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Norwegian Government Pension Fund - Global Annual Performance Evaluation Report 2006

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Norwegian Ministry of Finance

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MERCER
Investment Consulting

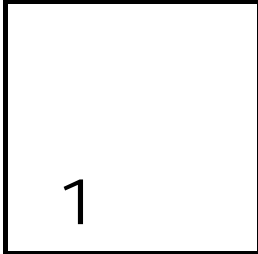
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- B. Mercer's Role and Control Function
- C. Style Research Portfolio Analysis Definitions



The Role of Mercer Investment Consulting and Mellon Analytical Solutions

1.1 Background

- This report was commissioned by the Norwegian Ministry of Finance (“the Ministry”) and has been prepared by Mercer Investment Consulting (“Mercer”) in accordance with the terms of the contract awarded by the Ministry in relation to Norwegian Government Petroleum Fund (“the Petroleum Fund”). At the beginning of 2006, the Petroleum Fund was renamed the Norwegian Government Pension Fund – Global (“the Pension Fund”). Prior to 1 December 2004, the Pension Fund consisted of the “Ordinary Portfolio” and the “Environmental Fund”. On 1 December 2004, when new ethical guidelines were adopted for the Pension Fund as a whole, the Environmental Fund’s investments were transferred to the Pension Fund. The terms of reference for this work are set out in the Invitation to Tender issued by the Ministry to Mercer on 13 May 2002.

1.2 Role of Mercer

- The purpose as set out in the Public Procurement document is for Mercer to verify Norges Bank’s internal performance measurements and to strengthen the Ministry’s basis for evaluating the competence and actions of Norges Bank. Mercer outsources the role of performance verification to Mellon Analytical Solutions, an independent performance measurer appointed by Mercer.

1.3 Role of Mellon Analytical Solutions

- The function of calculating and verifying Norges Bank’s internal performance measurement is carried out by Mellon Analytical Solutions under the guidance of Mercer who retains overall responsibility for the process. Mellon Analytical Solutions calculates performance for the Pension Fund based on portfolio data and market values supplied by the custodians, JP Morgan Chase and Citigroup.

- Mellon Analytical Solutions employs the “time weighted” rate of return as the base performance statistic. This return measure is consistent with the one employed by Norges Bank and takes into account investment income, as well as realised and unrealised capital profits or losses. The use of this statistic minimises distortions due to cash flows into and out of a portfolio which are, in general, outside the control of the investment manager. Further details about Mellon Analytical Solutions’ calculation methodology are contained within Appendix A.

2

Summary of Control Function

2.1 Scope of Control Function

- Mercer has, in conjunction with Mellon Analytical Solutions, performed control and verification functions throughout 2006, in accordance with the terms of the contract awarded by the Ministry.
- The objective of this process has been to check Norges Bank's internal performance measurements and to perform wider verification checks, both at portfolio and benchmark levels according to instructions received from the Ministry.

2.2 Controls conducted in 2006

- During the course of 2006 Mercer has, in conjunction with Mellon Analytical Solutions, measured and verified the monthly returns of the Pension Fund, along with both the respective benchmark returns in accordance with the currency basket measure and Norwegian Kroner terms.
- Throughout the report, performance for 2006 in respect of the Equity and Fixed Income segments of the Pension Fund and longer term performance (with the exception of the currency basket return and benchmark calculations prior to 31 December 2003) has been sourced from Mellon Analytical Solutions.
- The monthly performance of the Pension Fund at the Total, Equity and Fixed Income level has been reported to the Ministry by means of a report issued directly by Mellon Analytical Solutions.
- In the event of discrepancies in performance calculation between Norges Bank's internal performance measurement and Mellon Analytical Solutions' calculations, when measured to two decimal places (e.g. 0.01% difference), further checks are made, the results of which are reported to the Ministry by means of a letter accompanying the monthly report. Additionally, Norges Bank provides a summary explanation of the

differences in market values and performance reporting between Norges Bank and Mellon Analytical Solutions on a monthly basis.

- A comprehensive summary of the data processing and reporting process that Mellon Analytical Solutions carries out as a result of its role in the Control Function is contained within Appendix B.

