

Tapiola Pension's investment year 2009

TAPIOLA
Eläke-Tapiola



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Tapiola Pension's investment year 2009

- Tapiola Pension's performance in 2009 was excellent. Return on investment was 13.5 per cent, which was the best annual return to date.
- Investment income exceeded one billion euro and stood at EUR 1,013.0 million.
- Investments in equities yielded a return of 39.4 per cent, and return on fixed-income investments was 8.0 per cent, clearly outperforming the average market index returns.
- Despite the challenging circumstances in the investment markets in the previous year, the return on investment has been positive for the last two years with an annual average of 2.1 per cent. Already in September 2009, the gap caused by the losses for 2008 had been covered.
- In 2009, Tapiola Pension considerably increased company risk in its investment activities. Compared with previous years, in 2009 there was a significant increase in purchases of bonds issued by well-established companies with good credit ratings. Their proportion rose to about one third of fixed-income investments, and the return in 2009 was 17.3 per cent.
- Furthermore, the proportion of investments in equities increased significantly, from less than 15 per cent early in the year to nearly 30 per cent.
- Direct investments in equities performed best with a return of 53.1 per cent over the year.
- Investments in companies through various instruments now account for nearly 50 per cent of all investments. A considerable proportion has been invested in Finnish companies.

Investment markets in 2009

The financial crisis that culminated in autumn 2008 dominated the operating environment in 2009. The financial crisis was a symptom of more wide-ranging changes concerning the growth model for the entire global economy. In the fifteen years preceding the crisis, the debt-reliant operating model had accelerated global economic development, propelling it off a sustainable growth track. In the USA, consumer demand grew steeply and relied on debt. In Europe, strong global demand had enabled countries to maintain industrial production capacity which was no longer competitive.

In 2009, a process of change began that will gradually correct these imbalances in the global economy. The process will probably take many years. In the USA, the role of consumer demand will become less important because of a higher level of household saving, while European countries, especially those dependent on export such as Finland, will face huge changes in industrial structure. In developing economies, growth will rely increasingly on domestic demand.

Industrialised countries – as well as many large developing economies – have tackled the economic crisis with unforeseen financial and monetary stimulus measures. In some industrial countries, government budget deficits clearly exceeded 10 per cent of the GDP. In May 2009, the ECB lowered its key interest rate to the historically low one per cent. The US Federal Reserve (Fed) had cut its key interest rates to the range of 0 to 0.25 per cent already in December 2008. The monetary policies were complemented by various quantitative stimulus measures in order to guarantee liquidity and sufficient demand in the most important securities markets.

Thanks to these measures, a collapse in private demand was prevented and a repeat of the 1930s depression was averted. In the largest economies, the overall production got back on a growth track in the latter half of 2009. As regards investments, the key question in 2009 was whether the measures taken by central banks and governments are enough to restore investors' trust and willingness to take risks.

In the equity markets, rebound in values began in March and continued strong throughout the rest of the year. In well-developed markets, annual return on equities was commonly 25–30 per cent and reached even 50 to 80 per cent in the emerging markets. In credit markets, the disappearance of the historically high risk premiums guaranteed exceptionally high returns on investments in corporate bonds: more than 15 per cent on investment grade bonds and up to 50 per cent and even more on high yield bonds. Despite the slight rise in long-term interest rates, government bonds in the euro zone yielded a relatively good return of more than four per cent.

However, money market investments yielded a very low return of about 1.5 per cent in 2009.

On the foreign exchange market, the euro strengthened in 2009 against the dollar by about three per cent and against the yen by about five per cent but weakened against the pound sterling by nearly 10 per cent.

Results of investment activities in the 2000s

The last decade as a whole was a successful period for Tapiola Pension's investments and a good example of the efficiency of systematic, independent investment activities that rely on thorough analysis. Over the ten years, the average annual return on investment activities was 5.4 per cent and cumulative return was 68.2 per cent. Similar figures are hard to find in this industry.

The past decade showed that return on equities can be very low or even negative for a long time. Both the broad-based European stock index Stoxx 600 and the S&P 500 posted losses in the past decade. The annual return on Finnish equities was only slightly over one per cent.

Contrary to the negative development of markets, the cumulative return on Tapiola Pension's mainly European equity investments was nearly 60 per cent for the decade, or 4.6 per cent a year on average. Compared with the market development, the difference can be considered significant.

