	Semi-active	North America	MSCI North America	State Street	5,958	12.7	10.8	1.8
Equities	Semi-active	Europe	MSCI Europe	State Street	4,219	19.0	17.7	1.3
Equities	Semi-active	World ex Pacific	MSCI World ex Pacific	BlackRock	7,234	14.0	13.6	0.4
	Total semi-active mandates				**17,411**	**14.6**	**13.4**	**1.2**
Equities	Active	Pacific ex Japan	MSCI Pacific ex Japan	APS	3,160	8.2	21.6	–13.4
Equities	Active	Pacific ex Japan	MSCI Pacific ex Japan	Capital	1,947	21.5	21.6	–0.2
Equities	Active	Japan	MSCI Japan	Martin Currie	7,608	5.2	9.0	–3.8
Equities	Active	World	MSCI World DNI	Capital	3,274	12.0	13.4	–1.3
	Total active mandates				**15,989**	**8.9**	**13.6**	**–4.7**

** All indices currency hedged to SEK.*

Percentages in the above tables were accurately rounded up or down individually and totals therefore do not always exactly correspond to the component figures.

Operating expenses amounted to SEK 133 million (133). Personnel costs of SEK 86 million (91) included SEK 3 million (10) arising from reductions in the workforce. Other administrative expenses totalled SEK 47 million (42), with the entire increase attributable to information and IT costs.

Excluding commission expenses, the percentage of costs attributable to management (operating expenses in relation to total average fund capital) was 0.07% (0.08). Including commission expenses, the figure was 0.11% (0.13). The cost analysis performed by CEM during the year is discussed in greater detail above under “Review of operations in 2006.”

Fund capital at year-end totalled SEK 200,537 million (180,098), an increase of SEK 20,439 million (28,664). Net payments from the national pension system accounted for SEK 1,568 million (2,312) of this increase, while transfers from the special asset management funds contributed SEK 108 million (593) and the Fund’s net profit SEK 18,763 million (25,759).

Net contributions from external management of listed assets, 2006

SEK million	Total listed assets
Gross income	5,196
Less performance-based fees	–19
Net	5,177
Fixed management fees	–63
Net contribution	**5,114**
Assets under management, 31 December 2006	33,405

ASSET MANAGEMENT MANDATES

Tactical asset allocation

Tactical asset allocation provided a positive contribution of slightly more than 0.1 percentage points to active return for the total portfolio in 2006, exceeding the return requirement for the business area.

The Fund concluded during the year that market risks were high from a cyclical perspective and consequently elected to maintain risk at low levels. Despite the limited assumption of risk, the Fund was able to achieve the return requirement through fortuitous market timing and a favourable mix of positions. The key contributors to the business area’s net performance were overweight in European equities and underweight in Japanese bonds during the first four months of the year, accompanied by an overweight in US bonds during the second half.

Global equity portfolio

The market value of the global equity portfolio, including SEK 779 million (358) of unlisted equities, was SEK 80,766 million (76,813) at year-end. SEK 17,411 million (16,542) of this figure related to external semi-actively managed holdings and SEK 15,989 million (16,665) to external actively managed holdings of listed equities. Sub-portfolios in global equities account for all the Fund’s external mandates for listed assets.

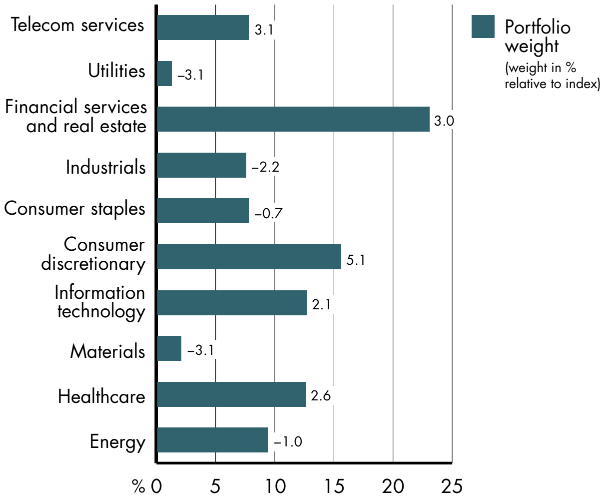
The return on the entire global equity portfolio, fully hedged, was 13.4%, which represented an underperformance of –0.2 percentage points (–0.2) against the benchmark index. The internally managed portfolio generated a return of 16.8%. Asset management outperformed the index by

0.5 percentage points (–0.9). Total return on external asset management mandates was 11.7% (21.0), underperforming the benchmark index by –1.8 percentage points (0.7).

Internal management of global equities is structured on a sectoral basis combined with separate sectoral allocations. The sectoral mix and weights of internally managed equities relative to the reference index at year-end are shown in the table at the foot of this page.

The strength and durability of the economic cycle and sustained high commodity prices did not favour the internal global equity portfolio in 2006 because of a defensive equity mix in certain sectors and sectoral allocation operations. The return on the internal global equity portfolio against the benchmark index is primarily attributable to the equity mix in the information technology, energy and financial services sectors. The primary sources of negative contributions were an underweight sector allocation in utilities, the best-performing sector of 2006, and an overweight in healthcare.

Internally managed global equity portfolio allocations by sector at 31 December 2006



Five largest holdings in the internally managed global equity portfolio

Largest holdings	Market value 31 Dec 2006, SEK million	Share of global portfolio, %
MICROSOFT	1,226	2.6
VODAFONE	853	1.8
IBM	828	1.8
CITIGROUP	818	1.8
EXXON MOBIL	760	1.6
Total	**4,485**	**9.6**

The equity mix in telecom services and consumer discretionary also had an adverse impact.

AP4 had seven external management mandates for listed equities in 2006; see the chart on page 29. Four of the mandates were actively managed, including one focused on global equities, one on Japanese equities and two on Asia-Pacific stocks, while three semi-active mandates cover quantitative management in mature equity markets other than Asia-Pacific. No changes were made regarding existing mandates during the year. The proportion of externally managed global equities at year-end 2006 was 42.4% (43.6) of the total global equity portfolio.

The three semi-actively managed mandates returned 14.6% (12.5), outperforming the index by 1.2 percentage points (0.7). The Asia-Pacific mandates, including Japan, generated a combined return of 8.1% (34.9), underperforming the index by –5.5 percentage points compared to last year's excess return of 0.4 percentage points. Income for the global equity mandate underperformed the benchmark index by –1.3 percentage points (–0.1).

Swedish equity portfolio

At year-end, the Swedish equity portfolio had a market value of SEK 41,522 million (36,304) including private equity assets worth SEK 462 million (426). The Swedish equity portfolio thus represented 19.9% (20.0) of the Fund's assets. The portfolio posted a return of 25.7% (34.1) and underperformed the SIX Return Index by –2.4 percentage points (–2.2). Excluding private equity assets, the underperformance was –2.2 percentage points (–1.9).

The year got off to a strong start, underpinned by surprisingly strong interim reports and optimistic statements from many chief executives. The record-high dividends promised in connection with AGMs in the spring also tempted investors. Following a sharp retreat in May and June, optimism returned with vigour in the autumn.

The more defensive nature of the portfolio early in the year had adverse impact on relative return, when companies with exposure to the favourable economic trends performed very strongly. The Fund exploited the opportunity during the downturn in early summer to increase its holdings of cyclical stocks. For instance, an overweight position was taken in Sandvik while holdings in ABB, Alfa Laval and Boliden were further increased during the summer months.

The higher weighting of cyclical stocks during the year benefited portfolio performance. The main positive contributors to relative return were holdings in Alfa Laval, Volvo and Getinge. Underweight positions in Gambro and Scania had an adverse effect on the relative performance of the Fund owing to takeover bids on the two companies. The underweight in TeliaSonera, the largest positive contributor to the portfolio last year, had a mainly negative impact on return this year.

Taken as a whole, the underperformance in asset management is partially attributable to the portfolio's average share of small cap equities during the year, which was about 5 percentage points lower than index, and partially to the less fortunate mix of small cap equities. However, the mix of large cap equities provided a positive contribution to active return. Among small cap equities, Clas Ohlson, New Wave and Millicom produced the largest negative contributions.

A project aimed at splitting management of Swedish equities into an actively managed portfolio of mainly large cap equities and a passively managed small cap portfolio was initiated towards the end of the year. As part of that process, there was a significant increase in the number of holdings in the Swedish portfolio.