3

Pension Fund Details

3.1 Performance objective

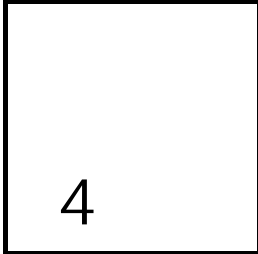
- The Ministry has delegated the operational management of the Pension Fund to Norges Bank who manage the Pension Fund in accordance with a mandate stipulated by the Ministry in public regulations. The performance objective is to maximise returns given the restrictions imposed by the regulations and the desired risk profile. The risk tolerance for the Pension Fund is determined to be an ex-ante tracking error of 1.5% p.a.
- The Ministry specifies the benchmark portfolio, comprised of equity and fixed income instruments reflective of the Pension Fund's investment strategy.

3.2 Pension Fund Benchmark

- The current strategic benchmark consists of 60% fixed income and 40% equities.
- A new fixed income benchmark was introduced in 2002, which is constructed from the Lehman Global Aggregate family of indices.
- The equity benchmark uses FTSE All-World indices and market capitalisation weights. In 2006, the strategic weights within the customised equity benchmark was changed from Europe 50% and Americas/Asia/Oceania/Africa 50% to 15% Asia and Oceania, 50% Europe and 35% Americas and Africa. In 2006, the strategic weights within the customised fixed income benchmark were changed from 55% Europe, 35% Americas and 10% Asia/Oceania to 5% Asia and Oceania, 60% Europe and 35% Americas and Africa. These changes were gradually phased in during 2006 and completed in the third quarter of 2006.
- The reader should note that extraordinary transaction costs are incurred when new transfers are made into the Pension Fund. Such costs are not deducted when the index supplier calculates the return on the benchmark.

For the purpose of this report the benchmark return has not been adjusted for such costs, despite the presence of such extraordinary transaction costs detracting from the Pension Fund's returns. In addition to the transaction costs outlined above, the Pension Fund pays tax on share dividends in a number of countries. As from 2004 the equity benchmark is adjusted for tax on share dividends.

- Further detailed information on benchmarks is contained within Appendix B.