Careful analysis and value appraisal of investments is one of the cornerstones that Tapiola Pension's investment activities rely on. When equities are valued high, like in the 2000s, the return on equity investments cannot be expected to be very good. The company's overall allocation during the decade was based on this guideline, and the proportion of equities has not been raised close to the maximum level. At the beginning of 2009, in the light of value indicators, the valuation of equities appeared to be moderate and the expected return was at an attractive level in respect of history. Therefore, the proportion of equities in the allocation of investment assets was doubled in 2009. An outstanding annual return of 40 per cent was achieved already in the first year. In accordance with the general development of the markets, Tapiola Pension's fixed-income investments in the past decade generated an average annual return of about 5.2 per cent, and real estate investments generated an annual return of more than six per cent.

During the decade, government bonds, corporate bonds and, surprisingly, even money market investments yielded better returns than industrialised market equities. Only the equity markets of emerging economies yielded better returns.

Outlook for 2010

Because of the revival of global trade and inventory demand, economic growth may continue surprisingly strong in the early part of 2010. However, the global economy is expected to pick up very slowly, since the burst of the debt bubble will restrict the development of consumption and investment for many years to come. In the euro zone, the latest peak of overall production (in 2008) may not be surpassed for some years. This means that unemployment rates will remain high in the coming years, and private demand will lag behind the economic production potential for quite some time. Potential economic growth in industrialised countries threatens to drop by one percentage point due to the ageing of population and the decrease in investment levels. This translates to growth of 1–1.5 per cent in the euro zone and around 2 per cent in the USA.

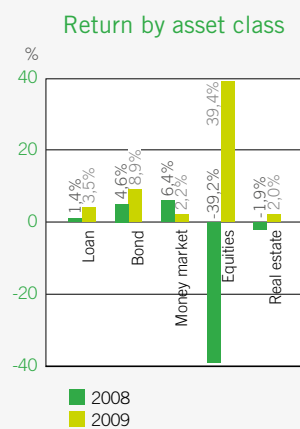
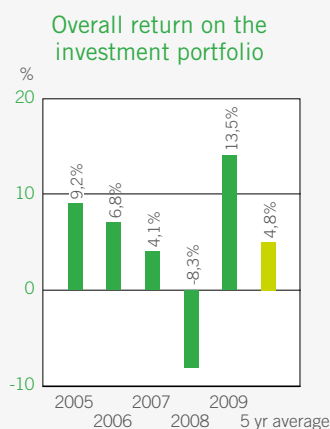
With regard to economic growth, the main risk is that public-sector stimulus is withdrawn and monetary policies are tightened before the recovery of private demand lies on a sustainable basis. Exceptional economic measures will still be required in 2010.

There are practically no signs of demand-based inflationary pressures at present. However, inflation may accelerate because of an increase in energy and raw material prices, as was the case in 2007–2008, or eventually as a result of necessary tax increases. For now, consumer price inflation is not accelerated by a heavy increase in money supply, seeing as

problems in the banking system still prevent cash from being transferred normally to the real economy. In future, inflation will primarily manifest itself as decreased value of money in relation to the prices of securities.

With private demand factors still fragile, central banks are in no hurry to raise interest rates. Money market interest rates are expected to remain low for quite some time, and any gradual rise will be slow. However, bond investments now carry a considerable interest rate risk. It is unclear whether investors are still willing to finance government budget deficits at the current interest rate levels, especially as central banks are gradually withdrawing their quantitative stimulus measures. Judging from the macroeconomic situation, however, there is no great pressure to raise long-term interest rates, and investments in government bonds can serve as a guarantee against unpleasant surprises in the economy.

The relative prospects in the equity market remain favourable. The improving growth outlook in the global economy, policies that support liquidity and very low inflation are factors that usually forecast high income on equity compared with the fixed-income market. In terms of the equity market, however, the uncommonly big gap between growth expectations and actual development involves a significant risk factor. If future growth does not meet expectations, notable adjustments may also be seen in equity market pricing. Unexpected increase in interest rates, resulting from problems relating to government debts, is another risk factor.



