

Interim Report 2018

AP4's mission is to contribute to the financial security of current and future pensioners in Sweden by managing part of the national pension system's buffer capital.



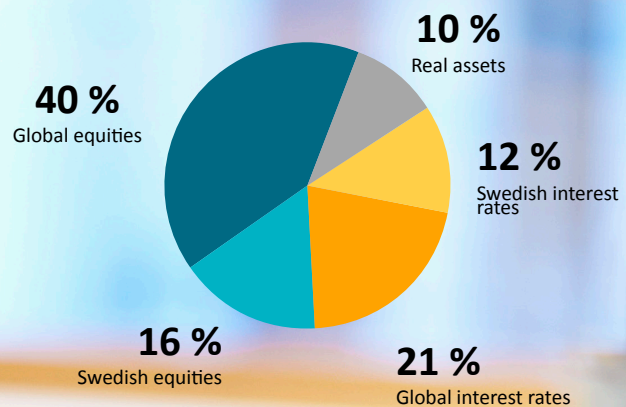
Favourable return in low-interest environment

With a net result of SEK 13.7 billion, total fund capital grew to SEK 366.9 billion at the end of the first half of 2018. The return was 3.9 % before costs and 3.8 % after costs. The return exceeded AP4's reference index by 1.4 percentage points. During the first half of the year a net total of SEK 3.3 billion was paid out to the pension system. Adjusted to a full-year basis, total costs amounted to 0.10 % of average fund capital. Costs are very low in an international comparison. Currency exposure was 17.7 %.

AP4 has taken additional steps to lower the carbon footprint of its portfolio. During the first half of 2018, shares in companies for which coal accounts for more than 20 % of sales were sold from the global equity portfolio. This has further lowered AP4's carbon footprint and reduced climate risk in the portfolio.

AP4 has taken active ownership responsibility by voting at the Annual General Meetings of 81 Swedish and 821 foreign companies during the first half of the year. Ahead of the 2018 AGM season AP4 participated on 32 nomination committees.

A diversified portfolio



AP4's mission, to generate high real rates of return, warrants a high share of equities.

367

SEK billion in fund capital

14

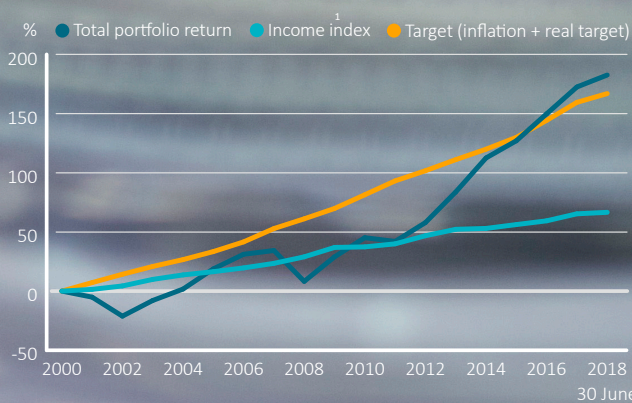
SEK billion in net result

3.8%

return after costs

Outperformed return targets

Since the Fund's inception, AP4's return has exceeded both the inflation-adjusted return target and the performance of the income index, entailing that AP4 is making a positive contribution to the stability of Sweden's pension system.



¹ Under the assumption that the return for the income index over a year can be distributed equally over the respective half-year periods. This is a simplification, as the income index for 2018 is calculated as a product of the income development between 2016 and 2017, and the income index for 2017.

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This half-year report has been prepared in accordance with the accounting and valuation principles common to the AP Funds. These can be found in the 2017 AP4 Annual Report, which can be read at www.ap4.se.

Figures in the half-year report for tables and charts are rounded separately, so the total amounts may not necessarily correspond with the individual entries. Figures in brackets refer to the first half of 2017, unless otherwise stated.

This Interim Report has not been audited by the AP4 auditors.

No significant events occurred after the end of the reporting period.

The AP4 Annual Report for the 2018 fiscal year will be published in February 2019.

Exceeding return targets

Exceeding real return target

The return was 3.8 % after costs for the first half of 2018. AP4 exceeded both its medium-term and its long-term return target. Key contributors to the return have been the equity allocation – especially Swedish equities – and a currency exposure that enhanced the return due to the weaker Swedish krona.