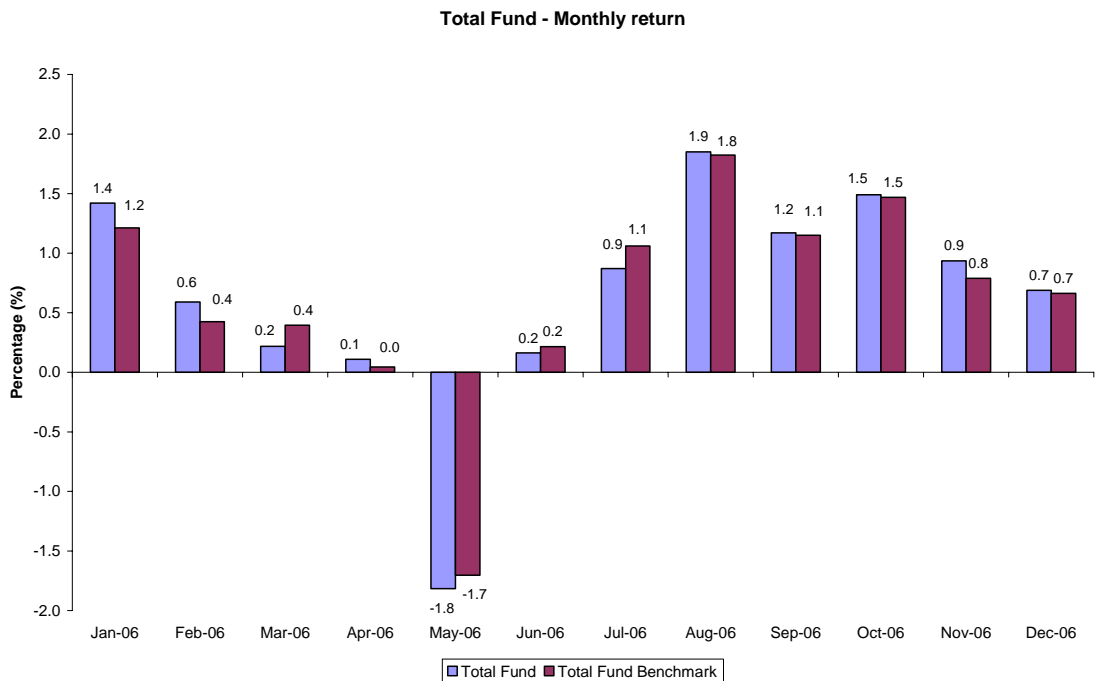
Fund Performance

This section of the report analyses the Pension Fund's monthly performance and corresponding benchmark performance over the twelve month period to 31 December 2006, along with longer term analysis. Numerical performance shown in the charts is given to one decimal place. Performance commentary considers performance to two decimal places.

For the purpose of this report all Fund and benchmark returns contained within sections 4.1 and 4.3 of this report are expressed in terms of the basket of currencies contained within the benchmark. The currency basket measure is relevant when assessing the Pension Fund's performance against the stated objective of maximising the Pension Fund's international purchasing power. Section 4.2 shows performance expressed in Norwegian Kroner.

Sections 4.1 and 4.2 consider the Pension Fund's performance along with the monthly performance for the Equity and Fixed Income segments of the Pension Fund over the twelve month period to 31 December 2006. Section 4.3 considers longer term performance for the Pension Fund.

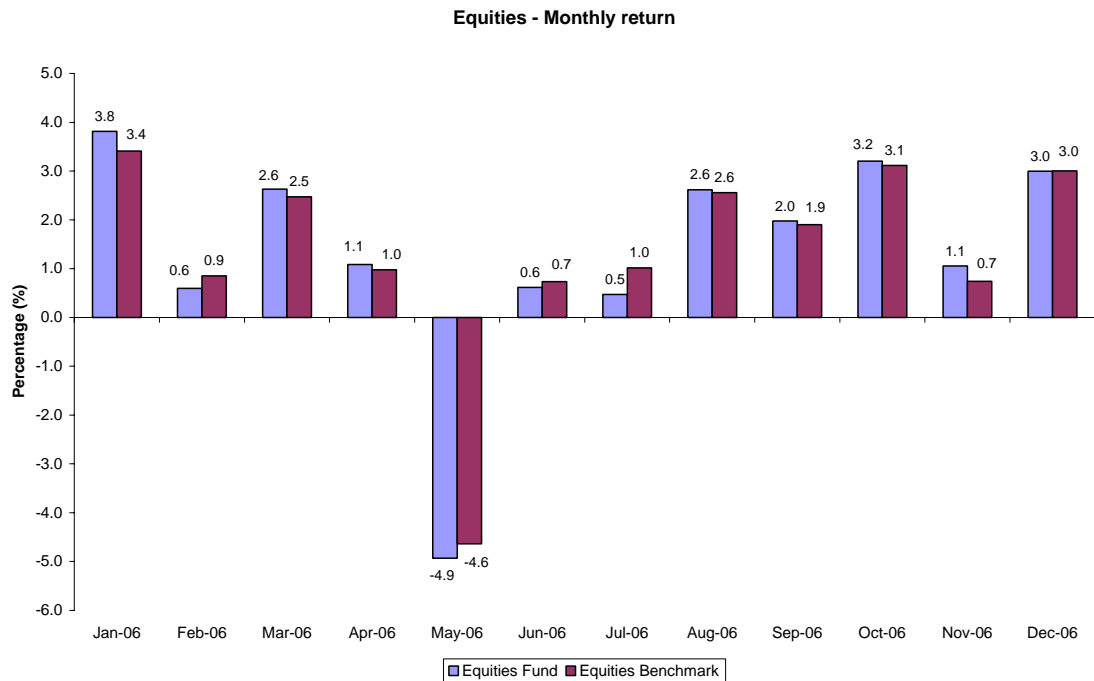
4.1 Pension Fund Returns (Currency Basket)



