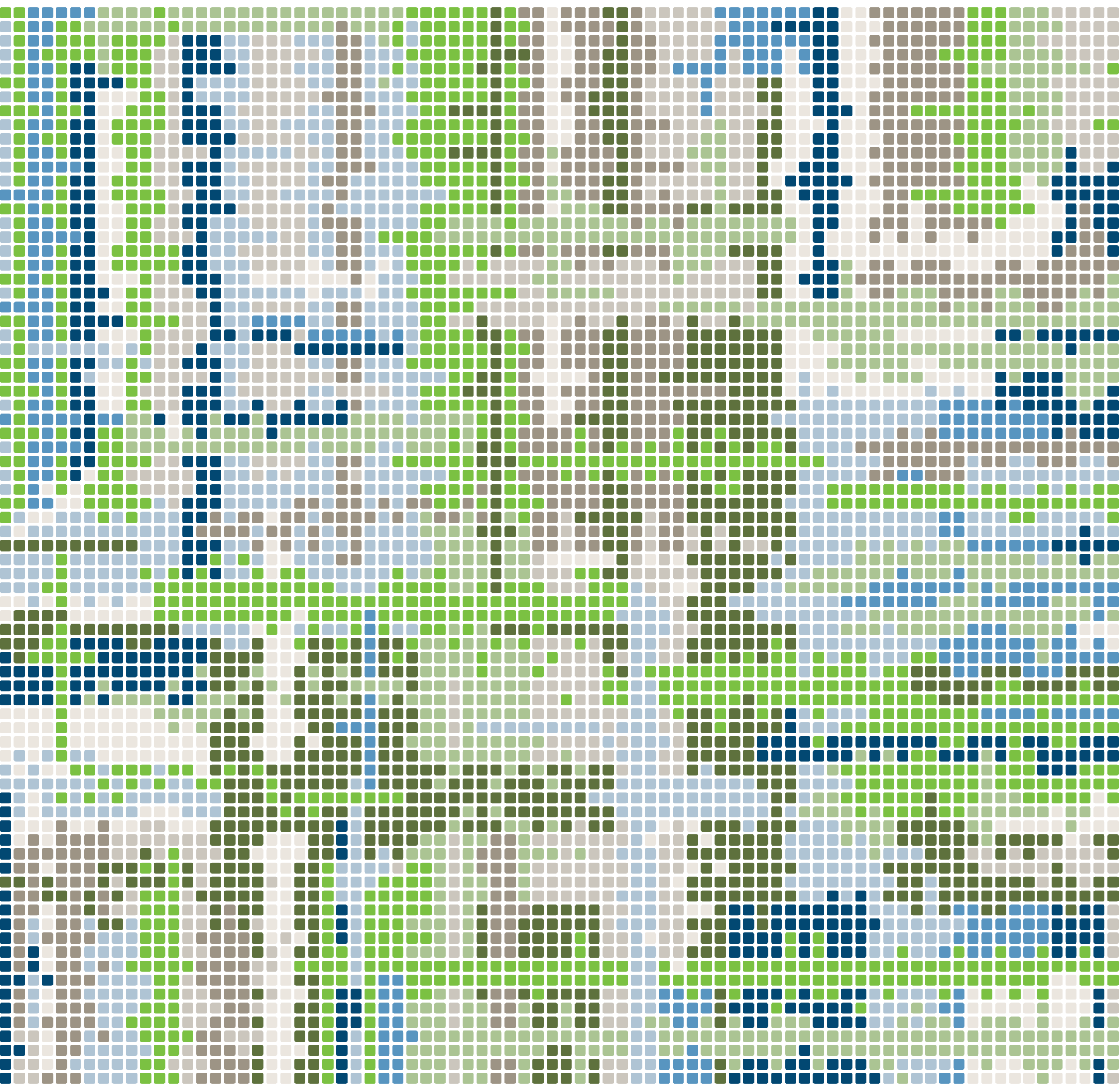


AP3 Third Swedish National Pension Fund

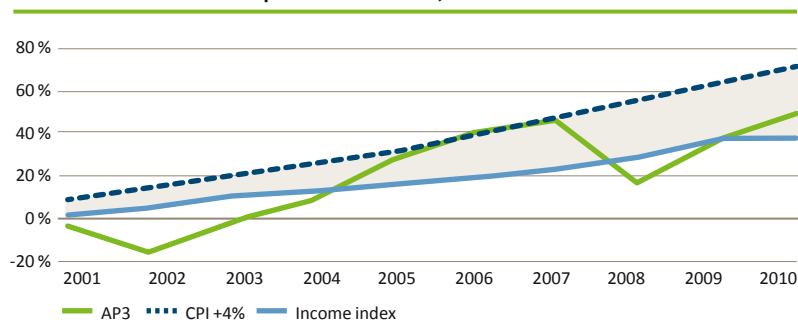


Annual Report 2010

AP3 since inception in 2001

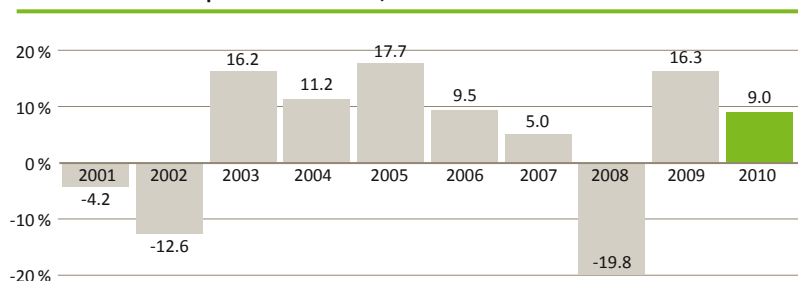
AP3 has a long-term mission. The Fund aims to provide an adequate buffer to guarantee the value of pensions today and tomorrow.

Cumulative return after expenses 2001–2010, %



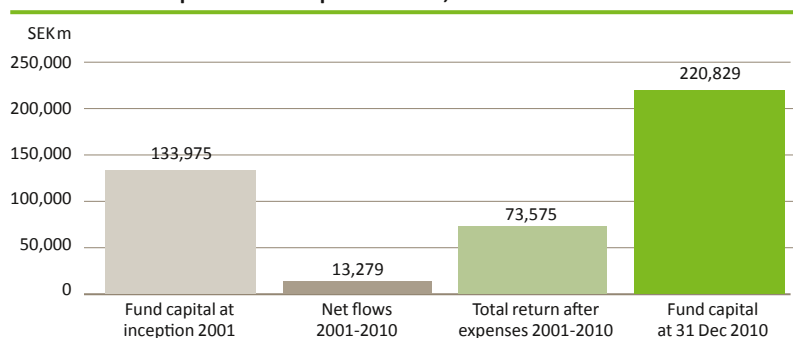
AP3 has recorded a nominal annual return of 4.1% since 2001. Pensions and pension entitlements are indexed to keep pace with income, making it important for AP3's investment returns at least to keep pace with the income index. AP3's returns since inception have exceeded the income index, which has increased by 3.2% per year. AP3's long-term target is a real annual return (adjusted for inflation) of 4%. Since inception, a real return of 2.4% has been achieved.

Total return after expenses 2001–2010, %



World equity markets experienced two major corrections in 2001–2010 and AP3 recorded a nominal annual return of 4.1% in this period.

Growth in fund capital since inception in 2001, SEK million