Fixed income portfolio

The fixed income portfolio had a market value of SEK 69,642 million (63,339) at year-end. The portfolio generated a return of 0.6% (3.7), outperforming AP4's reference index by 0.1 percentage points (0.3). The fixed income group, which has maintained essentially the same mandate and investment philosophy for the past four years, has exceeded the Fund's return requirement for that period even though the target for active return was not met in 2006.

The year-end duration in the fixed income portfolio was 4.7 years, which was somewhat longer than the reference index. The table below provides a breakdown of bond holdings by rating class.

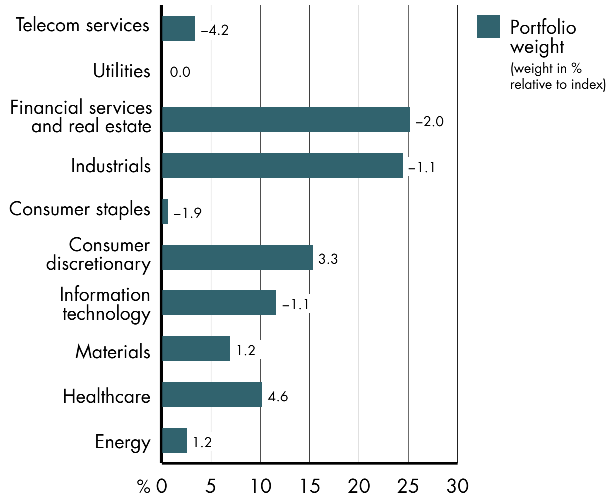
At year-end, the Fund was positioned for rising credit spreads and steeper yield curves in Australia and the UK. The Fund was also overweight in Swedish bonds and underweight in euro-dominated bonds.

Currencies

Active currency management generated a negative contribution of 0.1 percentage points to the Fund's income from asset management. The main driver was an overweight position in Japanese yen versus the euro. Costs for strategic currency management, which refer to hedging of foreign assets to achieve strategic currency exposure in accordance with investment decisions, were substantially lower than expected. The favourable outcome was due primarily to lower interest risk in foreign currency forward contracts than in the benchmark index.

AP4 reduced its strategic currency exposure from 20 percentage points to 10 in late 2005, based on the assessment that the Swedish krona was, from a medium-term perspective, undervalued. The krona became considerably stronger in 2006 and the Fund accordingly decided in December to raise strategic currency exposure to 15%. The krona strengthened by 7.5% during the year against a currency basket with the same composition as the Fund's long-term currency exposure. The decision to reduce medium-term strategic currency exposure thus resulted in a contribution of 0.6 percentage points to the Fund's absolute return.

Swedish equity portfolio allocations by sector at 31 December 2006



Five largest holdings in the Swedish equity portfolio

Largest holdings	Market value 31 Dec 2006, SEK million	Share of global portfolio, %
ERICSSON	3,363	8.2
SWEDBANK	2,588	6.3
VOLVO	2,575	6.3
H&M	2,349	5.7
ASTRAZENECA	1,949	4.7
Total	**12,824**	**31.2**

Largest active positions in internally managed equity portfolios at 31 Dec 2006

LARGEST OVERWEIGHTS (SWEDEN)

Company	Active weight, %	Portfolio weight, %	Index weight, %
SWEDBANK	3.3	6.3	3.0
GETINGE IND	3.1	3.8	0.7
TELE2	2.3	3.4	1.0
BOLIDEN	1.8	3.0	1.2
ASTRAZENECA	1.8	4.7	2.9

LARGEST OVERWEIGHTS (GLOBAL)

Company	Active weight, %	Portfolio weight, %	Index weight, %
SWEDBANK	1.5	1.5	0.0
MICROSOFT	1.5	2.6	1.2
WALGREEN	1.3	1.5	0.2
ADIDAS	1.3	1.3	0.0
WPP	1.3	1.4	0.1

LARGEST UNDERWEIGHTS (SWEDEN)

Company	Active weight, %	Portfolio weight, %	Index weight, %
TELIASONERA	–5.8	0.0	5.8
SEB	–3.2	0.2	3.4
SCANIA	–2.2	0.0	2.2
ERICSSON	–2.1	8.2	10.3
SCA	–1.9	0.0	1.9

LARGEST UNDERWEIGHTS (GLOBAL)

Company	Active weight, %	Portfolio weight, %	Index weight, %
P & G	–0.9	0.0	0.9
CISCO	–0.7	0.0	0.7
NESTLE	–0.6	0.0	0.6
ROYAL DUTCH	–0.6	0.4	1.0
INTEL	–0.5	0.0	0.5

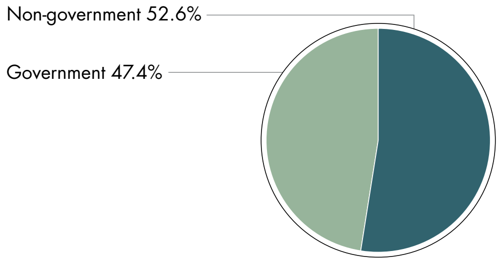
Currency exposure was 15.0% of total assets at year-end, compared to 10.1% at the start of the year. The key positions in active currency management at that date were overweight positions in Norwegian kronor and Japanese yen versus an underweight in euro.

Real estate

The Fund holds a 25% stake in AP Fastigheter Holding AB, which is one of Sweden's largest property groups, with a portfolio worth SEK 35 billion. The group's main holdings are of commercial real estate and residential properties in Stockholm, Uppsala and Gothenburg. Corporate governance by the Fund is effectuated mainly through proactive initiatives within the framework of its board mandate. The return on the Fund's holding in AP Fastigheter was 38.1% (47.7) while the market value of a comparable portfolio within the group rose by more than 11%. The remaining return in relation to the appreciation in property values is mainly attributable to borrowing within the group. Nearly two thirds of the high return in 2005 was an effect of the new valuation principles used to calculate the net worth of the company.

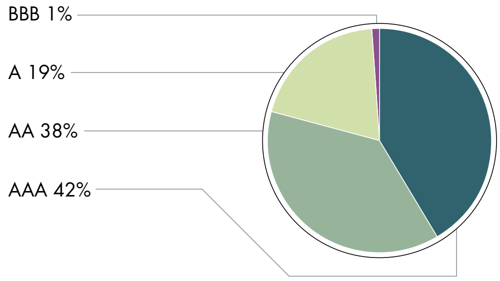
AP Fastigheter's actual return is used as the reference index for the security holdings.

Fixed income portfolio allocations by type of issuer at 31 Dec 2006



Roughly equal proportion of government and corporate bonds.

Bond holdings by rating class at 31 Dec 2006



High concentration of investment grade corporate bonds.

Currency exposure* at 31 Dec 2006, SEK million

	USD	EUR	GBP	JPY	Other	Total
Shares and investments	38,691	13,684	9,193	7,961	7,424	76,953
Bonds and other fixed income assets	20,507	10,304	7,032	0	0	37,843
Derivatives excl. currency derivatives	–36	127	–279	21	–205	–372
Net other receivables and liabilities	15	215	175	42	322	769
Currency derivatives	–50,830	–15,555	–20,017	–766	2,159	–85,009
Net currency exposure	**8,347**	**8,775**	**–3,896**	**7,258**	**9,700**	**30,184**

Currency exposure* at 31 Dec 2005, SEK million

	USD	EUR	GBP	JPY	Other	Total
Shares and investments	38,147	11,870	8,230	8,987	6,986	74,219
Bonds and other fixed income assets	19,181	9,767	6,065	0	0	35,013
Derivatives excl. currency derivatives	66	–347	80	3	–129	–327
Net other receivables and liabilities	36	143	116	0	287	582
Currency derivatives	–52,716	–11,535	–12,244	–7,980	–6,870	–91,345
Net currency exposure	**4,714**	**9,898**	**2,247**	**1,010**	**274**	**18,142**

** Currency exposure was formerly calculated on the basis of legal domicile. As of 2005, AP4 uses the MSCI currency domicile definition for equities and the denomination currency for fixed income assets.*

Private equity

Private equity operations experienced a record year in 2006 with respect to new investment commitments, even though AP4 maintained its cautious approach to proposals from new counterparties. Committed capital increased during the year from SEK 2.4 billion to 3.6 billion and the number of funds increased from 11 to 16. The Fund's private equity portfolio is nevertheless concentrated, as nearly two thirds of total commitments were allocated to funds within EQT and Goldman Sachs.