Over a ten-year evaluation horizon the portfolio has generated an average annualised return of 8.7 %, compared with the real return requirement with the addition of inflation of 5.2 % per year over the ten-year period. AP4's return is also higher than the performance of the income index, which forms the basis for indexing the liability in the income pension system. AP4 has thereby made a positive contribution to stability of the system.

Strong active return during first half of the year

AP4's return exceeded the return for the Fund's reference index by 1.4 percentage points. Over a five-year evaluation horizon the average annualised active return was 1.7 %. This means that AP4 has created value-added in its asset management. The active return target is 1 % per year and is evaluated over a rolling five-year period. Essentially most asset management areas have contributed to the positive result, with Swedish and global equities as particularly large contributors.

AP4 conducts active asset management with the goal over time to generate a return that is higher than the market in general. Active return is measured as AP4's return in relation to the return for a reference portfolio made up of various market indexes. In the reference portfolio, various market indexes are weighted together with weights that indicate AP4's target allocation to various asset classes and markets.

Asset class	Market value, SEK bn	Portfolio return, %	Exposure ¹ , %
Global equities	148.4	0.7	40.4
Swedish equities	58.4	9.1	15.9
Global interest rates	78.4	-0.9	21.4
Swedish interest rates	45.2	1.4	12.3
Real assets	37.1	6.2	10.1
Other investments	-0.7	-0.1	-0.2
TOTAL INVESTMENTS	366.9	3.9	100.0

¹ Refers to exposure. Underlying derivative values in the passive allocation have been distributed over the respective asset classes.

Real assets new asset class

Starting in 2018 AP4 has defined real assets, such as real estate and infrastructure, as a separate asset class in the portfolio. What characterises real assets is that they are generally have long-term and relatively stable cash flows that are coupled to inflation development. As a result, these assets contribute to stable returns and spread of risk, and are suitable components in the portfolio for a long-term investor such as AP4. Real assets consist today mainly of unlisted and listed real estate equities and to a smaller degree of funds focused on infrastructure investments.

The current allocation to real assets is 10.1 % of the portfolio, and the goal is to increase this share over the long term. An example of this is the new internal mandate for listed European property companies that was initiated during the first half of the year.

Continued net payments to the pension system

AP4's payment to the pension system during the first half of the year amounted to SEK 3.3 billion. Since 2009 AP4 has made regular payments to the pension system, and since then has contributed a total of SEK 47.2 billion.

Government's evaluation positive

The government's annual evaluation of the AP Funds for 2017 affirms that the AP Funds have achieved their return targets and made a positive contribution to the long-term funding of the national income pension system, both in 2017 and since their inception in 2001. A cost analysis shows that the funds are cost effective compared with a selection of foreign pension funds with similar mandates and sizes.

Changed rules for the AP Funds

In June 2018 the Swedish government submitted a proposal to parliament on changed rules for AP1–AP4. The intention is that the first step of the legislative change will take effect on 1 January 2019. The Pensions Group has also determined that certain, additional changes of the investment rules pertaining to the AP Funds' opportunities to invest directly in unlisted companies and credits will be studied in autumn 2018. The intention is that these legislative changes will be able to take effect on 1 July 2019.



AP4 sets a long-term real return target based on an analysis of the pension system's obligations and of future return opportunities for various asset classes. Starting in 2018 the long-term real return requirement was lowered from 4.5% per year to 4% per year. The long-term target was also complemented with a medium-term target of a 3% real return over the coming ten years. This change was motivated by the fact that the pension system is more robust today than previously and that the anticipated return is lower than what it has been historically. A more in-depth description of AP4's return targets is provided in the 2017 Annual Report.