AP3's fund capital rose from SEK 133,975 million in 2001 to SEK 220,829 million in 2010, an increase of SEK 86,854 million that comprises returns of SEK 73,575 million and net flows of SEK 13,279 million from the pension system. As of 2009 the Fund is a net contributor to the pension system and has paid in a total of SEK 7,947 million.

The year in brief

■ Profit of SEK 18,331 million

AP3 recorded a profit of SEK 18,331 million in 2010. The year was marked by market concern over the health of government finances in Europe and over growth prospects in the United States. Corporate earnings growth and relatively loose global monetary policy fuelled strong gains in equity markets, particularly in Sweden.

■ Total return of 9.1%

The total return was 9.1% before expenses and 9.0% after expenses. Equities were the main growth driver, contributing 7.4 percentage points to total return.

■ Fund capital up by SEK 14,290 million

Fund capital stood at SEK 220,829 million on 31 December 2010, an increase of SEK 14,290 million from the start of the year.

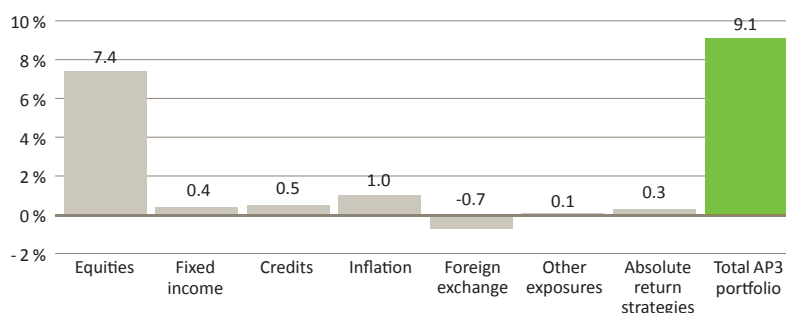
■ Payment of SEK 4,041 million to the pension system

As of 2009, the Fund is a net contributor to the pension system, which means that AP3 helps to finance deficits between pension contributions and pension commitments. The Fund paid a total of SEK 4,041 million to the pension system in 2010.

