FJÄRDE AP-FONDEN

2024

CEO Letter and Key Ratios

FJÄRDE AP-FONDEN

The Year 2024

548.2
SEK billion in fund capital.

50.7
SEK billion in net result.

2.0
SEK billion, net, transferred from AP4 to the pension system.

10.1%
return after costs. Over a ten-year measurement horizon, the return has averaged 8.0% per year.

0.07%
in total costs. Operating expenses amounted to 0.06% and commission expenses amounted to 0.01%.

46
nomination committees AP4 has worked in at listed Swedish companies.

77
investor bodies in unlisted investments AP4 has been active in.

1 357
general meetings of Swedish and foreign listed companies at which AP4 has voted.

15%
lower carbon footprint. Since 2010, the portfolio's carbon footprint has decreased by 70%.

4.6
SEK billion in new thematic sustainability investments.

Good return in a turbulent year

2024 brought a good return for AP4 of 10.1% and a result of SEK 50.7 billion. AP4's asset management takes a long-term approach, with the aim of managing the fund capital to achieve the greatest possible benefit for the income pension system.

In order to fulfil our mission and generate the long-term return that the pension system requires, AP4 has implemented a diversified investment strategy with a relatively large allocation to equities.

AP4's asset management model has achieved success. However, with an investment strategy that has a broad allocation to equities, it is inevitable that some individual investments will not perform in line with expectations, even if the portfolio as a whole generates a good return. The alternative would have been to invest the entire fund capital in fixed income assets, which carry very low risk but also have considerably lower expected returns.

As a hypothetical example, if AP4's fund capital had, since its inception in 2001, been invested in such a low-risk strategy instead, the fund capital today would have amounted to around SEK 200 billion rather than the current figure of almost SEK 550 billion. This represents a contribution to the pension system of almost SEK 350 billion from AP4 alone. In other words, it is the balanced risk-taking approach of the AP Funds involving equities that has created most of the current surplus in the pension system.

Major economic uncertainty requires a focus on diversification

Over the past decade or so, we have experienced several tumultuous events such as the financial crisis, euro crisis, refugees, pandemic and war. These have created significant imbalances that many economies are continuing to grapple with. In addition, recent years have seen an escalation of geopolitical tensions and increased political uncertainty, affecting many of the world's major economies.

All of the above means there is great uncertainty in our assessment of future economic development. This uncertainty is reflected in AP4's macroeconomic scenario analysis, which is a key element in determining the benchmark portfolio for operational asset management, the Dynamic Normal Portfolio (DNP), as our analysis in recent years has produced an unusually large number of fairly different scenarios, all of which have had a reasonably high probability.

In view of the uncertain economic situation, AP4 has been working intensively for several years to increase the diversification and robustness of the portfolio. The aim of this is to maintain the long-term return potential of the portfolio, while also offering better protection against the negative scenarios we have identified. This work has continued in 2024, an example of which is the redesign of – and increased allocation to – the Defensive Equities asset class. Defensive Equities were introduced into AP4's portfolio in 2022 and are composed of global equities designed to provide relatively good characteristics in the more challenging economic environments found in our scenario analysis.

One-sided market and increased concentration

Although 2024 brought a good return for a broad, well-diversified portfolio of the kind AP4 has, the year was also characterised by a one-sided, flow-driven market. A significant amount of capital flowed to the USA, resulting in a strong US dollar and a US stock market that outperformed other major stock markets.

The one-sidedness does not stop there. If we examine the performance of the US stock market in more detail, we find that just a small number of companies were responsible for the bulk of the strong return – namely the companies commonly referred to as the "Magnificient Seven" (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla).

One consequence of this one-sided, flow-driven market is that the standardised market capitalisation-weighted indices used by many as the basis for their asset management have become increasingly concentrated. For example, a global market capitalisation-weighted equity index at the end of the year contained as much as 67% US-listed equities, with the

"Magnificient Seven" companies accounting for 30% of the value of US-based companies. This means that global standard indices are now so concentrated it can be argued they no longer provide effectively diversified portfolios.

The development described above also risks periodically becoming self-reinforcing in that much of today's capital is almost routinely allocated to standard market capitalisation-weighted indices. For example, these are often used as entry-level savings products and as the basis for the asset allocation of many portfolios. The result is that new savings and new flows are automatically allocated to the USA to a significant extent and to those few companies where the major concentrations already exist.

