# ➔ Quarterly review ABP, fourth quarter 2006

**The investment result in the fourth quarter of 2006 amounted to 3.9% and 9.5% for 2006 as a whole, bringing the ABP capital to €209 billion. Thanks to this result, the financial position (coverage ratio) on the basis of current market interest rates has risen to 133.0%. That is a rise of 3.7 percentage points compared to the previous quarter, and compared to the end of 2005 it means an improvement of 13.3 percentage points.**

## Main points

- Coverage ratio 133%. That means ABP has formally recovered
- Return for 2006 was 9.5%
- New ABP investment strategy important step towards realisation of indexation ambition

**Heerlen, 18 January 2007 – Stichting Pensioenfonds ABP reports that its return on investments for the fourth quarter of 2006 was 3.9%, the annual return thus reaching 9.5%. That means the capital of ABP at the end of 2006 was more than €209 billion. The value of the nominal liabilities dropped by nearly €2 billion in 2006. As a result of the addition of interest and indexation, the liabilities increased in value, but the increased capital market interest rate caused a slightly larger decline of the liabilities. Due to the increased capital and decreased liabilities, the coverage ratio in 2006 rose by 13.3 percentage points to 133% at the end of 2006.**

The return on investments of ABP for 2006 was good. The ABP investment portfolio achieved a return of 9.5% for the whole of 2006. A major positive contribution came from shares (13.5%), Private Equity (+29.8) and particularly real estate (+36%), while the return on commodities was clearly negative (-18.5%)after a number of very good years.

Thanks to these good investment performances, the financial position has improved considerably, helped by the increased capital market interest rate. The coverage ratio is 133%, which means ABP has formally recovered. As a result, ABP meets the solvency requirements set by *De Nederlandsche Bank* (Dutch Central Bank). The requirements ABP itself attaches to the financial position are higher as a result of the ambition to fully compensate the participants for wage inflation in the government and education sectors.

In the fourth quarter of 2006, the ABP Board adopted the three-yearly investment strategy for the 2007-2009 period. The strategy continues to build on the successful policy of the past three years. With the new strategic plan, ABP intends to realise an even better coherence between long-term capital value development and ABP's pension liabilities. The new strategy is expected to slightly increase returns in the long-term, while risks are somewhat reduced. As a result, the risk of underfunding is reduced creating a more favourable prospect towards the indexation of pensions. By doing so, ABP takes an important step in realising its ambition: providing its participants with a fully indexed pension at an attractive price.

Dick Sluimers (Chairman of the ABP Board): "The development of the financial position of 2006 was clearly positive and has exceeded our previous expectations. We hope that for the next three years, the new strategic plan will enable us to continue the favourable trend of the past years, so that we can achieve a financial position which enables us to offer full compensation for wage trends in the government and education sectors."

## Development of the financial position

Across 2006, the coverage ratio rose by 13.3 percentage points. The following factors contributed to the improvement of the position (in percentage points of coverage ratio):

| | ***2006*** |
|---|---|
| increase in capital thanks to return on investments | +9.5 |
| increase in liabilities value thanks to addition of interest and indexation | −6.6 |
| decrease in liabilities value due to an increase in capital market interest rate | +7.9 |
| denominator effect | +2.5 |
| | --------- |
| on balance | +13.3 |

The coverage ratio mainly increased thanks to the return of 9.5% achieved on the capital. Liabilities increased as a result of the addition of interest and indexation (6.6%), but this was largely compensated by the drop in liabilities (7.9%) that was the result of the increased capital market interest rate from 3.70% to 4.25%. The denominator effect (2.5 percentage point) is caused by the capital exceeding the liabilities. It mirrors the achieved return on the financial buffer of ABP to a significant extent.

## Return on investments – fourth quarter of 2006

The ABP investment portfolio achieved a return of 9.5% for the whole of 2006. Of this percentage, 1.5% (150 basic points) can be attributed to an active investment policy. The three-year average return currently stands at 11.2%. An important positive contribution was made by investments in shares (13.5%), while commodities did poorly (-18.5%), especially due to the lower price of oil. The return on fixed-income securities was small (+0.9%) as a result of the increase in yields both in Europe and the United States. Within illiquid assets, Private Equity (+29.8%) and real estate (+35.7%) did extremely well, with listed real estate once more being the highlight (40.9%). In relation to the Euro, the American dollar weakened by more than 10% this year. The strategic hedging of the dollar resulted in a yield of more than €7.1 billion.