Key ratios for AP4's operations

	June 30, 2018	June 30, 2017	December 31, 2017
Fund capital at end of period, SEK bn	366.9	347.6	356.6
Net result for the period, SEK bn	13.7	17.3	30.1
Net disbursements to pension system, SEK bn	-3.3	-3.7	-7.4
Fund capital at beginning of period, SEK bn	356.6	333.9	333.9
Asset management costs, operating expenses, %	0.06	0.06	0.06
Asset management costs, commission expenses, %	0.04	0.04	0.04
Total asset management costs, %	0.10	0.10	0.10
Return on total portfolio, net of asset management costs, %	3.8	5.2	9.1
Real return on total portfolio, net of asset management costs, % ¹	2.9	4.5	7.4
Annualized total return after asset management costs, average 5 years, %	11.0	11.8	11.5
Annualized total return after asset management costs, average 10 years, %	8.7	6.5	7.3
Real annualized return after asset management costs, 10 years, % ¹	7.9	5.4	6.9

¹ The KPI for June 2018 is an estimate, since this figure was not yet available at the time of this report's publication.

Letter from the CEO

Market and return

The stable performance of the world's stock markets in 2017 has given way to higher volatility and flatter performance during the start of 2018. Granted, the economy continues to be strong across a broad base both in Sweden and internationally, however, during the spring we have seen a higher risk premium in the financial markets.

There are several explanations for the relatively tentative sentiment in the markets. In part, we have a long period of high and stable returns behind us. We are also in a later stage in the economic cycle with a waning growth rate and expectations for a less expansive monetary policy in many countries. The latter has already become apparent, mainly in the USA, where the Federal

"It's very gratifying that our active management continues to deliver an excess return."

Funds Rate has been raised and bond rates have risen during the first half of the year.

Internationally there have also seen signs of political concern, such as the USA's increasingly protectionist stance. We have also seen financial problems in a number of emerging markets, with Argentina and Turkey perhaps as the most prominent examples. These types of fears have fuelled periodic volatility in the markets. In addition, at the start of 2018 the Swedish krona weakened, owing in part to the Central Bank of Sweden's continued expansive monetary policy paired with concerns over the Swedish housing market.

AP4 posted a return of 3.8 % for the first half of 2018, which I am satisfied with given the prevailing macro and market environments. As I noted in my CEO's letter in the 2017 Annual Report, we also see considerable challenge for the AP Funds during the coming ten-year period to deliver returns at the levels we experienced during the past ten years. In this context it is very gratifying that our active management continues to deliver an excess return in relation to the reference index that guides our long-term asset allocation. This excess return was 1.4 percentage points during the first half of 2018 and thereby accounts for a considerable share of AP4's total return. Significant contributors during this period were Swedish and global equities, and unlisted assets. Of course, a half year is a short period of time on which to base an assessment, but the fact is that AP4's asset management has now generated a positive active return for ten years running. This is an impressive achievement that I thank my competent and committed colleagues for.

"We have also taken further steps to reduce the carbon footprint in our portfolio by divesting companies in which thermal coal accounts for more than 20 % of sales."



Continued development in sustainable investments

The work on developing and adopting a comprehensive approach to AP4's sustainability work that was begun in 2017 continued with full force during the spring. Naturally, the new framework encompasses sustainability in general. However, Climate & Environment and Corporate Governance continue to be our special areas of focus.

Our development work in sustainability is conducted as a prioritised project that encompasses a broad spectrum of initiatives and activities. A concrete example of a sustainability initiative that was carried out during the first half of 2018 is the investment we made in the Amundi Planet fund, which aims to develop and invest long-term in the market for green bonds in emerging markets and developing countries. An interesting aspect of the fund is that International Finance Corporation (IFC), which is a part of the World Bank, has provided equity capital and with its long experience in working in developing countries will also help educate and develop these markets.

We have also taken further steps to reduce the carbon footprint of our portfolio. To begin with, we have now incorporated low carbon strategies into our internal asset management. This gives us greater control to develop and streamline methods, and enable us to further reduce our carbon footprint. In addition, it also gives us an opportunity over time to add other sustainability factors, such as resource efficiency. Second, we have divested

our shares in companies in which thermal coal accounts for more than 20% of sales, which has lowered our carbon footprint while also reducing climate risk in our portfolio.

Corporate governance – An integral part of asset management

Corporate governance is a central feature in AP4's asset management. As a long-term active owner of listed companies in Sweden and internationally we have a responsibility to contribute to development and improvements in the companies' operations and to ensure that our ownership role is performed responsibly and transparently. Consequently, AP4 was very active in corporate governance during the first half of 2018. For example, during this year's AGM season we participated on 32 nomination committees and voted at the Annual General Meetings of 81 Swedish and 821 foreign companies.