Tapiola Pension's investment allocation

Tapiola Pension's investment operations were chosen the best investment organisation in Europe in 2009 in the competition arranged by Investment and Pensions Europe (IPE). The winner was declared on 18 November 2009 in Dublin. This was not the first award for Tapiola Pension's investment operations. Various investment market players voted Tapiola Pension the best treasurer in Finland in the international 2008 Thomson Reuters Extel Survey.

Tapiola Pension stresses perseverance and independence in its investment operations. Investments are chosen so that the company can assess the related risks as accurately as possible. External asset managers manage only about 15 per cent of the investment portfolio. Furthermore, Tapiola Pension continued to strengthen its investment organisation in 2009.

Tapiola Pension's performance in 2009 was excellent. Return on investment was 13.5 per cent. This was the best annual return in history. Direct equity investments yielded the best return, more than 50 per cent over the year.

Investments in bonds issued by companies also yielded a record-high return of 17.3 per cent. Returns on equities and fixed-income investments in Tapiola Pension's portfolios clearly exceeded the benchmark yields.

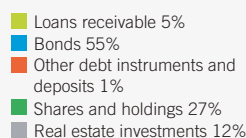
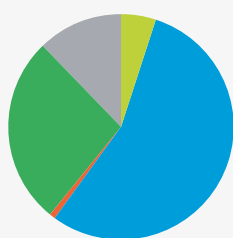
Tapiola Pension considerably increased the proportion of equity investments in 2009. At the end of 2009, they accounted for some 29 per cent of total investments, compared with 15 per cent at the end of 2008. The change in equity allocation was implemented mainly during the spring. Another significant change concerned the fixed-income portfolio. The proportion of corporate bonds was considerably increased, starting already in the latter half of 2008.

Tapiola Pension's return on investment at current value was 13.5 per cent (-8.3%). Investments at current value totalled EUR 8,473.4 million (EUR 7,299.3 million), and net investment income at current value came to EUR 1,013.0 million (EUR -667.1 million). The average return on investment in 2000–2009 was 5.3 per cent.

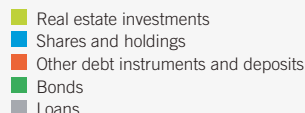
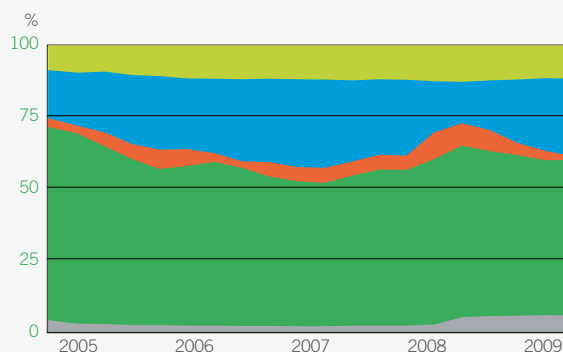
Distribution in accordance with risk 1 Jan 2009 – 1 Dec 2009

	Market value, EUR m	Market value, %	Risk distribution, EUR m	Risk distribution, %	Return, %
Loans receivable	407.6	4.8	407.6	4.8	3.5
Bonds	4,644.0	54.8	4,644.0	54.8	9.0
Other debt instruments and deposits	115.9	1.4	8.6	0.1	2.1
Fixed-income investments	5,167.4	61.0	5,060.2	59.7	8.1
Listed shares	2,132.9	25.2	2,240.2	26.4	45.3
Venture capital funds	115.6	1.4	115.6	1.4	-11.4
Unlisted shares	55.8	0.7	55.8	0.7	4.6
Equity investments	2,304.3	27.2	2,411.6	28.5	39.4
Direct real estate investments	836.5	9.9	836.5	9.9	5.0
Real estate investment funds and collective investments in transferable securities	165.2	2.0	165.2	2.0	-12.2
Real estate investments	1,001.7	11.8	1,001.7	11.8	2.0
Total investments	8,473.4	100.0	8,473.4	100.0	13.5

Investment allocation
31 Dec 2009



Allocation development



Fixed-income investments

In 2009, return on Tapiola Pension's fixed-income investments was 8.0 per cent, while the benchmark index showed a return of 6.9 per cent. The return on fixed-income investments was higher than in previous years because of a significant decrease in credit margins of corporate bonds and a reduction in interest rates. The decrease in key interest rates and other stimulus measures taken by central banks made the interest curve steeper in the first half of the year. At the same time, liquidity in the markets began to improve and credit margins began to contract. The strongest contraction of margins was seen in high-risk corporate bonds and emerging market fixed-income investments.

