CASE STUDY

AP4 - 50 years of service to Swedish pensioners

AP4 senior portfolio manager, Jan Petersson, **tells** Francesca Fabrizi **how AP4 has been setting the bar high for the European pensions sector for 50 years**

I gather 2024 is a special year for the AP4 fund? Please tell us more.

■ It is indeed. This year, AP4 celebrates 50 years as a buffer fund for the public Swedish pension system, having been founded in 1974. It was reformed in 2001 with the creation of four buffer funds, each starting out with the same amount of capital, SEK 134 billion, and the same mandate. AP4 however is now, together with AP3, the largest of the AP funds, each managing SEK 500 billion. This implies an annual average return since inception in 1974 of 13% and, since reformation in 2001, an average annual return of 6.4%. During a volatile 2023, the return reached 9.6%, topping the league of the AP Funds. The return is the result of a well-developed risk culture in connection with the long-term investment horizon, which has led to a comparatively high allocation to equities in an international context.

Please tell us more about your asset allocation.

■ By the end of 2023, the allocation to the different asset classes was the following: Global equities 34%, defensive equities 5%, Swedish equities 16%, bonds 29% and real assets (listed and unlisted real estate/infrastructure) 16%.

With changes in legislation in 2019 and 2020, the AP funds were given increased flexibility to invest in unlisted assets, which has led to alternative investments growing as a share of fund capital. This, combined with interest rates almost at zero, or even negative for several years, and with equity markets returning far above average return, meant that we saw difficulties in continuing to match historical returns.

So how did we go about it? With an innovative perspective, we implemented a new asset class called defensive equities in 2022. This new asset class was simply made possible by taking funding funded from the global equities and the bond portfolio. The purpose and goal was to give a higher return than bonds, but without the same risk as the equity market. This made us look for equities with the following characteristics: High dividend yields, strong balance sheets and low earnings volatility. In a relatively short period of time, the new asset class has turned out well.

AP4 historically has been a thought-leader in climate related investment strategies. How is this developing?

■ That's true. AP4 has been a pioneer in climate related investment strategies since 2012. Back then, it was unusual in the investor community to see engagement and investments relating to climate change. This has developed rapidly in the past five to six years, with more funds seeing the necessity of addressing climate change. Even if we did this year, unfortunately, see some institutions, especially in the US, backing off from these strategies, for European investors this continues to be of highest importance.

On our side, we started out with quant strategies in order to reduce CO_2 emissions in the global equities portfolio. Four years ago, we also started to manage the resource intensive sectors (energy, materials, utilities and transportation) fundamentally, with a dual ambition – to get a superior return and, at the same time, contribute to the reduction of CO_2 emissions within these sectors. These sectors are chosen with the perspective that if we can contribute to the climate transition, it will make a change for the whole equities portfolio.

The ambition is high for these sectors, and we aim at being net zero in CO_2 emissions (scope 1&2) in 2040. In the resource intensive sectors, we strive to select either the best-in-class companies when it comes to CO_2 emissions, or the ones that might have just started their journey, where it is conducted in an ambitious and credible way, and where we also believe in the equity story.

This strategy means that we do not act like some of our peers, by avoiding the troublesome sectors, but rather we see ourselves as responsible owners and engage with companies in a way that we believe is both responsible for climate transition/ climate change and, at the same time, will give a long-term good return for the companies involved.

For example, we have engaged in the shareholder resolution by Follow This in trying to get Shell to be more precise in their short- to mid-term climate targets being able to meet their long-term ones.

We are realistic in our approach to fossil fuels and we acknowledge that we would not be able to create economic growth and energy security without fossil fuels on a short-term basis, but there is no doubt that we must strive for a future based on renewable energy.

With our investment approach, combining quant strategies and fundamental analysis, we have been very successful in reducing our CO_2 emissions so far. Since 2010, the CO_2 emissions for the equity portfolio have been reduced by 65%. Ever since our investment strategies in 2012 included CO_2 strategies, AP4 has been awarded numerous prizes within the pension industry.

Please tell us more about your equity allocations.

■ The equity portfolio of SEK 280 billion, by end of 2023, was divided by about two thirds in global equities, where the mentioned resource intensive sectors are managed by a fundamental approach and the other sectors are quantitatively managed with an aim to reduce CO_2 emissions.

We manage all developed markets internally, while emerging markets are managed by external fund managers.

In the domestic equity portfolio, which represents about one third of the equities portfolio, we are often a large shareholder in the companies we are invested in – we often own between five to ten per cent, making us one of the larger shareholders. Because of this, we put significant effort into shareholder engagement and, in a large part where we are one of the larger shareholders, we work on the nomination committees for the board of directors. We put a lot of effort into being responsible shareholders for all ESG aspects but also, with nominating the best boards, get the companies to generate good returns.

The described strategies have served us well over the years. Looking forward, we must keep striving to achieve the highest possible returns, being a responsible shareholder and keeping our leadership in environmental investment strategies.

We live in a challenging world, both economically and politically, so we must always be on our toes and be able to take risks when we see high possibilities for it to pay off.

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