AP4 advocates for greater diversity and a more even gender balance on company boards, since we believe that this creates value for the companies in which we own shares. Toward this end, AP4 demands that at least one person of each gender should be on the short list of nominations for new board members.

Importance of new investment rules for the AP Funds

I am very happy to note that the Pensions Group's and Ministry of Finance's work on updating the AP Funds' investment rules is

beginning to reach concrete results, as evidenced by a proposal on the matter submitted by the government in June to Swedish parliament. Nearly 20 years have passed since the current investment rules were established, and the capital markets have changed fundamentally since then. I therefore have a very positive view of the modernisation of the investment rules. This modernisation is necessary to give the AP Funds the conditions for modern asset management that can generate the best possible returns at the

"I cannot stress enough the importance of this second step in the modernisation of our investment rules being carried out "

lowest possible cost. All in all, the proposed changes will give the AP Funds greater flexibility to fulfil their mandate, which will ultimately benefit today's and tomorrow's pensioners.

The changes in the investment rules are intended to be implemented in two steps. The bill I mentioned above pertains to the first step, which according to plans will go into effect on 1 January 2019. This change lowers the requirement that the AP Funds hold low yield liquid interest-bearing securities with high credit ratings from today's level of at least 30 % of the portfolio to 20 %. The change in the first step also opens up greater opportunities to allocate capital to illiquid investments. This is an investment category that is very well-suited for the AP Funds' very long-term asset portfolios and has the potential to make a significant contribution both to higher returns and better diversification of risk.

However, the first step in the changes does not include a modernisation of how and in which forms the AP Funds may invest in unlisted assets. This is a prerequisite in order for the AP Funds, in a suitable and cost effective way, to be able to use the greater degree of freedom that the initial change entails. It is therefore very positive that the Pensions Group has clearly communicated that it also intends to proceed with a second step and look into opportunities for direct investment in unlisted holdings, such as infrastructure companies, illiquid credits, and co-investments in unlisted companies. I cannot stress enough the importance of this second step in the modernisation of our investment rules being carried out. This would give the AP Funds

greater opportunities and the necessary tools to make long-term, sustainable and cost-effective investments in unlisted assets.

With these welcome and valuable indications from the Pensions Group and government concerning changes in the rules for the AP Funds, we at AP4 are already full speed ahead in our preparations to be fully ready to take advantage of the opportunities that the new investment directives will entail.

However, one should not expect an immediate restructuring of the portfolio, but rather a gradual process over several years. In this context one must also have great respect for the fact that we have a market situation with strained values in many respects. Changes will be made prudently and in stages. We will put great emphasis on ensuring that every individual investment can be made on solid grounds.

I also welcome the fact that sustainability is now being added to the wording of the investment rules with the clarification that asset management must be conducted in an exemplary manner through responsible investments and responsible ownership. In this regard as well, the change represents a modernisation and adaptation to the requirements that are put today on long-term institutional asset managers with high sustainability ambitions. In addition to this, of course the new wording in the investment rules will also spur us to continue development in the area of sustainability, with the ambition to steadily – over time – stay at the international vanguard in this area.

In conclusion, I would like to offer warm thanks to my colleagues at AP4 who through their professionalism, innovative thinking and ability to implement are helping manage the buffer assets and continuously develop our operations so that we can best execute our mission in Sweden's national pension system.

Stockholm July 12, 2018



Niklas Ekvall
CEO

Climate & Environment and Corporate Governance

Continued reduction of carbon emissions – divestment of shares in coal companies from the global equity portfolio

AP4 was early to conclude that over the long term, environmental and climate challenges will have a major impact on the return potential and risk of investments. It is for this reason that AP4 integrates sustainability in asset management through the Climate & Environment focus area. During the first half of 2018 AP4 took further steps to reduce the carbon footprint of the equity portfolio. Shares have now been divested in more than 20 coal companies that derive 20% or more of their sales from thermal coal from the global equity portfolio.