■ AP3 rated best pension fund in Europe and Sweden

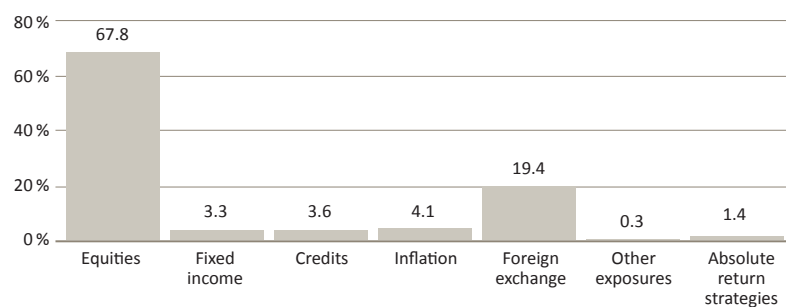
Investments & Pensions Europe (IPE) awarded AP3 its prize for best European state pension fund and number one Swedish pension fund in recognition of a new management model based on dynamic asset allocation and risk categories.

Contribution to total return per asset category in 2010, percentage points



AP3's management model is based on allocating assets across seven different risk categories in which risk is weighed against expected returns on the allocation date. These risk categories made varying contributions to the Fund's total return of 9.1% in 2010. Return on equities was the largest single contributor to total return.

Risk weight per risk category in 2010, %



The AP3 portfolio comprises assets in the risk categories shown above. The largest risk exposures were in equities and foreign exchange, amounting to 67.8% and 19.4% respectively of AP3's total risk in 2010.

AP3 in brief

Mission

AP3 is one of five so-called buffer funds in the national pension system. AP3 has a mandate from the Swedish Parliament to generate maximum possible benefit for the income pension system by managing our fund capital so as to deliver strong investment returns at a low level of risk.

Targets

- Generate a long-term real return (adjusted for inflation) of 4% per annum over time.
- Achieve high cost-effectiveness in our asset management.

Government pension fund

AP3 is a state-owned pension fund with a government-appointed Board of Directors. The fund is more independent than most government agencies because the AP funds are regulated solely by statute and not by government directives. The Ministry of Finance reviews the AP funds on an annual basis.

Investments

AP3 aims to achieve its target of a 4% real return over time by investing in a diversified global portfolio. As of 31 December 2010, the portfolio had a market value of SEK 220,829 million.

More prominent role for AP funds in the pension system

Financial markets were highly volatile in 2010. The first six months of the year saw modest returns in equity markets outside Sweden and long-term bond yields languishing at historic lows – a picture that was completely reversed during the second half. AP3 took an active approach to this turbulent environment, applying a dynamic risk allocation strategy, ensuring high cost-effectiveness in the portfolio, and managing the portfolio to generate positive results in our absolute return mandates.

We achieved a total return of 9%, which when combined with our performance in 2009 and 2010 means we have now more than recouped the losses incurred during the financial crisis of 2008. Fund capital nevertheless remains lower than it was at the start of 2008 due to the fact that we have made net payments of SEK 7.1 billion to the pension system since that date.

During 2010 we continued to see fallout from the financial crisis, with heavily indebted countries encountering growing problems while nations with more robust government finances benefitted from the upturn. The impact of these conditions was mirrored in a revaluation of government bonds, the safest form of national investment, as European states with weak public finances saw their credit ratings fall. Yield spreads inside the eurozone widened substantially, raising government borrowing costs, further undermining public finances and requiring governments to undertake restorative action. Sweden is one of the countries that entered the crisis with strong public finances and was able to reap the benefit in 2010 of high growth, low interest rates and equity market gains.

Sweden has a sustainable pension system

The reforms to the public finances adopted by the Swedish parliament in the early 1990s have proven highly effective in maintaining stability. The key decisions were to grant independence to the Swedish Central Bank, to implement a government spending ceiling, to introduce a public spending surplus target over the course of a business cycle, and to reform the pension system. The pension system reform is a crucial factor in ensuring long-term stability in the government finances. Sweden's pension system is independent of the government budget and subject to an automatic balancing mechanism which ensures that future pension commitments can be met without any need for further political intervention and without impacting the government budget. The credit ratings of many European countries are suffering not only from weakness in public finances but also from unfinanced future pension commitments. Sweden carries no such debt burden.