The new commitments in 2006 were: Priveq Investment Fund III, Health Cap V, Goldman Sachs Distressed III, Goldman Vintage IV and EQT V. The total investment commitment in private equity assets increased to around 2.0% of Fund capital at year-end, meaning that an interim target in the build-up phase of this portfolio is nearing its conclusion. The Fund's private equity assets, which have thus far been reported internally as sub-portfolios of the Swedish and global equity portfolios, were categorised as a separate asset class as of 2007. It should however be noted that invested capital at market value accounted for no more than SEK 1.3 billion or 0.6% of Fund capital at 31 December 2006.

The Fund's private equity portfolio is still young and income is consequently modest. Favourable exits in Accent Equity and EQT III provided a net contribution of SEK 55 million for 2006.

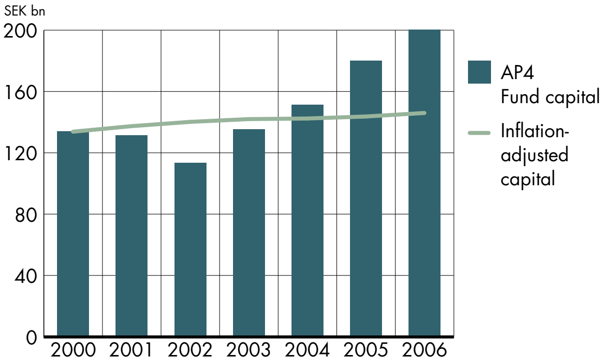
The AP4 Special Asset Management Fund has been managing a private equity portfolio on behalf of all Swedish buffer funds since 2001. The objective is to systematically and cost-effectively liquidate the commitments the buffer funds had when the pension system was restructured.

The favourable market conditions for private equity in recent years have resulted in excellent performance and significant distributions to the AP funds, including an additional SEK 180 million in 2006. That brings total distributions from Special asset management to SEK 1,933 million since inception, which is marginally higher than the portfolio's original estimated market value. The market value of the remaining portfolio at year-end 2006 was SEK 489 million, including a minor net cash surplus.

Net contribution from external management, private equity assets (excluding real estate), 2006

SEK million	Private equity assets
Gross income	54
Management fees refunded at profitable exit	8
Management fees reported as commission expense	–7
Net contribution	**55**
Receivables management fees private equity assets	52
Assets under management, 31 December 2006	1,262
Invested capital, 31 December 2006	1,331
Commitments, 31 December 2006	2,140

Fund capital and inflation



AP4 has attained the objective of generating strong absolute returns by a comfortable margin since the pension system was reorganised in 2000/2001.

RISK MANAGEMENT

The board sets an annual risk management plan that details the main operational risks and how these risks should be managed. The principal risks are of a financial and operational nature. Financial risks consist of market risks, credit and counterparty risks and liquidity risks. Operational risks are defined as administrative risks, IT risks, other technical risks, legal risks and ethical risks.

Performance and Risk Control is an autonomous department that reports directly to the President and the Board of Directors. Its task is to ensure compliance with legal investment rules and the risk management plan throughout the Fund. This is accomplished mainly through careful evaluation and analysis and daily reporting of absolute return and risk and in relation to relevant indices.

In the current organisation, the President of the Fund has operational charge of investment operations. Rules under this organisation aimed at securing the principle of duality include that the President may not independently carry out transactions and all limit adjustments must be reviewed in advance and approved by Performance and Risk Control. Moreover, the head of Performance and Risk Control has the unrestricted right to submit any questions that arise within the department's remit directly to the board.

Financial risks

The core aim of AP4's investment operations is to generate an active return in relation to the benchmark and reference indices. Accordingly, risk is primarily determined in relation to the index (active risk). Currency, fixed income and equity risks in active management are managed by means including limitation of active risk, duration and permissible deviations from index weights.

The use of derivatives is limited with respect to both nominal underlying value and market risk. All derivative positions and associated risks are subject to daily position and risk monitoring.

Credit and counterparty risks consist of the risk that individual counterparties will be unable to discharge their undertakings to the Fund. AP4 has established individual, continuously monitored counterparty limits in order to manage credit risks. Credit risks are limited by a rule that permits investments only in securities rated BBB or higher.

Liquidity risks are limited by special rules for investments in fixed income assets and close monitoring of cash balances.

Operational risks

AP4 managers are responsible for taking requisite steps to identify, limit and control their departments' operational risks in accordance with the risk management plan.

ADMINISTRATION REPORT

The board of directors has provided a separate Administration Report in this annual report (page 44), which gives a more detailed account of the board's activities.

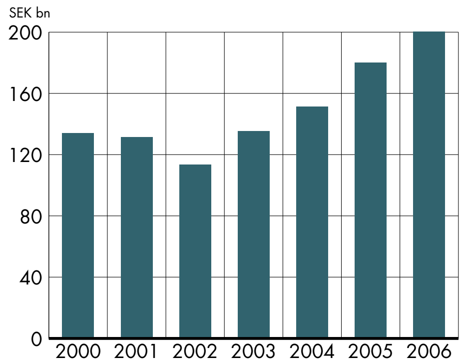
SIX-YEAR SUMMARY

	2006	2005	2004	2003	2002	2001
Fund capital, inflows and net profit, SEK bn						
Fund capital at 31 Dec	200.5	180.1	151.4	135.5	113.6	131.6
Net inflows from the pension system and special asset management funds	1.7	2.9	1.7	2.6	5.0	4.5
Net profit for the year	18.8	25.8	14.3	19.3	–23.0	–6.9
Return, %						
Return on total portfolio excl. expenses	10.5	16.9	10.6	17.0	–16.8	–5.0
Return on total portfolio incl. expenses	10.4	16.8	10.5	16.8	–16.9	–5.1
Return on total portfolio versus index excl. expenses	–0.6	–0.1	–0.3	–1.0	–0.5	–0.5
Return on listed assets versus index excl. expenses	–0.5	–0.1	–0.3	–0.4	–0.9	0.1
Inflation	1.6	0.9	0.3	1.3	2.1	2.7
Real return after expenses	8.8	15.9	10.2	15.5	–19.0	–7.8
Asset management cost quotient as % of assets under management						
Operating expenses	0.07	0.08	0.09	0.10	0.10	0.10
Operating and commission expenses	0.11	0.13	0.15	0.16	0.13	0.13
Risk in total portfolio, %						
Portfolio ex-post	7.1	4.7	6.0	9.0	14.0	10.8
Active risk, ex-post	0.8	0.8	1.0	0.9	1.4	3.5
Sharpe ratio	1.0	3.1	1.4	1.6	neg	neg
Currency exposure at 31 Dec, %	15.1	10.1	20.4	18.5	16.8	13.5
Share of active management incl. enhanced at 31 Dec, %	100	100	100	100	90.9	87.0
Share of external management including investments in venture capital firms at 31 Dec, %	17.3	18.8	20.6	13.2	13.5	13.1
Allocation of investment assets, %*						
Global equity portfolio	42.2	42.2	42.8	42.5	41.2	39
Internally managed	25.1	23.6	22.4	29.5	27.8	26.0
Externally managed	17.1	18.6	20.4	13.0	13.3	13.0
Swedish equity portfolio	19.9	20	19.3	20.1	19.3	24.2
Fixed income portfolio	36.3	36.4	35.8	35	36.4	33.9
Real estate	2.3	2.1	2.1	2.4	3.1	2.9
Currency/Tactical asset allocation/Cash **	–0.7	–0.7	0	–	–	–
Total investment assets	100	100	100	100	100	100
Average number of employees	44	46	48	49	46	39

* *Exposure per asset class; underlying values for derivatives have been distributed per asset class.*

** These items were included in the equity and fixed income portfolios in 2001–2003.

Market value of AP4's fund capital at 31 December 2000–2006



INCOME STATEMENT

SEK million	Note	2006	2005
OPERATING INCOME			
Net interest income	1	555	1,263
Dividends received		2,436	2,131
Net income, listed shares and investments	2,4	19,031	17,592
Net income, private equity	3	839	741
Net income, fixed income assets		–1,303	180
Net income, derivatives		99	351
Net income, foreign exchange		–2,686	3,721
Net commission expense	4	–75	–87
Total operating income		**18,896**	**25,892**
OPERATING EXPENSES			
Personnel costs	5	–86	–91
Other administrative expenses	6	–47	–42
Total operating expenses		**–133**	**–133**
Net profit for the year		**18,763**	**25,759**

BALANCE SHEET

SEK million	Note	31 Dec 2006	31 Dec 2005
ASSETS			
Shares and investments, listed	7	120,823	112,091
Shares and investments, unlisted	8	3,708	2,445
Bonds and other fixed income assets	9	70,389	64,611
Derivatives	10	4,757	1,404
Cash and bank balances		1,428	942
Other assets	11	63	74
Prepaid expenses and accrued income	12	2,148	2,166
Total assets		**203,316**	**183,733**
LIABILITIES AND FUND CAPITAL			
Liabilities			
Derivatives	10	1,247	2,322
Other liabilities	13	425	162
Deferred income and accrued expenses	14	1,107	1,151
Total liabilities		**2,779**	**3,635**
Fund capital	15		
Fund capital at start of year		180,098	151,434
Net payments to the national pension system		1,568	2,312
Transfers from liquidation fund and special asset management fund		108	593
Net profit for the year		18,763	25,759
Total fund capital		**200,537**	**180,098**
Total liabilities and fund capital		**203,316**	**183,733**
MEMORANDUM ITEMS			
Assets pledged and equivalent collateral	16	19,470	4,354
Undertakings	17	2,140	1,640

ACCOUNTING AND VALUATION PRINCIPLES

In compliance with the Swedish National Pension Funds Act, the annual accounts have been prepared according to generally accepted accounting principles. The buffer funds have developed and put into practice a set of common accounting and valuation principles that accord with existing regulations for comparable financial institutions.