Since 2012 AP4 has been investing in accordance with low-carbon strategies that reduce exposure to companies with high CO2 emissions and large fossil fuel reserves, and has thereby lowered climate risk in its portfolio. With the sale of the shares in coal companies, AP4 has now further reduced the carbon footprint of the global equity portfolio and thus also climate risk in the asset portfolio. The previous external low-carbon mandate has also been brought in to the internal asset management operation. This gives AP4 greater control and conditions to develop and streamline methods to further reduce our carbon footprint at the same time that it allows us to add additional sustainability factors to the portfolio, such as efficient use of resources.

The lower carbon footprint can be credited to three contributing factors. Since 2012 AP4 has worked according to low-carbon strategies which in each sector reduces holdings in companies with high CO2 emissions in relation to sales, in favour of companies with lower emissions. By selling its shareholdings in coal companies, AP4 has now further reduced its exposure to

carbon emissions. AP4 has substantial holdings in Swedish companies, which as a group have lower carbon emissions and thus also contribute to lower carbon exposure in the equity portfolio.

Investment to develop the market for green bonds in emerging markets and developing countries

AP4 has made an investment in the Amundi Planet fund, which aims to develop and invest long-term in the market for green bonds in emerging markets and developing countries. Amundi Planet is a collaboration between Amundi, which will handle management of the fund, and International Finance Corporation (IFC) – part of the World Bank – which has provided equity capital and with its long experience in working in developing countries will also help educate and develop these markets.

Active ownership responsibility

AP4 has taken active ownership responsibility by voting at the Annual General Meetings of 81 Swedish and 821 foreign companies during the first half of the 2018. Ahead of the 2018 AGM season AP4 participated on 32 nomination committees for Swedish companies.

One of AP4's most important duties as an owner is to ensure that companies have the best possible board in view of each individual company's unique needs. AP4 therefore works actively for greater diversity and a more even gender balance on company boards, as this creates better conditions for value creation. AP4 demands that at least one person of each gender should be on the short list of nominations for new board members.



Thus far in 2018 AP4 has divested shareholdings in more than 20 coal companies that derive 20% or more of their sales from thermal coal from the global equity portfolio. Through these sales AP4 has further lowered the carbon footprint of the global equity portfolio and has thereby also reduced climate risk in the portfolio.

Income statement

SEK million	Jan-Jun 2018	Jan-Jun 2017	2017
OPERATING INCOME			
Net interest income ¹	945	891	1 783
Dividends received	4 387	4 182	5 736
Net income, listed shares and participations	4 100	14 708	24 908
Net income, unlisted shares and participations	823	1 170	3 032
Net income, fixed income assets	-487	-2	-120
Net income, derivative instruments ¹	-1 312	210	-185
Net income/loss, changes in exchange rates	5 374	-3 664	-4 744
Commission expenses	-71	-66	-132
Total operating income	13 759	17 429	30 278
OPERATING EXPENSES			
Personnel costs	-63	-67	-130
Other administrative expenses	-41	-44	-84
Total operating expenses	-104	-111	-214
NET RESULTS FOR THE PERIOD	13 655	17 318	30 064

As a result of implementation of IFRS 9 and amendments to IAS 1, effective 1 January 2018, all interest components of derivative instruments are reported on the line "Net income, derivative instruments" instead of on the line "Net interest income". To facilitate comparisons with the preceding year, the comparison figures have been adjusted accordingly.

Balance statement

SEK million	June 30, 2018	June 30, 2017	December 31, 2017
ASSETS			
Shares and participations, listed	217 940	200 046	209 592
Shares and participations, unlisted	31 582	26 577	29 914
Bonds and other fixed income assets	120 264	112 136	111 321
Derivative instruments	1 519	5 636	3 254
Cash and cash equivalents	4 083	3 730	5 467
Other assets	277	643	2 686
Prepaid expenses and accrued income	1 258	990	1 375
TOTAL ASSETS	376 923	349 758	363 609
LIABILITIES AND FUND CAPITAL			
LIABILITIES			
Derivative instruments	8 757	1 168	2 265
Other liabilities	540	646	4 154
Prepaid income and accrued expenses	682	393	581
Total liabilities	9 979	2 207	7 000
FUND CAPITAL			
Fund capital, opening balance	356 609	333 920	333 920
Net payment to the pension system	-3 320	-3 687	-7 375
Net result for the period	13 655	17 318	30 064
Total fund capital	366 944	347 551	356 609
TOTAL LIABILITIES AND FUND CAPITAL	376 923	349 758	363 609