Sweden operates a pay-as-you-go system in which people currently employed pay contributions that finance the system's

current outgoings. This type of system is effective when the number of people in work significantly exceeds the number of people receiving pensions. Rising welfare provision in the West is, however, leading to greater longevity while birth rates are falling – a combination of circumstances that means pay-as-you-go systems are not sustainable over time unless they are fully financed or subject to another mechanism that adapts pension commitments to increased life expectancy. Most state pension systems lack these prerequisites and are therefore destined to impact on government finances.

The Swedish pension system uses a balancing mechanism that adjusts pension commitments to assets. The system is also partly funded via the AP funds, which provide an important source of capital to meet deficits arising due to size differences across generations. As the baby boom generation starts to retire, pension contributions are now insufficient to meet pension commitments – and it is this deficit that the AP funds are there to meet. In 2010, AP1, AP2, AP3 and AP4 covered a deficit of SEK 16 billion. In the absence of a funded pension system, this money would have had to come from the government budget. The AP funds will have a major role to play in easing the burden on the public purse. The AP funds became net contributors to the pension system in 2009 and will continue to be so for the next 40 years.

Increasingly important buffer role

In the next decade alone, the AP funds will need to cover a pension system deficit of more than SEK 300 billion, according to the Swedish Pension Agency's 2009 forecast¹. It is therefore important that we create the conditions for stable growth in our fund capital because any major interruptions in our growth trajectory will be more difficult to recoup when we are net contributors to the pension system. At AP3, we are working to address the challenge of developing our investment strategy through dynamic asset management and intensive risk monitoring to reduce our vulnerability to investment losses during equity market corrections. At the same time, we must ensure that we do not compromise our ability to earn strong returns over the longer term.

Thus, the AP funds are poised to play an increasingly critical role as a buffer fund for Sweden's pay-as-you-go pension system in the coming years. Forecast payments to the pension system mean that the funds' capital will grow at a much slower rate than investment returns. On the other hand, the funds will eventually play a lesser role in maintaining the long-term financial stability of the system as their share of total pension assets decreases over time. The Swedish Pension Agency's baseline scenario¹ suggests that the AP funds will be at their smallest in relative terms in 2046, with "fund strength" of 1.3 years' payments, compared to fund strength of 3.8 years in 2009.

¹ The Swedish Pension Agency, Orange Report 2009



“AP3 aims to help provide a sufficient buffer fund to guarantee the value of pensions today and tomorrow.”

Future challenges call for new investment rules

AP3 has developed a dynamic asset allocation model that focuses on total portfolio risk to optimise our investment activities in the light of the challenge we face. However, our scope for risk diversification is limited by the relatively detailed investment rules and regulations to which we are subject¹. We have on several occasions pointed out the need for a review of these rules and we welcome the government’s intention to reassess the rules as part of the Pension Group’s² mandate in 2011.

Today’s low interest rate environment makes this issue ever more pressing. The AP funds are required to invest a minimum 30% of their assets in fixed income securities with low credit risk. However, the currently low yields on government bonds limit our ability to deliver the investment growth that the pension system will require. The current investment rules also limit investments in private equity and preclude all investment in commodities. In their quest for higher returns, the AP funds may be forced to abandon their diversification ambitions and instead rely primarily on equity markets – a strategy that would increase volatility and risk in our investment and returns and would hardly serve the best interests of the pension system. Reducing the number of investment restrictions or mandating the funds’ boards to base the investment rule framework on the prudent investor rule, would increase our ability to adjust risk

to prevailing market conditions and thereby deliver optimal returns to the pension system. This would give the AP funds the same scope to identify investment opportunities as most large international pension funds. It would also create scope for greater differentiation among the AP funds. This was one of the aims of the pension system reform, reflecting the Swedish Parliament’s desire to have several buffer funds in order to diversify the risks inherent in pension fund management.

Expertise key to successful management

Our operating environment imposes high standards of competence and responsibility when it comes to managing AP3’s investment assets. Expertise, experience and cooperation between all employees and the Board of Directors are critical to our success. In 2010, we introduced our new strategy that was fully agreed between the Board and management. I would like to take this opportunity to thank everyone for their excellent efforts in 2010.