Transaction day accounting
Purchases and sales on the money, bond, equity and foreign exchange markets are reported in the balance sheet on the transaction date; that is, at the point when material rights, and therefore risks, are transferred between the parties. Receivables and liabilities that fall between transaction and settlement date are reported under other assets and other liabilities respectively. Net accounting is applied when permitted.

Foreign currency
Foreign currency-denominated assets and liabilities are stated at year-end exchange rates. Changes in the values of foreign-currency-denominated assets are divided between those attributable to the change in the value of the asset or liability in local currency and those stemming from fluctuations in exchange rates. Realised and unrealised changes in value arising from exchange rate fluctuations are reported in the income statement under "Net income, foreign exchange".

Shares and investments
Shares and investments are valued at fair value. Shares listed on an authorised stock exchange are valued primarily at the closing rate in local currency on the last trading day of the year or secondarily at the latest buying rate. Private equity holdings are valued in accordance with EVCA principles or equivalent standards. Fair value should primarily be calculated on the basis of transactions with third parties, though other valuation methods may be used.

Bonds and other fixed income assets
Bonds and other fixed income assets are valued at fair value. The market value of fixed income securities is determined primarily by the closing price on the last trading day or secondarily by the buying rate on the day preceding the last trading day.

Net income is the difference between average accrued acquisition value and sales or fair value. Accrued acquisition value is the discounted present value of future payments where the discount rate corresponds to the effective interest rate at time of purchase. Acquired premiums and discounts are accrued until the coupon rate changes or the instrument matures. Changes in accrued acquisition values are reported as interest income.

Buybacks
In a true buyback (repurchase), the asset remains on the balance sheet and cash received is reported as a liability. The divested security is reported under pledged assets on the balance sheet. The cash value difference between spot and forward legs accrues during the maturity period and is reported as interest.

Derivatives
Derivatives are valued at fair value based on year-end market rates. Derivative positions with a positive fair value at year-end are reported as assets, while positions with a negative fair value are reported as liabilities. The difference between forward and spot rates is accrued evenly over the term of the forward contract and reported as interest.

Securities loans
Lent securities are still reported in the balance sheet in a memorandum item as pledged assets. Received and accrued premiums are reported as interest income.

Items reported directly against fund capital
Transfers to and from the national pension system, along with transfers from the liquidation and special asset management funds owned jointly by the four buffer funds, are reported directly against fund capital.

Performance-based fees to external managers
Performance-based fees, which are paid only if the manager produces returns above the agreed level, are reported in the income statement under net income per asset category.

Commission expenses
Commission expenses are reported in the income statement as a deduction from operating income. They consist of direct transaction costs, custody account expenses and fixed fees paid to external managers. Fees for external management of private equity assets, for which repayment is permitted prior to distribution of profit and where repayment is assessed as likely, are reported in the balance sheet as a receivable under Other assets.

Operating expenses
All management expenses except brokers' commissions, fees to external managers and custody account expenses are reported as operating expenses.

Investments in property, plant and equipment and software, whether developed in-house or purchased, are customarily expensed as they are incurred.

AP4 is VAT-exempt since it is not classed as conducting business activities. Consequently, the Fund is not entitled to reimbursement of input VAT. VAT that has been paid or reserved for payment is reported under the relevant expense item.

Income taxes
AP4 is exempt from income tax on investments in Sweden. The tax liability on investments outside Sweden varies from country to country.

NOTES TO THE INCOME STATEMENT AND BALANCE SHEET

(SEK million, unless otherwise stated)

NOTE 1 Net interest income

	2006	2005
Interest income		
Bonds and other fixed income assets	2,523	2,358
Derivatives	4,097	2,089
Other interest income	173	12
Total interest income	**6,793**	**4,459**
Interest expenses		
Derivatives	–6,230	–3,196
Other interest expenses	–8	0
Total interest expenses	**–6,238**	**–3,196**
Net interest income	**555**	**1,263**

NOTE 2 Net income, listed shares and investments

	2006	2005
Net income, listed shares and investments	19,179	17,687
Less brokers' commissions	–129	–79
Less performance-based fees to external asset managers	–19	–16
Net income from listed shares and investments	**19,031**	**17,592**

NOTE 3 Net income, unlisted shares and investments

	2006	2005
Capital gain	76	13
Unrealised changes in value	763	728
Net income from unlisted shares and investments	**839**	**741**

NOTE 4 Net commission expenses

	2006	2005
External management fees (listed assets)	60	67
External management fees (unlisted assets)	7	8
Other commission expense, incl. custody account fees	8	12
Net commission expenses	**75**	**87**

Performance-based fees to external managers during the year totalled SEK 19 million (16) and are reported under net income for each asset class. External management fees for unlisted assets are reported under commission expenses to the extent agreements do not permit repayment prior to distribution of profits in connection with future profitable exits. Management fees totalling SEK 44 million (32) were paid during the year in respect of unlisted assets, including SEK 28 million (24) which has been assessed as likely for repayment in connection with future profitable exits and reported in the balance sheet under "Other assets." SEK 8 million (0) was repaid to the Fund during the year in conjunction with profitable exits.

NOTE 5 Personnel

NUMBER OF EMPLOYEES	2006 Total	2006 Female	2005 Total	2005 Female
Average number of employees	44	14	46	17
Number of employees at 31 December	46	18	50	22
Number of executive management committee members at 31 December	6	1	6	1

PERSONNEL COSTS, SEK '000	2006	2005
Salaries and remuneration		
Chairman of the board*	150	100
Other directors**	475	425
President	1,794	1,731
Other executive management committee members***	8,986	10,919
Other employees****	32,299	36,799
Total salaries and remuneration	**43,704**	**49,974**
** Thereof additional remuneration for committee service*	*50*	*0*
*** Thereof additional remuneration for committee service*	*50*	*0*
**** Thereof employment termination costs for other executive management committee members*	*0*	*3,189*
***** Thereof employment termination costs for other employees*	*0*	*1,011*
Incentive-based pay		
President	0	0
Other executive management committee members	487	345
Other employees	1,657	817
Total incentive-based pay	**2,144**	**1,162**
Pension costs		
President	2,091	1,781
Other executive management committee members*	2,868	2,529
Other employees**	10,860	12,484
Total pension costs	**15,819**	**16,794**
** Thereof employment termination costs for other executive management committee members*	*0*	*124*
*** Thereof employment termination costs for other employees*	*2,560*	*3,803*

Social security costs

Chairman of the board	48	33
Other directors	151	135
President*	3,714	645
Other executive management committee members** ***	4,283	4,133
Other employees****	13,373	15,019
Total social security costs	**21,569**	**19,965**
* *Thereof costs for payroll tax not previously recognised as an expense on pension provisions for the President*	*2,628*	*0*
** *Thereof costs for payroll tax not previously recognised as an expense on pension allocations for the deputy managing director*	*529*	*0*
*** *Thereof employment termination costs for other executive management committee members*	*0*	*1,065*
**** *Thereof employment termination costs for other employees*	*621*	*1,251*
Other personnel costs	**3,424**	**2,820**
Total personnel costs	**86,660**	**90,715**
Thereof costs of employment termination	3,181	10,443

Costs of employment termination

The costs total SEK 3,181,000 and relate to costs for early retirement pensions. All employment termination costs were recognised as an expense in the 2006 accounts but will be disbursed in 2007.