### Key figures

| | 2005 | fourth quarter 2006 | until fourth quarter 2006 | change 2006 |
|---|---|---|---|---|
| **Fund position (Nominal coverage ratio, %)** | **119.7** | | **133.0** | **+13.3** |
| **Capital (€ billion)** | **190.6** | | **209.2** | **+18.6** |
| **Liabilities (€ billion)** | **159.2** | | **157.3** | **-1.9** |
| **Return on investment portfolio (%)** | **12.8** | **3.9** | **9.5** | |
| **Fixed-income securities** | **4.3** | **0.2** | **0.9** | |
| **Shares and property** | **20.8** | **7.2** | **17.0** | |
| Shares | 20.8 | 6.9 | 13.5 | |
| Real estate and property funds | 18.2 | 11.0 | 35.7 | |
| Private equity | 27.2 | 8.9 | 29.8 | |
| Commodities | 23.2 | -5.2 | -18.5 | |
| **Hedge Funds (incl. other investments)** | **4.8** | **5.8** | **9.5** | |
| **Composition of investment portfolio (%)** | | | | |
| Fixed-income securities | 43.2 | | 41.8 | -1.4 |
| Shares and property | 53.6 | | 54.4 | 0.8 |
| Hedge Funds (incl. other investments) | 3.2 | | 3.8 | 0.6 |

### Economic prospects

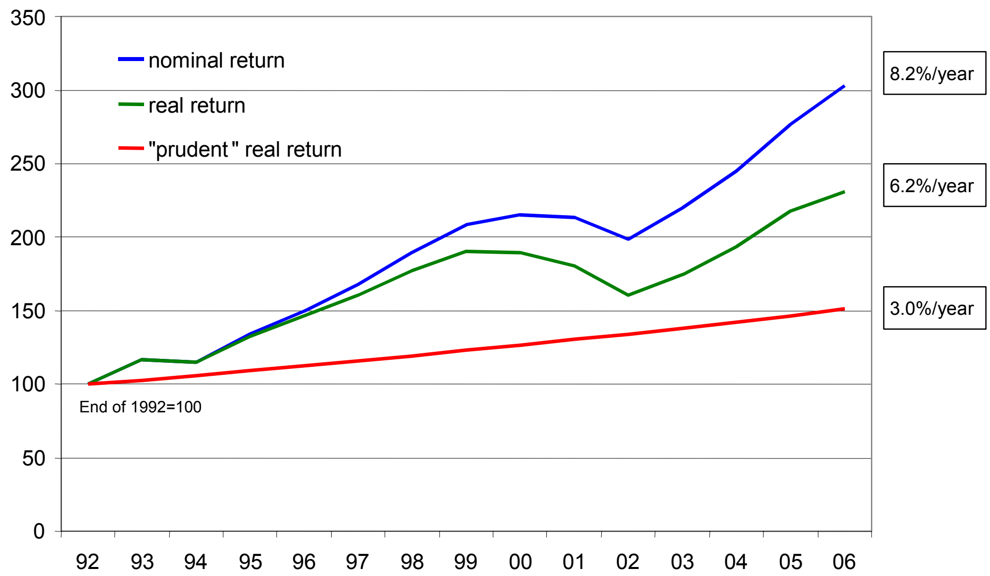
The world economy is still growing favourably under a structurally moderate rate of inflation. Powerful dynamics in the development of the supply of goods and services mean that the potential economic growth is higher, which has decreased the chances of overheating. Nevertheless, a cyclic delay is anticipated for the United States, caused by a cooling down of the house market. Despite this anticipated deceleration in America, it is favourable that the rest of the world will only see its growth levelled off only to a moderate extent. High profits, continued employment growth and a solid trust among consumers and companies support the growth in Europe and Japan. In the emerging markets too, growth is expected to remain solid.

Since the worldwide delay in growth is expected to be small, interest rates for long-term bonds will not change much during the next quarters. That means that capital losses caused by interest movements will remain small and future returns will be close to the current levels. The profit figures for trade and industry were moderate during the past quarters, with shares still being valuated relatively favourably. When economic growth is lower, the profit growth for the next quarters may be lower. On balance, however, shares are expected to slightly outperform fixed-income securities. Corporate bonds are not expected to profit much more than government bonds, influenced by the decreasing profit growth and a rise in debt financing. The spread between corporate bonds and government bonds is expected to rise modestly. Compared to other investments such as shares and bonds, real estate is relatively expensive. The prospects for investments in commodities are moderate following a poor performance in the second half of 2006.

## Long-term return

The diagram below shows the cumulative return from 1993, both in nominal and in real terms. As at 31 December 2006, the value of every €100 invested in 1993 has grown to €303. The average annual return is 8.2%. The return after deduction of the wage inflation (real return) for this period is 3.2 percentage points above the 3% applied when calculating pension contributions.

**Returns 1993 – 2006 Q4**



## Strategic Investment Plan 2007 – 2009

Two important changes in the new investment strategy contribute to the improved coherence between investments and pension liabilities. The first entails a (limited) shift in various parts of the strategic investment portfolio. The second consists of the introduction of an investment framework which facilitates the introduction of investment strategies that are more strongly geared towards the long-term benefits of the pension fund and its participants.

### Changes in the strategic investment portfolio

As part of its investment plan, ABP will focus more on long-term investment strategies. This includes the further expansion of private illiquid investments, which are expected to produce higher and more stable returns in the long-term. The exposure to asset classes like infrastructure, private equity and hedge funds, in particular, will be increased. Infrastructure will be distinguished as a separate strategic asset class. Thanks to its specific characteristics - scale, long-term horizon and skills - ABP is well positioned to invest in private, illiquid assets. By making use of its long investment horizon, an improved balance can be found between a maximal real return and the associated investment risks. As a result, ABP is able to collect additional premiums for illiquidity (lower marketability) that remains out of reach for parties with a shorter horizon.

