

# Important mission require world-class management

**Andra AP-fonden will contribute to a good financial future for Sweden's pensioners. It is an important mission that the Fund takes very seriously, and which gives inspiration every day to take another step towards Andra AP-fonden's vision of World-class management. In 2018, this meant, among other things, preparing the organisation for new investment rules and continuing integration of sustainability, work which in the case of the Fund's new equity indices can be described as pioneering.**

AP2's management is based on the purpose of being of the greatest possible benefit for the state income pension system. To achieve this, the Fund bases its management on three principles: risk diversification, cost efficiency and sustainability.

"We work hard to generate a good return to the income pension system without taking unnecessary risks. And we make it cost-effective and long-term because our investments are made in a sustainable way. In this way, our portfolio is most beneficial to the pension system," says Hans Fahlin, Chief Investment Officer at AP2.

## Three guiding principles

AP2 is constantly working to spread the risks between different asset classes and markets worldwide. Over the past decade, this work has created a significantly more diversified portfolio. The Fund achieves high cost effectivity by, among other things, managing much of the capital itself with modern technologies. International comparisons have also shown that AP2 is very cost-effective.

"The fact that comparisons in the industry show that we are cost-effective is good, but we cannot settle for just that. In recent years, we've succeeded in reducing the share of costs of our managed capital, even though the portfolio has become increasingly complex with more asset classes and markets," explains Hans Fahlin.

As a long-term manager, it's important for AP2 to protect the values that the Fund invests in, and that the value of the investments is sustainable in the longer term. By integrating sustainability into management, the Fund can identify assets that are incorrectly priced because the value may change, for example due to climate change.

"We've made great progress in the area of sustainability, but it's not easy and sustainability is a process that we will never be finished with. It's a prioritised area and we're always working to take these aspects into consideration," says Hans Fahlin.

## Changed investment rules

In 2018, AP2 worked hard to prepare the organisation for the AP funds' new investment rules. In the new rules, the AP Funds are given greater opportunities to invest in illiquid, or alternative, assets that have in common that they are difficult to sell quickly or that this is associated with high costs. A long-term investor is compensated via the possibility of higher returns. Another important change is that the requirement for a minimum proportion of fixed-income securities with low credit and liquidity risk is reduced from 30 to 20 per cent.

"We welcome both these changes. As a long-term investor, we have the best conditions to get the extra return that alternative investments provide. At

the same time, the low interest rate levels of recent years have meant that fixed-income securities have had a low return," explains Hans Fahlin.

## Private equity investments

In 2018, AP2 analysed the consequences of the new investment rules for the Fund's portfolio. The Fund has, among other things, investigated investments in private equity, an area where AP2 has previously had good experience. In this work, the Fund's own empirical experiences and data have been used and there is also good access to academic research on the subject.

Another area that AP2 has investigated is infrastructure, which is often described as a stable investment. However, there is relatively little academic research and empirical data that explains this. The Fund, after analysing research and data, has instead concluded that infrastructure is often reminiscent of private equity investments with high risk and the possibility of high returns.

"We will keep looking at whether infrastructure investments can have a place in our private equity portfolio. In addition, we will analyse climate-improving investments, for example in electricity production. Here there are opportunities to find investments that can yield a good return while at the same time helping to finance the transition to a fossil-free society," says Hans Fahlin.



Hans Fahlin,  
Chief Investment Officer at AP2

### **Bonds with higher credit risk**

A third area analysed by AP2 is bonds with a higher credit risk. The Fund's analysis shows that such an investment co-varies more with equities, and thus can be regarded as an interim between equities and bonds.

"Our analysis shows that the possibility of a good return compensates for the increased risk, and therefore it's an interesting type of asset. However, we need to investigate how this type of investment can fit into our portfolio. Emerging market bonds issued in dollars, which the Fund already manages, can be an equally attractive option," says Hans Fahlin.

### **Continuous work on integrating sustainability**

The new investment rules for the AP funds also include changes in the sustainability area.

"We believe that our focus on sustainability is already in line with the new law," says Hans Fahlin.

AP2 views sustainability as being based on a conviction that it leads to a better management result, and thus that it becomes better for the income pension system and for pensioners. The Fund's overall focus on sustainability work is therefore to integrate sustainability into management.

"For each management unit, we have projects on sustainability in our asset classes. We try to continuously identify improvements in how we deal with risks

and opportunities within sustainability in all asset classes," explains Hans Fahlin.

### **Important to succeed in the mission**

For many years, AP2 has actively worked on developing within the sustainability area. Among the Fund's employees, there is a consensus that joint work on these issues is good for the pension system and important for the success of the Fund's mission. A fundamental success factor is that, in this work, AP2 has been open to change and dared to go its own way.

"What we do is not controversial, and there are several others who also do this. But we are good at sustainability because we do our analysis properly, and when we've reached what we think is best for the pension system, we make the changes that are required," says Hans Fahlin.

### **Changes in the pension system**

In parallel, AP2 has also analysed the effects of other changes that affect the development of the pension system. The system has now recovered after the financial crisis and the financial position is good today, partly because of the AP funds' good returns. In the demographic scenario from Statistics Sweden, which the Fund uses as a basis, the forecast is now also less pessimistic than before. In addition, proposals for higher retirement age have been presented, which can be expected to strengthen the system in the long term.

"The overall picture in the Fund's simulations of the pension system is brighter than before, which plays a role in how our portfolio should look in order to create as much benefit as possible in the system. With the help of our ALM model, we have, among other things, analysed the effects of the higher retirement age. The uncertainty is, of course, still a large factor in this matter and we will need to analyse the effects on an ongoing basis," says Hans Fahlin.

### **World-class management**

AP2's vision is World-class management. The vision expresses the Fund's aim of constantly looking to develop and become better by learning from market developments and what other players are doing.

"There are elements in what we do that can be considered world-class, for example our way of working cost-effectively with emerging markets and developed markets, while incorporating sustainability aspects. And our new internally-developed indices for global equities in the quantitative management, which have attracted a lot of international attention, have been described as pioneering by many. At the same time, we need to continue to develop in all areas. World class is a constant aim of ours," concludes Hans Fahlin.

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A review of AP2's sustainability activities and measures in each asset class in 2018 can be found on pages 28–55.