Kerstin Hessius
CEO

¹ Proposition 2010/11:1

² The Pension Group is the group within the Swedish Parliament that takes care of the pension reform

Market performance and AP3's return in 2010

Major contrasts in macroeconomic developments and economic policy were seen in 2010. A number of emerging markets experienced strong economic growth, in sharp contrast to parts of Europe, where growth was weak or even negative as governments tightened fiscal policy to address rising budget deficits. Inflation rose in many emerging markets, including China and India, but remained very low in the US and Japan.

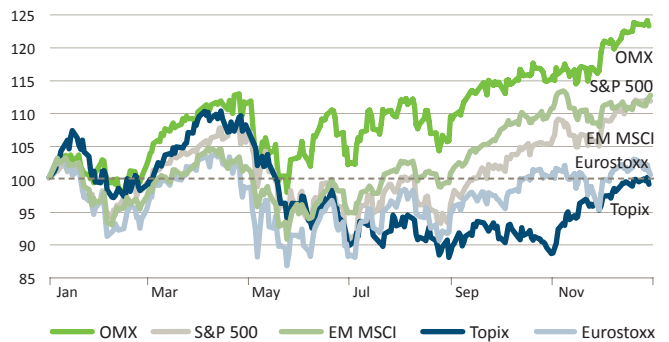
These disparate economic patterns resulted in wide divergences in economic policy. Governments in emerging markets sought to contain rapid growth and inflationary pressure, while the US and Europe pursued a loose monetary policy to stimulate growth in an environment offering limited scope for fiscal expansion.

The major contrasts in the macroeconomic environment and in fiscal and monetary environments resulted in highly variable investment returns on assets between different regions. Equity markets in the US and emerging markets rose by more than 12%, while European and Japanese stock markets remained virtually flat. Sweden, meanwhile, saw share prices rise by more than 20% due to strong economic growth.

Ten year government bonds fell during the first half of the year but began to rise again during the fourth quarter as growth indicators turned more positive. Long-term yields for the year as a whole fell by around half a percentage point in both the US and the euro zone. Two year bonds also displayed contradictory performance. In Sweden, the 10 year bond yield was in practice unchanged over the course of the year, while the 2 year yield rose by 0.12 percentage points.

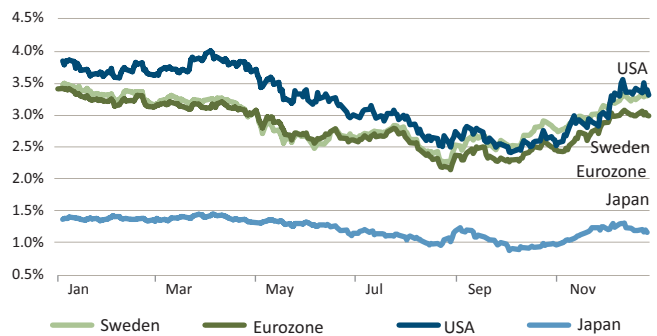
2010 brought major fluctuations in foreign exchange markets, with the euro attracting the most attention amid fiscal difficulties in the PIIGS countries (Portugal, Italy, Ireland, Greece and Spain). The Swedish krona strengthened appreciably against both the euro and the dollar during the year.

Equity returns in local currency 2010



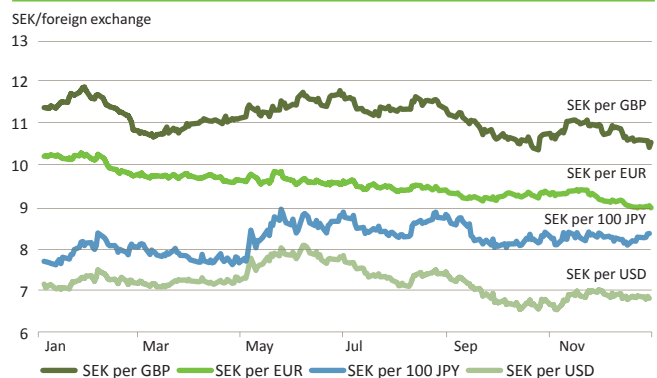
Equity markets were highly volatile during the first half of the year but began to stabilise during the summer and made headway in the last quarter in particular. Equities made full year gains in Sweden, the US and in emerging markets but remained relatively flat in Japan.

Ten year bond yields 2010



Bond market performance in 2010 can be divided into two periods: the first three quarters, during which yields fell, and the fourth quarter, when yields rose in response to a higher appetite for risk among investors. Overall, bond yields fell over the course of the year as a whole, which benefitted the fixed income risk category.

The Swedish krona versus other currencies 2010



The Swedish krona strengthened against the US dollar, the euro and sterling in 2010 but weakened against the yen.