The percentage of listed shares within the portfolio as a whole will fall slightly. Within the listed share markets Europe and upcoming markets show an increase, whereas interest in US equities has fallen.

The fixed income investment portfolio will be gradually reduced from 44 to 40 per cent of the total portfolio. Moreover, government and corporate bonds will be shifted to long-term, indexed, fixed-interest securities. They tie in well with the liabilities of the pension fund, as they offer compensation for inflation.
The duration of ABP's fixed-income investments will slightly increase, which results in a reduced probability that the coverage ratio will drop below a hundred per cent in any one year.

Part of the strategic plan is the policy of integrating non-financial (ESG=environment, social and governance) criteria in the investment processes. Taking into account environmental, social and governance factors when investment decisions are made will contribute to the return and reduce risk. In 2007, ABP will start this via two internally managed equity portfolios, representing a joint value of €22 billion. The integration of ESG factors is in line with the ABP Statement of Investment Principles.

A new element in ABP's strategy is promoting an internal climate for innovation. This includes new and promising investment opportunities which can make an interesting contribution in terms of return. Hence innovation is given a powerful impulse within Asset Management by introducing an Innovation Committee and by making available a budget of no more than 2% of the total capital invested (approximately €4 billion) for the next three years.

The main changes compared to the 2004-2006 strategy are:

- A reduction in fixed-income securities in favour of real assets

- Within real assets: a shift from listed to private and less liquid investments, particularly to infrastructure, private equity and hedge funds
- Within listed shares, an increase in interest in emerging markets and Europe at the expense of the American market
- Infrastructure as a separate asset class becomes part of the strategic mix
- Within fixed-income securities: a moderate shift towards indexed bonds
- A limited increase in the duration of the fixed income portfolio
- Non financial (ESG) information will play a more important role in the investment process
- 2% of the total capital is reserved for innovative strategies

**Strategic investment portfolio**

| | SIP 07-09 | SIP 04-06 |
|---|---|---|
| *Shares and property* | | |
| Equity developed countries | 27.0% | 30.5% |
| Equity emerging markets | 5.0% | 3.5% |
| Convertible bonds | 2.0% | 2.0% |
| Private Equity | 5.0% | 4.0% |
| Hedge Funds | 5.0% | 3.5% |
| Commodities | 3.0% | 2.5% |
| Real estate | 9.0% | 10.0% |
| Infrastructure | 2.0% | |
| Innovation | 2.0% | |
| *Total of shares and property* | *60.0%* | *56%* |
| | | |
| *Fixed-interest securities* | | |
| Index linked bonds | 7.0% | 4.0% |
| Treasury | 10.0% | 15.0% |
| Corporate bonds | 23.0% | 25.0% |
| *Total of fixed-interest securities* | *40.0%* | *44.0%* |
| | 100.0% | 100.0% |
| | | |
| Duration (fixed-income investments) | 8.0 | 4.8 |
| US Dollar hedge[1] | 100% | 100% |

[1] Not covering the dollar risk would produce a slightly higher expected return, yet at the same time increase the mismatch risk and the risk of underfunding.

**The introduction of an investment framework**
ABP introduces a new investment framework that more closely ties the investment strategies and the long-term interest of ABP's participants. The framework is ideally suited to pension fund investors and will help gear innovation towards the long-term interest of the fund.
The framework makes explicit the two purposes of the investment strategy. The one is hedging of risks to the liabilities. This will be done through a portfolio of strategies *(liability hedging portfolio*) that gets as close as possible to providing a risk-free investment. The other goal is making the best possible use of the risk that may be run in terms of investing *(risk optimising portfolio)* in order to generate the highest possible return. The new framework provides an insight into the trade-off of both functions. The framework will be gradually implemented during the coming years. This will result in an optimisation of both portfolios through more favourable return prospects and/or reduced risks.

For further information on the investment strategy: see the brochure 2007-2009 Strategic Investment Plan, www.abp.nl

**Profile**
Stichting Pensioenfonds ABP (ABP) is the general pension fund for public employees in the Netherlands. ABP has 2.5 million clients and managed assets of €207 billion (as at 31 December 2006). This makes ABP one of the three biggest pension funds in the world.

**Disclaimer**
This announcement contains future expectations. They are based on current assumptions and insights. ABP is not obliged to publicly update these as a result of future insights or events. Furthermore, ABP points out that the expressed expectations are subject to insecurities perforce, as a result of which ultimate returns can substantively deviate, for instance due to unforeseen circumstances in markets relevant to ABP, exchange rates, the interest rate level and developments in legislation. The figures in this document are partly based on estimates and have not been verified by the accountant and external actuary.

**For more information:**
Stichting Pensioenfonds ABP
Corporate Communication
Tel: +31 (0)45 579 81 00
Fax: +31 (0)45 579 21 94
E-mail: corporate.communicatie@abp.nl

You can also find this quarterly review on our website:
www.abp.nl, press the flag-button in the upper right corner of the portal, followed by Press Service

or go immediately to

http://www.abp.nl/abp/abp/press/