Salaries and remuneration

The government sets remuneration for the Board of Directors. The Board of Directors determines the employment conditions of the President and Deputy Managing Director based on the recommendations of the Chairman and Deputy Chairman. Remuneration to the President and Deputy Managing Director is limited to base salary. Remuneration to other members of the executive management committee is made up of base salary plus incentive-based pay, where applicable. The principal terms and conditions of employment for the new President are outlined in the Administration Report on page 45.

Incentive-based pay

The incentive scheme has been adopted by the Board and covers all employees who have been with the Fund for more than six months except the President and Deputy Managing Director. The basic principle is that employees earn incentive-based pay if the Fund outperforms the benchmark and reference indices. The maximum incentive-based entitlement for a full-year employee is two months' salary. The item includes provisions for incentive-based pay awarded in 2006 that will be paid in 2007 after the annual report has been adopted by the Board and estimated returns on investments have been examined by the Fund's auditors. In addition, particularly deserving efforts may be rewarded with performance bonuses, which are set by the President.

Pensions and similar benefits

The President's pension benefits and severance package are specified in his employment contract. The main provisions of the agreement are pension entitlement from the age of 58 at 75% of full salary as of the date of retirement until the age of 65. The President is also entitled to a severance package equal to two years' salary.

Other executive management committee members have individual employment contracts. The Deputy Managing Director is entitled to retire at age 63 at a pension equal to 75% of salary as of the date of retirement date until the age of 65.

The Fund's pension commitments in respect of the individual agreements for the President and Deputy Managing Director amount to SEK 15,345,000.

The President and Deputy Managing Director have agreed with AP4 to reduce their previously stipulated retirement age by two years in return for abstaining from commensurate salary increases.

Sickness absence

Sickness absence in 2006 amounted to 1.4% (2.7) of normal working hours. The figures were 2.5% (5.2) for female staff and 0.6% (0.9) for male staff and 0.4% (1.2) of absences lasted 60 days or longer. The sickness absence rate was 0.0% (0.0) for employees aged 29 or younger, 1.3% (3.0) for employees aged 30-49 and 1.5% (1.5) for employees over 50.

NOTE 6 Other administrative expenses

	2006	2005
Costs of premises	8	9
Information and IT expenses	24	18
Services purchased	8	8
Other administrative expenses	7	7
Total other administrative expenses	**47**	**42**
Purchased services include fees to accounting firms as follows:		
Audit services, Öhrlings PwC	0.8	0.8
Audit services, KPMG	0.3	0.3
Other services, KPMG	0.0	0.2
Total fees to accounting firms	**1.1**	**1.3**

NOTE 7 Listed shares and investments

	31 Dec 2006		31 Dec 2005	
	Fair value	Acquisition value	Fair value	Acquisition value
Listed Swedish equities (internally managed)	44,550	32,761	38,230	28,878
Listed foreign equities (internally managed)	43,033	39,909	40,883	36,042
Listed foreign equities (active external asset management)	12,549	10,666	13,228	8,960
Investments in foreign mutual funds	20,691	16,421	19,750	16,473
Total listed shares and investments	**120,823**	**99,757**	**112,091**	**90,353**

A detailed list of holdings is published on the AP4 website and printed copies may be ordered from the Fund.

NOTE 8 Unlisted shares and investments

Holding at 31 Dec 2006	Corp. ID no.	Number	Equity capital, %	Voting capital, %	Acquisition value
Swedish shares and investments:					
AP Fastigheter Holding AB	556650-4196	1,000,000	25	25	721
Innoventus AB	556602-2728	2,334	17	17	1
Innoventus Project AB	556616-8356	31,032	9	9	13
Accent Equity 2003 KB	969694-7739		19*		51
BrainHeart Capital KB	969674-4102		21*		196
HealthCap III Sidefund KB	969699-4830		20		42
HealthCap Annex Fund I-II KB	969690-2049		20		49
HealthCap IV KB	969683-6650		41*		34
Innoventus Life Science I KB	969677-8530		16		17
Northern Europe Private Equity KB (EQT III)	969670-3405		10*		50
Priveq Investment Fund III KB	969704-1524		19*		25
Total Swedish shares and investments					**1,199**
Foreign investments:					
EQT IV LP			4*		557
EQT V LP			2*		26
EQT Opportunity LP			12*		11
European Strategic Partners II			4		117
Goldman Sachs Multi Strategy Fund			**		136
HelathCap V LP			13		6
Total foreign investments					**853**
Total acquisition cost, unlisted shares and investments					**2,052**
Total fair value, Swedish shares and investments					2,865
Total fair value, foreign investments					843
Total fair value, unlisted shares and investments ***					**3,708**

* AP4's share of the total commitment is 6% in Accent, 19% in BrainHeart, 2% in HealthCap IV, 1% in EQT III, 12% in Priveq Investment Fund III, 3% in EQT IV, 1% in EQT V and 7% in EQT Opportunity.

** AP4's share of the underlying funds is 1% and 4% respectively.

*** The fair value of the holding has been reduced by SEK 52 million in balanced asset management fees, which are reported in the balance sheet item "Other assets."

NOTE 9 Bonds and other fixed income assets

	31 Dec 2006		31 Dec 2005	
	Fair value	Accrued acquisition value	Fair value	Accrued acquisition value
Issuer category				
Kingdom of Sweden	14,539	14,745	10,062	10,018
Swedish housing institutions	14,306	14,541	16,531	16,637
Other Swedish financial services companies	1,426	1,443	940	942
Swedish non-financial companies	2,080	2,078	2,079	2,080
Foreign governments	16,923	18,077	17,366	16,428
Other foreign issuers	21,115	22,674	17,633	17,115
Total fixed income assets	**70,389**	**73,558**	**64,611**	**63,220**

	31 Dec 2006		31 Dec 2005	
	Fair value	Accrued acquisition value	Fair value	Accrued acquisition value
Instrument type				
Bonds	68,259	71,425	61,681	60,294
Promissory note loans	2,000	2,000	2,000	2,000
Subordinated debentures	130	133	221	217
Overnight loans	0	0	709	709
Total fixed income assets	**70,389**	**73,558**	**64,611**	**63,220**

NOTE 10 Derivatives

	31 Dec 2006		
	Nominal value	Fair value Positive	Fair value Negative
Share futures	*3,954*	*72*	*0*
thereof cleared	3,954	72	0
Interest-related instruments:			
Swaps	77,520	79	796
FRA / Futures	113,044	388	151
Total interest-related instruments	*190,564*	*467*	*947*
thereof cleared	113,044	388	151
Currency forward contracts	*129,013*	*4,218*	*300*
Total derivatives	**323,531**	**4,757**	**1,247**
thereof cleared	116,998	460	151

NOTE 11 Other assets

	31 Dec 2006	31 Dec 2005
Receivables on unsettled transactions	6	46
Management fees receivable for unlisted assets	52	24
Other assets	5	4
Total other assets	**63**	**74**

NOTE 12 Prepaid expenses and accrued income

	31 Dec 2006	31 Dec 2005
Accrued interest income	2,075	2,111
Accrued dividends and repayments	67	50
Other	6	5
Total	**2,148**	**2,166**

NOTE 13 Other liabilities

	31 Dec 2006	31 Dec 2005
Trade payables	4	4
Pension provisions	15	13
Payables for unsettled transactions	401	141
Other liabilities	5	4
Total other liabilities	**425**	**162**

NOTE 14 Deferred income and accrued expenses

	31 Dec 2006	31 Dec 2005
Accrued interest expenses	1,028	1,077
Accrued personnel costs	14	12
Accrued external management expenses	58	60
Other accrued expenses	7	2
Total	**1,107**	**1,151**

NOTE 15 Fund capital

	31 Dec 2006	31 Dec 2005
Fund capital at 1 Jan	**180,098**	**151,434**
Net payments to the national pension system		
Paid-in pension contributions	45,906	44,883
Disbursed pension payments	–44,033	–42,268
Transfer of pension rights to the EU	–6	–14
Settlement of pension rights for prior years	0	5
Administration fee paid to the Swedish Social Insurance Agency	–299	–294
Total net payments to the national pension system	**1,568**	**2,312**
Transfer from AP1 liquidation fund	63	363
Transfer from AP4 special asset management fund	45	230
Total transfers	**108**	**593**
Net profit for the year	**18,763**	**25,759**
Fund capital at 31 Dec.	**200,537**	**180,098**
Capital under management AP1 liquidation fund*	3,643	3,688
Capital under management AP4 special asset management fund*	489	472

* *Annual reports may be ordered from AP1 and AP4.*

NOTE 16 Pledged assets and equivalent collateral

	31 Dec 2006	31 Dec 2005
Bonds pledged as collateral for futures	1,112	1,199
Bonds pledged as collateral for buybacks	0	3,155
Lent securities*	18,358	0
Total bonds pledged as collateral	**19,470**	**4,354**

* Collateral received for lent securities 19,044 (0).