The one-sided market has also created major differences in valuations and profit expectations, both between markets and between companies. There is a chicken and egg debate to be had here of course, as much of the differences are naturally due to differences in economic development and future potential. However, there is no escaping the fact that the differences are starting to look challenging in some quarters.

All in all, therefore, we can expect periods of major market movements and great volatility, particularly when there are uncertainties about the reasonableness of the large differences in valuations and expectations, and when many investors want to change to a similar positioning in a similar way at the same time.

Europe needs to regain optimism and self-confidence

Europe is undoubtedly facing many major structural and political challenges and in recent years has experienced a significantly worse economic performance overall than the USA. Up to now, it also seems that Europe has been almost unable to recognise this fact, which makes it difficult to find the energy and focus to take the necessary actions to change the situation.

It is therefore positive that the problem now appears to be gradually gaining recognition and becoming a higher priority on the EU's political agenda. One indication of this is that the issue of Europe's long-term competitiveness and productivity development is being discussed and debated more intensively within the EU and many of its Member States.

Two important results of the increased focus on Europe's competitiveness are the comprehensive EU reports presented in 2024 by Enrico Letta and Mario Draghi respectively. The reports describe in detail several of the strategic and structural challenges that are facing Europe, and also contain a number of suggested solutions of varying scope.

> **Managing part of the fund capital in the Swedish pension system is the best job in the world.**
> Niklas Ekvall, CEO

In my view, there are two measures mentioned in the above reports which, if successful, would be of particular significance, and both of these relate to areas where Europe diverges significantly from the USA in a negative way. The first is to ensure that the EU's internal market for goods and services starts to function as the "single market" it was intended to be. Unfortunately, this is far from being the case today. The second is to achieve a better-functioning and more homogeneous EU market for corporate financing and the supply of risk capital. If these by no means new ideas could be converted from ambition to reality, this could significantly strengthen Europe's competitiveness and growth potential.

Just as important as the above, however, is Europe's ability to shake off its current, sometimes almost paralysing, pessimism and regain a self-confidence and optimism about the future that in many respects is justified. Europe not only faces challenges and problems, but also without doubt has many strengths. For example, we carry out world-class research in many areas and we have many companies that are world leaders in their respective fields. Overall, Europe also has a well-educated population and well-functioning democracies and societies, which provide their citizens with a quality of life that ranks very high on those lists that attempt to measure this admittedly hard-to-define parameter.

A modern system platform makes us ready for the challenges of the future

AP4 and AP3 are in the midst of implementing a new portfolio system, undoubtedly one of the most extensive and challenging projects that a pension fund can undertake. When the new system comes into operation, AP3 and AP4 will have implemented modern, cloud-based system platforms that will significantly enhance functionality and efficiency all the way from investment decision to custodian bank.

This project clearly demonstrates the strength of the AP Funds when we work together and use our combined efforts to achieve a common purpose. The platform, together with the experience gained from our joint project, will undoubtedly also provide great opportunities for further value-creating collaborations between our funds.

Changes for the buffer funds – we will build on strength

At the end of January, the Swedish government and the pension group, with broad parliamentary support, announced future changes to the management of buffer capital. Under the proposal, from 1 January 2026 the number of buffer funds will be reduced from the current five to three funds by distributing the assets in AP1 equally between AP3 and AP4 and incorporating AP6 into AP2.

It is a good and natural thing to regularly review the pension system and the buffer funds to ensure they are meeting their objectives and that the Swedish people have confidence in the pension system. It is now our task to implement the proposed change in the best way possible for the pension system and with full vigour and commitment.

The AP Funds are proud to have delivered high returns that have contributed to strengthen the pension system. The AP Funds have built up competent, professional organisations that have a strong culture and investment processes. We are global leaders in terms of our good return, cost-efficiency and sustainability work.

Our starting point in implementing the change will be to build on the strengths and competencies that have been developed over a long period, with the aim of establishing an even stronger asset management organisation and an even more attractive workplace.

Finally, I would like to thank all AP4 employees for your sense of responsibility and commitment, and for your contribution to our ambitious work during the year. It is an honour to have you as colleagues and to manage part of the fund capital in the Swedish pension system together with you. It's the best job in the world.

Stockholm, 20 February 2025

Niklas Ekvall, CEO