INCOME IN 2010

AP3 recorded a profit of SEK 18,331 million for the year, which translates to a total return of 9.1% before expenses and 9.0% after expenses. Allowing for inflation of 2.3%, the real return was 6.5%. The return in 2010 made a positive contribution to the Fund's long-term target of a 4% real return.

The average annual real return from inception in 2001 to 31 December 2010 stands at 2.4%. The long-term target has yet to be met, though two major equity market corrections have occurred during the period in question. Despite not yet having reached the long-term target, AP3 has made a positive contribution to the pension system as returns since inception have exceeded the income index, which is used as the basis for pension indexation. Since 2001 the income index has risen by 3.2% per year, compared to AP3's nominal annual return of 4.1%.

Return per risk category

Since 2009, AP3 has operated a management strategy focused on risk allocation instead of traditional asset allocation. Portfolio risk comprises seven risk categories. Dividing the portfolio this way enables analysis and forecasts of future returns and risk in the different asset categories and their contributions to the total portfolio. Allocation decisions are based on these forecasts in combination with macroeconomic analysis, valuations and risk appetite.

Return per risk category 2010	Return, %	Contribution to total return, percentage points	Share of total return, %
Equities	13.5	7.4	71.5
Fixed income	1.8	0.4	3.8
Credits	3.8	0.5	5.1
Inflation	7.4	1.0	9.6
Foreign exchange		-0.7	6.4
Other exposure	9.4	0.1	0.8
Absolute return strategies		0.3	2.8
AP3 total	9.1	9.1	100

The table illustrates how returns on the different risk categories contribute to total return. The equities risk category was the strongest contributor, generating 7.4 percentage points of a total return of 9.1%. Returns on foreign exchange and absolute return strategies are not shown because no assets were allocated to these categories.

Risk taking per risk category

Risk in the AP3 portfolio is expressed using the Value at Risk¹ metric (VaR). VaR is defined as a 95% probability that the daily negative change in the value of the portfolio will not exceed the estimated amount. As at 31 December 2010, total risk exposure was SEK 919 million. Portfolio risk fluctuated considerably during the year, from a high of SEK 2,932 million to a low of SEK 686 million. These oscillations were due primarily to sharp swings in market volatility and changes in our equities and foreign exchange risk exposures. Portfolio risk in May-June was almost three times higher than at year end due to market instability that precipitated high volatility linked to brittle public finances in many European countries and weak growth indicators in the US.

Equities are the main risk category in the AP3 portfolio. Foreign exchange and fixed income have a negative covariance with equity risk and thereby help to reduce total portfolio risk. Credit exposures have a positive correlation with equities, while fixed income credit investments exhibit negative covariance. The risk category credits comprises both these elements. AP3 deploys a diversification strategy between asset classes and geographic markets to limit total portfolio risk. Total risk per risk category is 35% higher than total portfolio risk and this is known as the "diversification effect".

Risk-taking per risk category as at 31 Dec 2010	Value at Risk, SEK m	Value at risk, %	Contribution to total risk, percentage points	Share of total risk, %
Equities	983	0.45	101.9	67.8
Fixed income	48	0.02	-0.6	3.3
Credits	52	0.02	-1.1	3.6
Inflation	60	0.03	0.2	4.1
Foreign exchange	282	0.13	-1.2	19.4
Other exposures	5	0.00	0.2	0.3
Absolute return strategies	20	0.01	0.7	1.4
AP3 total	919	0.42	100%	100%

The table shows the breakdown of total portfolio risk into AP3's various risk categories. Due to the correlation between the risk categories, total risk is lower than the total risk for each risk category. This is known as the diversification effect. The share of total risk is measured as each risk category's share of total risk, excluding the diversification effect.

Exposure per risk category

Exposure is defined as underlying capital that is exposed to changes in value arising from market movements. AP3's exposure can be larger or smaller than the fund capital because derivatives are used to manage risk and ensure high efficiency in the asset management. As at 31 December 2010, the Fund had total exposure of 107%. Equities accounted for 56% of total exposure and 68% of total risk. The risk weight of equities exceeds exposure because volatility – day to day changes in value – is higher than for other risk categories.

Exposure per risk category as at 31 Dec 2010	Exposure, SEK m	Share of total exposure, %
Equities	123,068	55.7
Fixed income	32,086	14.5
Credits	40,964	18.6
Inflation	29,591	13.4
Foreign exchange ¹	24,932	11.3
Other exposure	2,473	1.1
Absolute return strategies	8,369	3.8
AP3 total	236,552	107.1

¹ Currency exposure is shown as the percentage of fund capital held in foreign currency and cannot be added to other exposure.