Multi-year summary

Key ratios	June 30, 2018	2017	2016	2015	2014
FUND CAPITAL, FLOWS AND RESULT, SEK BILLION					
Fund capital	366.9	356.6	333.9	310	294.9
Net flows to the pension system	-3.3	-7.4	-6.6	-4.9	-5.1
Net result for the period	13.7	30.1	30.5	20.1	40.2
RETURN, %					
Return, total portfolio before costs	3.9	9.2	10.1	6.9	15.8
Return, total portfolio after costs	3.8	9.1	10	6.8	15.7
Return, total portfolio after costs, annualised 5 yrs	11.0	11.5	12	9.7	10.5
Return, total portfolio after costs, annualised 10 yrs	8.7	7.3	6.7	6.7	7.6
OPERATING EXPENSE RATIO AS % OF AuM (ANNUALISED)					
Operating expenses	0.06	0.06	0.06	0.06	0.07
Operating expenses and commission expenses	0.10	0.10	0.10	0.11	0.11
RISK, %¹					
Standard deviation ex-post, Total portfolio	5.9	4.1	7.3	8.8	6
Standard deviation ex-post, Liquid portfolio ²	6.4	4.5	7.8	9.4	6.4
Standard deviation ex-post, Liquid portfolio, 10 yrs ³	8.5	9	9.1	9.3	8.9
Sharpe ratio, total portfolio ex-post	0.8	2.5	1.5	0.8	2.5
Sharpe ratio, liquidity portfolio ex-post ²	0.7	2	1.2	0.6	2.3

¹ Refers to return data, unless otherwise indicated.

² Refers to liquid assets excluding unlisted real estate, private equity funds and high-yield fixed income assets.

³ Refers to quarterly data for liquid assets (investments excluding unlisted real estate, private equity funds and high-yield fixed income assets).

Other key ratios, as per closing date	June 30, 2018	2017	2016	2015	2014
Active return, strategic management before costs,% ^{1, 2}	1.4	-1.1	1.0	4.8	1.4
Inflation, % ³	0.9	1.7	1.7	0.1	-0.3
Real return after costs, % ³	2.9	7.4	8.3	6.8	16
Active risk ex-post, active management,% ⁴	1.2	1.7	2.7	2.8	1.9
Currency exposure, %	17.7	18.4	26.9	27	28.1
Proportion external management incl. Investments in private equity companies, % ⁵	16.3	17	22.7	22.4	25.4
Number of employees on balance sheet date	54	53	54	55	54
ALLOCATION OF INVESTMENT ASSETS, %^{6, 7}					
Global equities	40.4	40.8	40.2	39.4	41.7
Swedish equities	15.9	16.6	17.6	17.8	18.0
Global interest rates	21.4	21.1	22.7	20.5	20.7
Swedish interest rates	12.3	11.6	10.6	14.5	13.2
Real assets	10.1	9.6	8.6	7.3	5.9
Other	-0.2	0.3	0.3	0.5	0.5
TOTAL INVESTMENT ASSETS, %	100.0	100.0	100.0	100.0	100.0

¹ The Fund's operative portfolio is evaluated against a reference portfolio made up of a number of market indexes with set asset weights. In connection with the adoption of a new asset management structure in 2018, the reference portfolio's market index, which was previously adjusted for the Fund's tax status, ethical aspects through exclusion of companies, and exclusions of non-US REITs, has been updated with a standardised index hedged to SEK in order to simplify and increase transparency. For 2018 the contribution from the Fund's active utilisation of its status as a state-owned pension fund was 0.11 percentage points.

² Active return, calculated as the difference in return between the operative portfolio and the reference portfolio.