The increased allocation to bonds issued by corporations, started in the latter part of 2008, proved a significant factor when comparing excess return with the benchmark index. Investments in corporate bond markets doubled compared with 2008. Investments in emerging markets were gradually increased over the year. The proportion of bonds issued by states was reduced in 2009, and the amount of money market investments decreased considerably compared with the beginning of the year. More than half of the bonds were rated AAA.

At the end of 2009, the total market value of Tapiola Pension's fixed-income investments was EUR 4,759.8 million. Corporate bonds made up about one third and government bonds less than half of the investments. The year-end modified duration of the portfolio, which indicates its interest rate risk, was about 4.2 years, slightly lower than the benchmark.

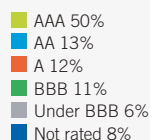
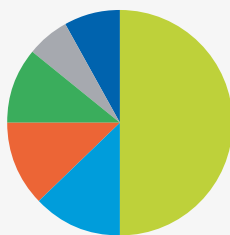
Loans

Demand for premium loans, which increased substantially towards the end of 2008, remained strong in early 2009 and decreased clearly in the latter half of the year. Overall, the decrease in demand for pension insurance company loans was a result of the recovery of bank financing and the price in relation to premium loans.

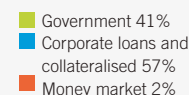
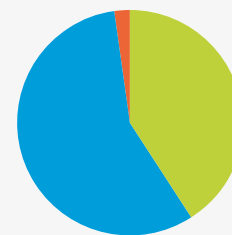
In 2010, no significant changes are expected in the financial position of companies. Working capital financing and reorganisation of financing are expected to be the key themes in the early part of the year. On the other hand, the slightly positive market signals may increase demand for financing for new investments and acquisitions.

At the end of 2009, loans receivable accounted for 4.8 per cent of Tapiola Pension's investments. The loan portfolio increased by some 32 per cent compared with the end of 2008. In 2009, the return on loans was 3.5 per cent.

Fixed-income investments by credit rating



Allocation of fixed-income investments



Shares and holdings

Listed shares

The equity markets were divided in two categories in 2009. The plunge of share prices, a result of the global financial crisis, continued in the first part of 2009 with the prices falling by some 25 per cent. The equity market hit the bottom in March, after which the prices continued to rise vigorously until the end of 2009. The rise in prices was mainly caused by massive support measures by central banks and states. These measures restored trust in the financial markets. After March the economy took an upward turn and, consequently, the news became more positive.

The Nordic equity market rose clearly more strongly than other European equity markets. Emerging markets were also strong. Cyclical industries, such as mechanical engineering, mining, construction and financing, were the strongest sectors. Development was more modest in sectors that have traditionally been considered stable and safe, such as health care and utility companies.

In 2009, Tapiola Pension successfully increased the share of the equity investments in its total investment portfolio. Equity allocation was increased in the first half of the year, even though the outlook for the economy was still very uncertain. Equity allocation was increased throughout the year, even though the majority of purchases were made in the first part of the year. In particular, Tapiola Pension purchased shares of well-established global companies with a good market position, whose share prices had fallen without good reason as a result of the financial crisis. Furthermore, the proportion of emerging markets was increased in 2009.

Thanks to successful choice of companies, industries and countries and good timing, return on Tapiola Pension's listed

shares was 45.3 per cent, while at the same time the wide MSCI World index that depicts the global equity market yielded 27.1 per cent. At the end of 2009, Tapiola Pension's investments in listed shares totalled EUR 2,132.9 million. The equity allocation doubled in 2009.

Finnish shares accounted for about 21 per cent of listed equity investments, which was slightly less than 2008. At the turn of the year, Tapiola Pension was a shareholder in 77 companies; 28 of them were Finnish. Furthermore, it had fund investments in 19 funds. The 25 largest equity investments accounted for 50 per cent of the direct equity portfolio.

10 largest investments, % of direct equity portfolio.