NOTE 17 Undertakings

	31 Dec 2006	31 Dec 2005
Capital investments not yet drawn down.	2,140	1,640

NOTE 18 Related enterprises

AP4 rents its office premises from AP Fastigheter at market rates.

Stockholm, 15 February 2007

Birgit Friggebo
CHAIRMAN

Karl-Olof Hammarkvist
DEPUTY CHAIRMAN

Göran Johnsson

Kajsa Lindståhl

Marianne Nivert

Sture Nordh

Inga Persson

Ilmar Reepalu

Ulrik Wehtje

Mats Andersson
PRESIDENT

We expanded our audit remit to include examination of the administration report for the Fourth Swedish National Pension Fund in 2006. We found no cause for qualification in respect of our audit. Our auditors' report was submitted on

Stockholm, 15 February 2007

Anna Hesselman
AUTHORISED PUBLIC ACCOUNTANT
Appointed by the government

Anders Bäckström
AUTHORISED PUBLIC ACCOUNTANT
Appointed by the government

AUDITORS' REPORT

for the Fourth Swedish National Pension Fund
(corporate identity number 802005-1952)

We have examined the annual accounts, the accounting records and the administration of the Fourth Swedish National Pension Fund by the Board of Directors for the financial year 2006. The Fund's annual accounts are included in the printed version of this document on pages 24–42. These accounts and the administration, and the application of the Swedish National Pension Funds Act in conjunction with the annual accounts, are the responsibility of the Board of Directors. Our responsibility is to express our opinion on the annual accounts and the administration based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Sweden. These standards require that we plan and perform the audit to obtain high but not absolute assurance that the annual accounts are free from material misstatement. An audit involves examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and their application by the Board of Directors, the significant estimates made by the Board when compiling the annual accounts and evaluating the overall presentation of information in the annual accounts. We believe that our audit provides a reasonable basis for our opinion set out below.

The annual accounts have been prepared in accordance with the Swedish National Pension Funds Act and give a true and fair view of the company's financial position and results of operations in accordance with generally accepted accounting standards in Sweden. The administration report is compatible with the other sections of the annual accounts.

The audit has given us no reason for qualification with regard to the annual accounts, the income statement and balance sheets, the accounting records, the inventory of assets or the administration of the company in general.

We recommend that the income statement and balance sheet be adopted.

Stockholm, 15 February 2007

Anna Hesselman
AUTHORISED PUBLIC ACCOUNTANT
Appointed by the Government

Anders Bäckström
AUTHORISED PUBLIC ACCOUNTANT
Appointed by the Government

ADMINISTRATION REPORT

The assets of AP1, AP2, AP3, AP4 and AP6 are state-owned and reserved by law for specific asset management purposes in accordance with chapter 9, section 8 of the Instrument of Government. The organisational structure and activities of the AP funds are regulated by the Swedish National Pension Funds Act. The law provides that the Government may not use fund assets for purposes other than those specified in the act, unless the Riksdag decides otherwise. The AP Funds are state bodies, but there are material differences between the Funds and other government agencies. The funds are more independent than most other agencies and have separate boards of directors and external auditors. The Government adopts the Funds' annual income statements and balance sheets and orders annual evaluations of the Funds' performance. The outcome of the evaluation is reported to the Riksdag in a written communication.

As a state body, AP4 is not directly covered by many of the provisions of the Swedish Code of Corporate Governance. In any case, there are substantial differences between public law and commercial law. This administration report is therefore limited to relevant areas. The report has been examined by AP4's auditors.

BOARD OF DIRECTORS

The AP4 Board of Directors is made up of nine directors with no alternate directors, all appointed by the Government. Two directors are appointed on the basis of nominations from employer organisations and a further two on the basis of nominations from employee organisations. The government appoints the chairman and deputy chairman from among its own nominees.

All directors were re-elected in May and their mandate runs until the Fund's income statement and balance sheet for 2006 have been adopted. Board remuneration is set by the Government. The annual fees are SEK 100,000 for the chairman, SEK 75,000 for the deputy chairman and SEK 50,000 for other directors. During the year, the Board also formed a recruiting committee, whose members were paid remuneration of SEK 100,000 in addition to customary board fees. More information is provided about the directors on page 42.

RULES OF PROCEDURE

The board is responsible for the Fund's organisation and management of its assets. The Board has adopted a charter for its work and a charter for the President. These documents are revised annually, as are the ethical guidelines for employees and rules for reporting holdings of financial instruments.

BOARD ADMINISTRATION IN 2006

The Board held seven minuted meetings in 2006, the same number as in 2005. An eighth meeting was held to evaluate board activities. The President and other AP4 staff also attend board meetings in the role of reporter and secretary. An average of eight members attended board meetings in 2006. The Board has not yet found it necessary to appoint standing sub-committees to handle specific tasks, but a temporary recruiting committee was appointed after the resolution in 2006 to appoint a new President.

The Board, and especially the recruiting committee, devoted particular attention to recruiting a new President to succeed Thomas Halvorsen, who will be retiring as contractually agreed at the beginning of 2007 after 14 years as President of the Fund. At an extraordinary board meeting on 6 July, the Board resolved to appoint Mats Andersson, MBA and then Chief Investment Officer at Skandia Liv, as the new President. Mr Andersson worked in parallel with Mr Halvorsen throughout December and formally took up his position on 1 January.

The Board of Directors discussed in depth the new major ALM analysis performed by the Fund during the year. As in previous years, the Fund's positions on various matters of corporate governance were discussed on several occasions.

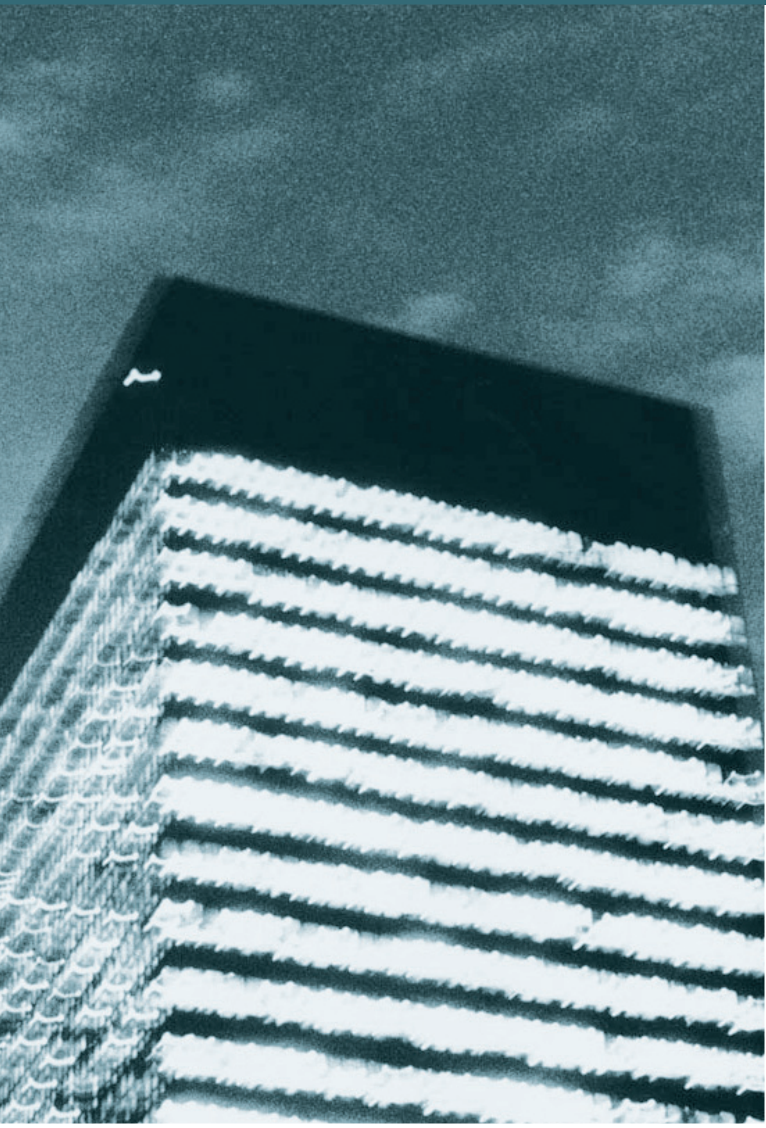
In accordance with its charter, the Board customarily adopts an operations plan for the following year during the latter half of the financial year. The operations plan for 2007 includes an investment policy and risk management plan, as well as an annual plan and operating cost budget. The document was reported at the board meeting in December, but will not be adopted this time until the new financial year, due to the change of President.