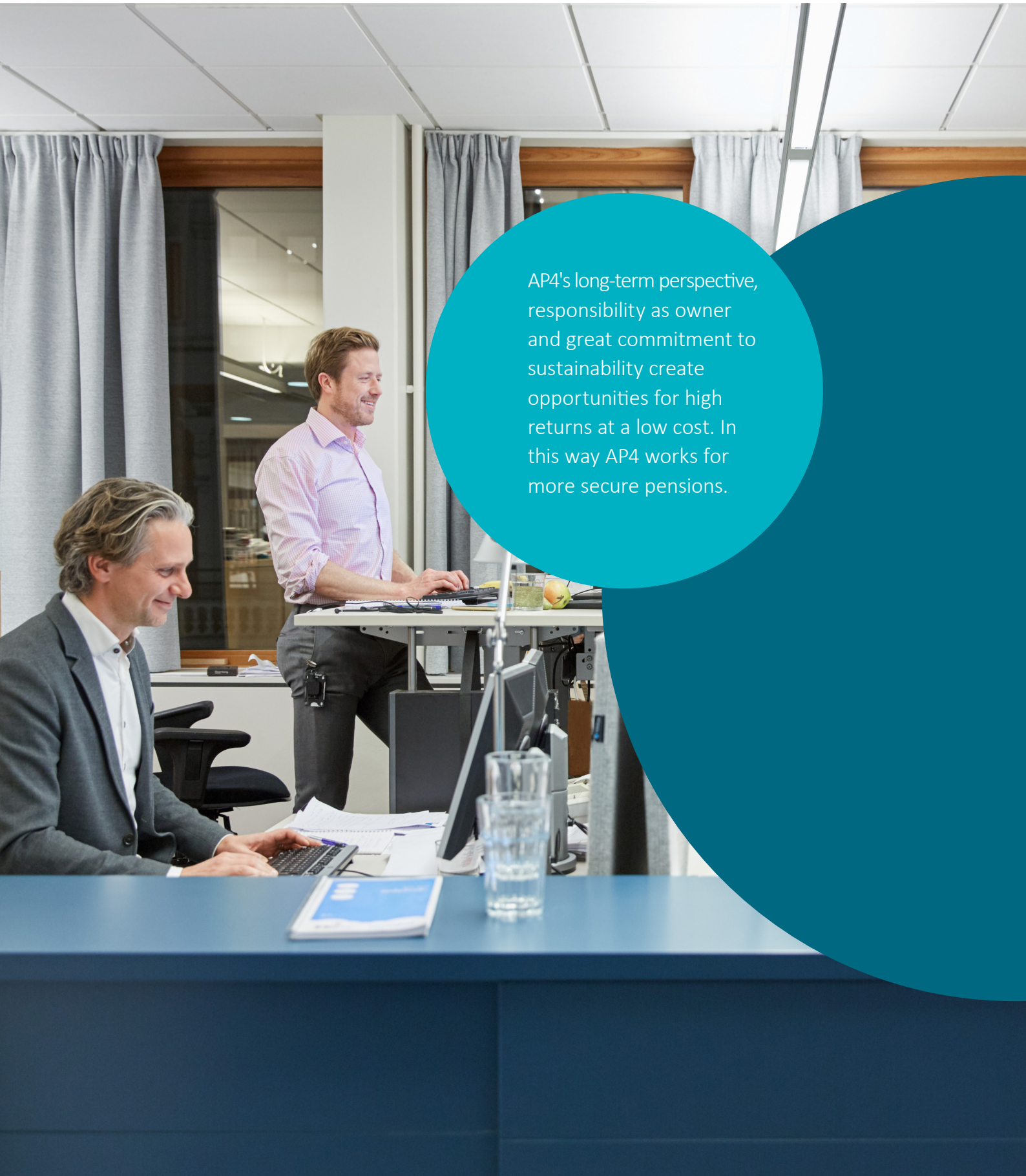
³ The KPI for June 2018 is an estimate, since this figure was not yet available at the time of this report's publication.

⁴ Active risk, calculated as standard deviation, measured on an annualised basis, in the difference between the operative portfolio and the reference portfolio.

⁵ Wholly or partly owned property companies are reported as internally managed.

⁶ Refers to exposure. Underlying derivative values in the passive allocation have been distributed over the respective asset classes.

⁷ In connection with a new asset management structure, minor changes have been made in the asset classes as well as in the assets in the respective asset classes. "Other" includes non-capital mandates. For comparison purposes, previous years' figures are presented in accordance with the new asset management structure.



AP4's long-term perspective, responsibility as owner and great commitment to sustainability create opportunities for high returns at a low cost. In this way AP4 works for more secure pensions.