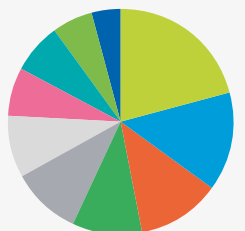
Yara International Asa	2.5%
Kone Corporation B	2.4%
E.On Ag	2.4%
BASF Ag	2.4%
Fortum Corporation	2.3%
Siemens Ag	2.3%
Électricité de France	2.3%
Lassila & Tikanoja plc	2.3%
Bayer AG	2.2%
Heineken Nv	2.0%

Investments in non-listed companies

At the end of 2009, the current values of investments in unlisted companies totalled EUR 55.8 million. The main focus of these investments is on Finland.

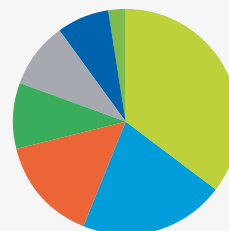
In 2009, acquisition activity decreased clearly. This was reflected in Tapiola Pension's new investments and exits from investments. Because of the market conditions, only a few initial investments and exits were carried out in 2009. Acquisition activity is expected to pick up in 2010.

Equity investments by industry in 2009



Industrial services	21%
Consumer goods	14%
Basic industry	12%
Services to consumers	10%
Health care	10%
Energy	9%
Utilities	7%
Financial services	7%
Technology	6%
Telecommunications	4%

Equity investments by region in 2009



Rest of Europe	35%
Finland	21%
Emerging markets	15%
United States	10%
Sweden	9%
Norway	8%
Japan	2%

The annual return on unlisted direct investments was 4.6 per cent. The general rise in company valuation levels also had a positive effect on annual returns on unlisted investments.

Venture capital investments

Venture capital investments are investments in venture capital funds which invest in unlisted companies. The main focus of these investments is on international funds. The reduction in acquisition activity was also reflected in venture capital investments so that cash flows between Tapiola Pension and funds

were clearly smaller compared with the previous few years. The general rise in company valuation levels is reflected in fund investments with a delay. In 2010, acquisitions are expected to pick up and investments in funds are expected to increase. An increase in activity also requires the recovery of financial markets with regard to financing of acquisitions.

At the end of 2009, the current values of investments in venture capital funds totalled EUR 115.6 million and the annual return was -11.4 per cent.

Real estate investments

Uncertainty dominated the international real estate market in the first part of 2009. When the financial crisis eased, real estate business recovered, but in Europe, for example, the trading volume was 40 per cent lower than the previous year. In Finland, sales of high-quality real estate assets continued throughout the year, but the business volume was only about a third compared with the previous year.

In 2009, the required rate of return on real estate stopped increasing, and the pressure to lower values was partly relieved. Nevertheless, the general economic situation is still uncertain, and if it weakens it may create further pressures on the values of real estate.

In the real estate markets in general, vacancy rates have increased considerably because of the high supply of office premises. The vacancy rates of real estate owned by Tapiola Pension continued to be low.

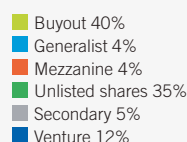
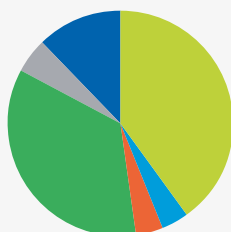
At the end of 2009, the current values of Tapiola Pension's direct real estate investments totalled EUR 836.5 million, and

the rate of return was 5.0 per cent. The main additions to the domestic real estate portfolio included real estate fund investments and direct investments in Espoo, Lappeenranta and Tampere. There were no significant sales.

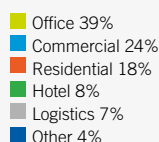
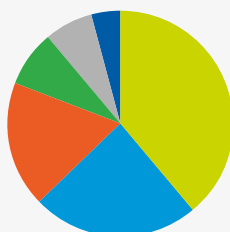
Indirect real estate investments consist of investments in real estate venture capital funds and investments in mutual funds. The values of and returns on these investments developed into different directions in 2009. Value adjustments on real estate venture capital funds were realised in 2009 and formed the majority of value adjustments in Tapiola Pension's real estate portfolio. The listed real estate market developed favourably in 2009. This had a positive effect on the value and return development of mutual fund real estate investments.

At the end of 2009, the current values of Tapiola Pension's indirect real estate investments totalled EUR 165.2 million, and the rate of return was -12.2 per cent. The negative rate of return was due to the development of real estate venture capital funds.

Venture capital investments by type



Real estate investments by type



Real estate investments by region