EXECUTIVE MANAGEMENT

The Board delegates responsibility for day-to-day management of AP4 to the President. The President has an executive management committee of five other employees to support him in the decision process. The executive management committee is presented on page 43.

SALARIES AND REMUNERATION

The Board approves the employment terms and conditions for the President and Deputy Managing Director based on the



recommendations of the Chairman and Deputy Chairman of the Board. All employees have individual employment contracts. The Board has also adopted an incentive scheme for all employees who have been with the Fund for more than six months (apart from the President and Deputy Managing Director). Bonuses under the scheme are limited to an amount equal to two months' salary.

Detailed information about salary and remuneration paid to the President, members of the executive management committee and other employees and the outcome of the incentive scheme is provided in Note 5 on page 38.

The principal terms of employment for the new President of the Fund are fixed salary (SEK 2,800,000 per annum) and pension benefits equal to 20% of fixed salary. The President is also entitled to a severance package equal to 18 months' salary, from which income from other employment is fully deductible.

As of the end of the 2007 financial year, employment conditions at the Fund will be fully harmonised with the 2003 guidelines for employment conditions for executive employees of state-owned companies.

AUDIT

AP4's auditors are appointed by the Government. The current audit mandate came into effect in 2005 and is shared between Anna Hesselman of Öhrlings PricewaterhouseCoopers and Anders Bäckström of KPMG. The mandate runs until the Fund's income statement and balance sheet are adopted in 2008. Anders Bäckström is also responsible for coordinating the audit process across all AP funds.

The auditors submit a report based on their audit. They report directly to the Board by way of the written report and an oral presentation. The auditors attend at least one board meeting per year. An additional minimum of two meetings are held each year between the auditors and the chairman and deputy chairman. The auditors also provide report annually to the Swedish Financial Supervisory Authority. The practical examination of the accounts and procedures is performed by a team of auditors from Öhrlings PricewaterhouseCoopers.

INTERNAL CONTROL

The Board of Directors produces an annual Risk Management Plan in accordance with generally accepted financial market standards and the Swedish National Pension Funds Act. The plan is meant to ensure effective internal risk control and that the duties of the Performance and Risk Control Department are clearly stipulated and attached to the appropriate powers.

Performance and Risk Control is independent of the Fund's other operations and reports directly to the President and, if so required, directly to the Board. The plan states that the executive management committee must be aware of risks arising within the Fund's operations and how the risks are managed. The committee must also ensure that procedures are in place to make certain that AP4 complies with relevant legislation and decisions taken by the Board and President.

The Head of Performance and Risk Control submits written and oral reports to the Board at every board meeting. The Board believes the structure outlined above is adequate to ensure the Fund meets its obligations.

OTHER DISCLOSURES

Various aspects of the Board's work in 2006 are described in fuller detail in the Report of the Directors. In particular, the sections entitled "Significant events" and "Risk management" provide a more detailed picture of financial and operational risks. The main Board documents referred to in this Administration Report are publicly available and may be accessed from the AP4 website at www.ap4.se.

BOARD OF DIRECTORS AND AUDITORS

BIRGIT FRIGGEBO

Year of birth1941. Chairman since 2000.

Other assignments:

Chairman of the University College of Opera and the Swedish Educational Broadcasting Company.

Preses: Smålands Akademi.

KARL-OLOF HAMMARKVIST

Professor. Pro-Vice-Chancellor of the Stockholm School of Economics. Year of birth 1945. Deputy Chairman since 2000.

Other assignments:

Member of the Board of the Stockholm Institute for Financial Research, Länsförsäkringar Liv AB, Kungliga Dramatiska Teatern.

INGA PERSSON

Professor. Year of birth1945. Member of the Board since 2000

Other assignments:

Member of the Board of the Sida/SAREC Research Board

KAJSA LINDSTÅHL

Director. Year of birth1943. Member of the Board since 2004

Other assignments:

Chairman of the Board of Stiftelsen Tumba Bruk and Aktiefrämjandet

Member of the Board of Länsförsäkringar AB, NGM Holding AB, SWEROAD (Swedish National Road Consulting AB), Riksbankens Jubileumsfond and SIFR (Swedish Institute for Financial Research).

ILMAR REEPALU

Chairman of Malmö City Executive Board. Year of birth 1943. Member of the Board since 2000

Other assignments:

Chairman: Svenska Kommunförbundet and Förenade kommunföretag AB

Deputy Chairman of KPA AB

Member of the Board of E.ON Sverige AB

MARIANNE NIVERT

Director. Year of birth 1940. Member of the Board since 2000

Other assignments:

Chairman of Posten AB and Rädda Barnen

Member of the Board of SSAB, Beijer Alma AB, Karolinska Universitetssjukhus, Lennart Wallenstam Byggnads AB and Systembolaget

GÖRAN JOHNSSON

Former Head of the Swedish Metalworkers' Union. Year of birth 1945. Member of the Board since 1997 and Deputy Member of the Board 1993–1996

Other assignments:

Deputy Chairman of the Swedish Export Credits Guarantee Board

Member of Swedbank, Swedish Foundation for Strategic Research, Elanders AB and Sveriges Television (SVT – public service TV)

Ambassador of Blekinge Institute of Technology

ULRIK WEHTJE

CEO Rydsgårds Gods AB, Master of Engineering. Year of birth 1956. Member of the Board since 2004

Other assignments:

Deputy Chairman of the Swedish Bookbinders' Union, the Swedish Graphic Companies' Federation and the Confederation of Swedish Enterprise's SME Committee

Member of the Board of the Confederation of Swedish Enterprise and AFA Trygghetsförsäkring

STURE NORDH

Chairman of the Swedish Confederation of Professional Employees. Year of birth 1952. Member of the Board since 1999

Other assignments:

Chairman of the Board of Karlstad University

Deputy Chairman of Folksam Liv

Member of the Board of the Swedish National Labour Market Administration, Riva del Sole Spa and the European Trade Union Confederation

ANNA HESSELMAN

Authorised Public Accountant: Öhrlings PricewaterhouseCoopers

ANDERS BÄCKSTRÖM

Authorised Public Accountant: KPMG

EXECUTIVE MANAGEMENT COMMITTEE

From left:
Göran Schubert, Leif Hässel, Agneta Wilhelmson Kåremar, Björn Franzon, Mats Andersson and Anders Årjes.

MATS ANDERSSON

Year of birth 1954

President. Employed at AP4 since 2006

Bachelor of Science

Previous employment: Deutsche Bank, AP3 and Skandia Liv

Directorships: KMT AB

BJÖRN FRANZON

Year of birth 1944

Deputy Managing Director. Employed at AP4 since 1993

Bachelor of Science

Previous employment: Affärsvärlden and Alfred Berg Fondkommission

Directorships: AP-fastigheter (Deputy Member of the Board) and others

LEIF HÄSSEL

Year of birth 1960

Head of Fixed Income & Currencies. Employed at AP4 since 2000

Bachelor of Science

Previous employment: The Riksbank, Alfred Bergs Transferator and TryggHansa/SEB

Directorships: AP-fastigheter (ord.)

GÖRAN SCHUBERT

Year of birth 1953

Head of Performance and Risk Control. Employed at AP4 since 2004

Bachelor of Science

Previous employment: Nordea and Alecta

AGNETA WILHELMSON KÅREMAR

Year of birth 1952

Director of Administration. Employed at AP4 since 2001

Bachelor of Laws and DIHM Diploma in Business Finance

Previous employment: Handelsbanken, Swedbank Markets and Nordnet

ANDERS ÅRJES

Year of birth 1971

Head of Global Equities. Employed at AP4 since 1998

Bachelor of Science

Previous employment: MoDo and Myrberg Fondkommission

GLOSSARY

Active management
Asset management via a portfolio composed differently from the index in an effort to secure a higher return.

Active position
Difference between a portfolio and its reference or benchmark index, e.g. in terms of weighting in individual equities (in active stock selection), sectoral weighting (in active sectoral allocation) or duration (in active duration management).