¹ See Glossary

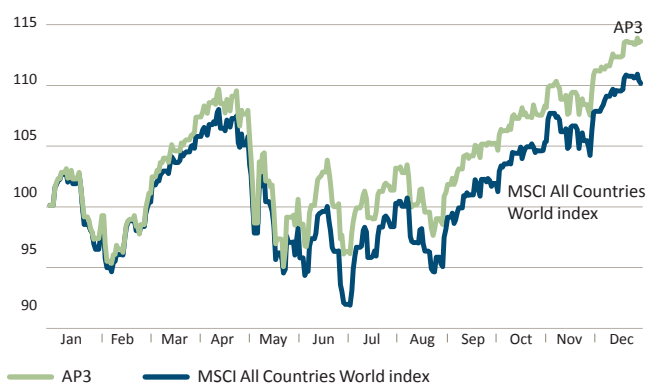
RETURN PER RISK CATEGORY

Risk category Equities

	%	SEK m
Return	13.5	15,146
Contribution to AP3's return	7.4	
Realised volatility, 12 months	14.8	
Exposure as at 31 Dec 2010	55.7	123,068
Exposure as at 31 Dec 2009	58.2	120,205

The equities risk category consists of listed equities and private equity. The equity portfolio delivered a return of 13.5% in 2010 and contributed 7.4 percentage points to AP3's total return. A total of 1.8 percentage points of the equity portfolio's return consisted of currency hedges used by the Fund because the equity portfolio is hedged in Swedish kronor. Equities delivered a strong return for the 12 months, but performance fluctuated substantially during the year and from region to region. Volatility was high on equity markets during the spring and summer due to uncertainty over the strength of the US economy and mounting concern over the state of many European countries' public finances. However, share prices climbed during the autumn and volatility eased. Average volatility for equities was 14.8% in 2010 – the highest across all AP3's risk categories and reflecting the fact that equities accounted for an average 74% of total risk during the year.

AP3's equity returns compared to global share index in 2010



The AP3 equity portfolio outperformed the market weighted MSCI All Countries World Index.

AP3's equity portfolio benefitted from the regional weights selected during the year and outperformed the market weighted MSCI All Countries World Index (MSCI), which gained 10.6% during the year. Overweights in Swedish and small cap equities helped the portfolio to outperform the index. Swedish equities accounted for just over 25% of exposure and yielded a return of 26% during the year. Swedish companies were helped by exposures to developing countries and by the relatively strong state of Sweden's public finances. The overweight in small cap equities was due to a high proportion of private equity holdings (totalling 8% of equity exposure) and a 1% holding of growth companies in the life sciences sector.

The private equity market continued its recovery in 2010, with increased activity in the form of capital injections and new investments. AP3's private equity holdings recorded a return of 14% in local currency terms.

Risk category Fixed Income

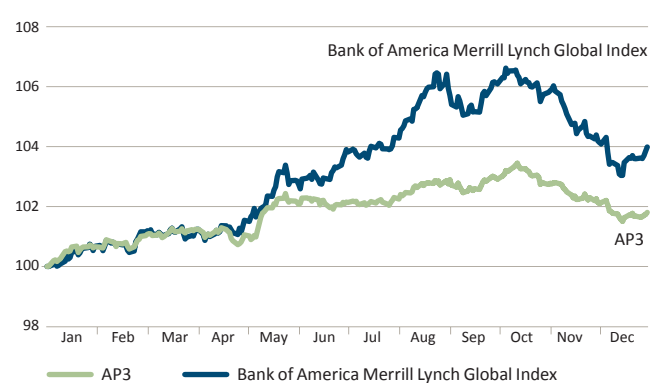
	%	SEK m
Return	1.8	814
Contribution to AP3's return	0.4	
Realised volatility, 12 months	1.5	
Exposure as at 31 Dec 2010	14.5	32,086
Exposure as at 31 Dec 2009	14.2	29,328

The fixed income risk category comprises investments in government bonds, government guaranteed bonds and supranational bonds. In 2010, the portfolio had a duration of 2.5 years and was 75% invested in bonds with the top AAA credit rating. The portfolio was assisted by falling long-term bond yields in the US and Europe in particular.

Fixed income recorded a return of 1.8%, equating to a contribution of 0.4 percentage points to the portfolio's total return.

Just over 50% of exposure was to sovereign debt in Sweden and Germany. AP3 expanded sovereign debt allocations during the year in order to benefit from the higher yields that arose in some markets.

AP3's fixed income returns compared to global bond index in 2010



AP3's fixed income portfolio underperformed the Bank of America Merrill Lynch Global Index.

AP3's portfolio of government bonds can be benchmarked against other portfolios by using a global index such as the Bank of America Merrill Lynch Global Index, which in 2010 recorded a return of 4% with identical currency exposure. Shorter bond duration was unfavourable to the AP3 portfolio.

Risk category Credits

	%	SEK m
Return	3.8	1,094
Contribution to AP3's return	0.5	
Realised volatility, 12 months	2.5	
Exposure as at 31 Dec 2010	18.6	40,964
Exposure as at 31 Dec 2009	13.8	28,502

The credits risk category primarily comprises Swedish mortgage bonds and investment grade¹ corporate bonds in Sweden, the US, Europe and the UK. It also includes secured bank loans. The credit portfolio had a longer duration (around 4 years) than the fixed income portfolio.

Credits generated a return of 3.8%, corresponding to a contribution of 0.5 percentage points to total return.

The credit markets were volatile at the start of the year as the price of credit risk rose amid concern over the state of government finances in a number of countries, led by Greece. The price of credit risk decreased somewhat during the autumn, impacting AP3's returns favourably. During the second half of the year AP3 reduced exposure to corporate bonds in favour of mortgage bonds in anticipation of higher risk adjusted returns.

Risk category Inflation

	%	SEK m
Return	7.4	2,036
Contribution to AP3's return	1.0	
Realised volatility, 12 months	4.0	
Exposure as at 31 Dec 2010	13.4	29,591
Exposure as at 31 Dec 2009	13.4	27,676

The inflation risk category includes investments in index linked bonds in Sweden, the US and Europe and in real estate. Timberland, agricultural holdings and infrastructure investments are also part of this portfolio. AP3 has for a number of years been gradually increasing its weight in real estate, for example by acquiring the property company Hemsö in 2009. The ratio between index linked bonds and other assets offering real returns was roughly 50:50 at year end.

The inflation risk category produced a return of 7.4%, amounting to a contribution of 1.0 percentage points to AP3's total return.

The real estate portfolio generated a return of just over 18%. The market saw a considerable decrease in yields during the year, which led to higher property values.

Risk category Foreign Exchange

	%	SEK m
Contribution to AP3's return	-0.7	-1,364
Exposure as at 31 Dec 2010	11.3	24,935
Exposure as at 31 Dec 2009	8.3	17,143

The foreign exchange risk category groups the Fund's exposure to changes in foreign currencies against the Swedish krona. These exposures relate to investments in foreign assets not hedged in Swedish kronor and in direct currency positions. Currency positions are taken to increase returns or reduce risk in the total portfolio.

Currencies accounted for just over 19% of risk in the total portfolio at year end and were the second largest risk area after equities. Currency risk correlates negatively to some extent with equity risk at the overall level and thus helps to diversify the total portfolio. AP3 used active currency exposure to diversify total portfolio risk during the year and exposure varied from 3% to 15%. A substantial strengthening of the Swedish krona made it preferable to have low currency exposure during the first six months. As the Swedish krona attained a more normal valuation, the Fund elected to increase currency exposure during the second half of the year.

Foreign exchange made a negative contribution of 0.7 percentage points to total return.

Risk category Other Exposure

	%	SEK m
Return	9.4	163
Contribution to AP3's return	0.1	
Realised volatility, 12 months	4.3	
Exposure as at 31 Dec 2010	1.1	2,473
Exposure as at 31 Dec 2009	0.3	620

The other exposure risk category comprises investments that include different risk combinations, such as investments in convertible debentures and insurance related bonds.

The other exposure risk category recorded a return of 9.4% and contributed 0.1 percentage points to the total portfolio. The risk adjusted return was the best of the seven risk categories.

Risk category Absolute Return Strategies

	%	SEK m
Contribution to AP3's return	0.3	563

The absolute return strategies risk category covers mandates that set out to generate an absolute return. AP3 does not allocate assets to this risk category; instead, the Board of Directors allocates a management risk mandate that provides an operating framework. The aim is to make the risk category independent of market movements and to achieve low covariance with total risk over the short term. Absolute return strategies consist of around 30 mandates managed by internal and external managers.

Return in 2010 totalled SEK 563 million, equivalent to a contribution of 0.3 percentage points to the total portfolio. Risk adjusted return on absolute return strategies, expressed as the information ratio, was 1.2.

¹ See Glossary