Active return
Difference between the return on a portfolio compared to the return on its benchmark or reference index. Synonymous with relative return. See also Excess return

Active risk
Risk that arises as a result of active management. Is defined as the standard deviation of the difference between fair return and index return (i.e. the standard deviation of the active return) and also known as tracking error.

Active stock selection
The taking of active positions in individual equities, aimed at outperforming the reference index.

Asset liability modelling
Analysis model used for compiling AP4's strategic portfolio. An ALM analysis is premised on the Fund's long-term undertakings, forecast pension contributions and the expected return and risk of different asset categories. The model simulates theoretical portfolios to provide a basis for selecting a strategic portfolio that provides the optimum combination to meet the Fund's pension commitments.

Asset management cost quotient
Operating expenses as a ratio of average fund capital.

Automatic rebalancing
A mechanism that reduces pensions when pension liabilities exceed pension assets (see Balance figure).

Balance ratio
The total assets of the national pension system (excluding premium pensions) divided by pension liabilities. It is an estimate of the pension system's financial balance. If the balance figure falls below 1.0, the automatic rebalancing mechanism is triggered and pension disbursements are reduced.

Benchmark index
Combination of various reference indices. Is a series of index returns against which AP4's total risks and return is compared. Returns mirror those from the strategic portfolio.

Beta value
Denotes the portfolio's propensity to rise or fall when the benchmark or reference index rises or falls. It states the expected percentage change in the value of the portfolio given a change of 1% in the reference or benchmark index.

Buffer fund
The name for the First, Second Third, Fourth and Sixth National Swedish Pension Funds. The funds' purpose is to compensate for temporary deficits in pension contributions in relation to pension disbursements (i.e. periods when disbursements exceed contributions) and also to maintain the value of pension assets in relation to pension liabilities. See Balance ratio.

Contribution value
Estimate of the present value of future forecast pension contributions to the national pension system (excluding the premium reserve pension scheme). Calculated by multiplying a three-year average of contributions by the "turnover period", which measures the average time between acquired pension entitlement and disbursed pension payments.

Corporate governance
The sharing and exercise of rights and responsibilities in relation to the running of a company, notably between management and shareholders.

Country risk
A risk arising from differentials in yield spreads between countries in the context of an international bond portfolio.

Credit risk
Risk that a counterparty wholly or partly cannot fulfil his undertakings due to financial incapacity.

Currency exposure
Denotes the proportion of the portfolio exposed to currencies other than the Swedish krona and for which currency risk has not been neutralised by hedging.

Currency risk
The risk of a change in value of the portfolio as a result of fluctuations in foreign exchange rates.

Derivatives
Collective term for financial instruments whose value is linked to the value of an underlying instrument. Government bond futures are an example of a derivative linked to government bonds as an underlying instrument.

Duration
Approximate measure of interest rate risk. Measures the average outstanding life of all future cash flows (coupon yields and final maturity) for a bond or portfolio of bonds. Is also known as McCauley Duration. See Modified duration.

Enhanced index management
See semi-active management.

Excess return
Arises when a portfolio outperforms its benchmark or reference index. Is the same as active return where the latter exceeds zero.

Fixed income portfolio
Comprised of fixed income assets including interest rate derivatives. The foreign portion of the fixed income portfolio's reference index is hedged in Swedish kronor.

Fundamental analysis
Analysis aimed at predicting a company's future value. Is based primarily on information about companies and their markets, e.g. information about their executive management, strategy, earnings forecasts and financial status and performance.

Global equity portfolio
Consists of equities and equity-related instruments listed on global stock exchanges included in the MSCI World Index. (Note that a share listed on the Swedish stock exchange may be included in both the Swedish and global equity portfolios and such shares are allocated to the intended portfolio at the time of purchase.) The reference index is the MSCI World DNI hedged.

Handelsbanken Markets Bond Index
Svenska Handelsbanken's return index for Swedish fixed income bonds.

Hedging
The removal of currency risk by swapping exposure to foreign currencies for Swedish kronor using currency futures.

Import basket
Basket of currencies weighted in relation to their respective share of Swedish import revenues.

Information ratio
A measure of risk-adjusted return. Measured as a portfolio's active return compared to its active risk.

Interest rate risk
Measurement of the change in value of a fixed income portfolio after a specified change (often 1%) in market interest rates.

Investment assets
Used in the annual report to denote the Fund's total capital under management.
In the balance sheet, however, investment assets are defined in accordance with generally accepted accounting principles. These require that buybacks, liquid assets and derivatives with negative market value are reported under items other than investment assets.

Investment grade
Term to describe borrowers assigned an A-rating (A, AA, AAA or equivalent) or triple-B-rating (BBB or equivalent).

Legal risk
Risk of unforeseen losses arising because of legal errors in agreements and contracts, e.g. that an agreement proves invalid or less advantageous than intended.

Liquidity risk
Risk that a financial instrument cannot be divested within a reasonable period without significantly affecting its pricing.

Market risk
Risk of a change in the value of a financial instrument due to changes in equity prices, exchange rates or interest rates.

Merrill Lynch GBI
The Merrill Lynch Global Bond Index is a return index for government and non-government bonds. It is used as the reference index for the foreign part of the fixed income portfolio.

Modified duration
Measure of interest rate risk. Defined as the percentile change in value of a fixed income security as a result of a 1% parallel shift in the yield curve. Calculated by dividing duration (see definition) by the market interest rate plus 1.

MSCI World DNI
The Morgan Stanley Capital International World Developed Markets Daily Net Index. Is the reference index for AP4's global equity portfolio and charts global market performance, including dividends.

Net contributions
Difference between annual pension contributions to the national pension system and disbursed pension payments.

Non-government bond
Bond carrying a higher credit risk than a government bond, for instance a corporate bond.

Normal portfolio
The asset allocation assessed as most closely corresponding to the Fund's general long-term objective. The composition of the normal portfolio is decided by the Fund's Board of Directors following ALM analysis.
See also Strategic portfolio.

Operational risks
Collective term for risk of losses arising through operational disruptions, e.g. human error, deficient systems or shortcomings in instructions or procedures.

Passive management
Portfolio management where portfolio holdings mirror a chosen index in order to match the index return.

Pension liability
The financial commitment to current pensioners plus total pension entitlements accumulated by those in work.

Reference index
Index series against which a portfolio's return and risk is compared, e.g. the MSCI World DNI or SIX Return Index.

Return
Time-weighted return excluding asset management costs, calculated on a daily basis and assuming that all transactions are carried out at the end of the day. Is used when reporting the financial performance of the portfolio and sub-portfolios.

Risk-adjusted return
The return on a financial instrument or portfolio divided by the level of risk (measured as volatility). If two portfolios offer the same return but differ in volatility, the one with the lower volatility offers the higher risk-adjusted return. This is often measured as an information or Sharpe ratio.

Sectoral allocation
Active overweights or underweights in different equity market sectors relative to the index in order to outperform the index.

Semi-active asset management
Portfolio management with a somewhat higher active risk than passive management, i.e. resembling index management but with a limited active component. Also known as tracking error.

Sharpe ratio
A measure of risk-adjusted return. Calculated as portfolio return minus risk-free interest and divided by portfolio volatility.

SIX Return Index
Reference index for the Fund's Swedish equity portfolio. Charts the market performance of companies listed on the Stockholm Stock Exchange's A and O lists, including dividends.

Strategic portfolio
The distribution of assets deemed to correspond best to AP4's long-term objectives and targets. Its composition is determined by the Fund's Board of Directors following an ALM analysis. The strategic portfolio thus determines the benchmark index against which the Fund's risk and return are compared.

Swedish equity portfolio
For 2006, the portfolio consists of equities and equity-related instruments listed on the Swedish stock market and unlisted Swedish shares and participating interests except for holdings in AP Fastigheter. The reference index for 2006 is the SIX Return Index.
In 2007, the Swedish equity portfolio will be divided into three components: large-cap listed companies with the SIX60 Return Index as reference index, other listed companies with the SIX60 Return Index excluding companies on the SIX60 Index as the benchmark index and unlisted companies, for which the SIX Return Index plus four percentage points will be the reference index.

Tactical asset allocation
Active position-taking between different asset categories or regions in order to outperform the index.

Tracking error
See Active risk.

Volatility
Risk yardstick that corresponds to the measured standard deviation of the return on an asset. It shows the extent to which returns vary.

Yield curve
Graph created by plotting the market interest rates of a particular class of security according to maturity.

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