Data source: Returns calculated by Mellon Analytical Solutions Ltd. (c)
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- Over the twelve month period to 31 December 2006, the Pension Fund produced a cumulative return of 7.91%, ahead of the benchmark return of 7.76% by 0.15%. Norges Bank calculated the twelve month Pension Fund return to be 7.92%. The 0.01% difference is due to Norges Bank adding estimated revenue from equity lending at NOK 62 million and actual revenue from bond lending being added to the end of December value. Please refer to Section 6 of this report for a more detailed explanation.
- Total Fund performance exceeded the benchmark in each month of 2006 with the exception of March, May, June and July where performance was marginally behind the benchmark. Outperformance was greatest in January and February, where performance exceeded the benchmark returns by 0.21% and 0.17% respectively. Outperformance achieved during February was however offset by underperformance of 0.18% achieved in March. Please refer to Section 6 of this report for an explanation of the return deviations experienced during February and March.

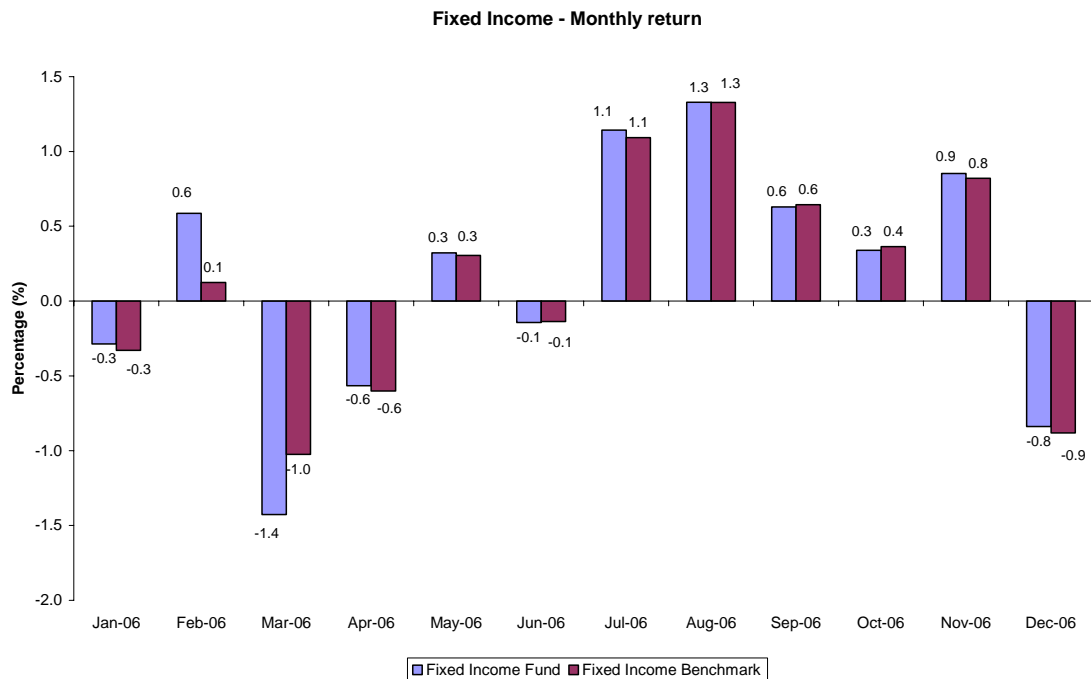
4.1.1 Pension Fund - Equity Returns (Currency Basket)



Data source: Returns calculated by Mellon Analytical Solutions Ltd. (c)
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- Over the twelve month period to 31 December 2006, the Equity segment of the Pension Fund produced a cumulative return of 17.03%, below the benchmark return of 17.10% by 0.07%.
- On a month-by-month basis, the performance of the Pension Fund's Equity segment exceeded the benchmark in each month, with the exception of February, May, June, July and December, where performance was marginally behind benchmark. Outperformance was greatest during January and November, where performance exceeded the benchmark by 0.40% and 0.31% respectively. Underperformance was greatest during May and July, with performance below benchmark by 0.30% and 0.54% respectively. The underperformance of 0.54% is large in view of historical returns.

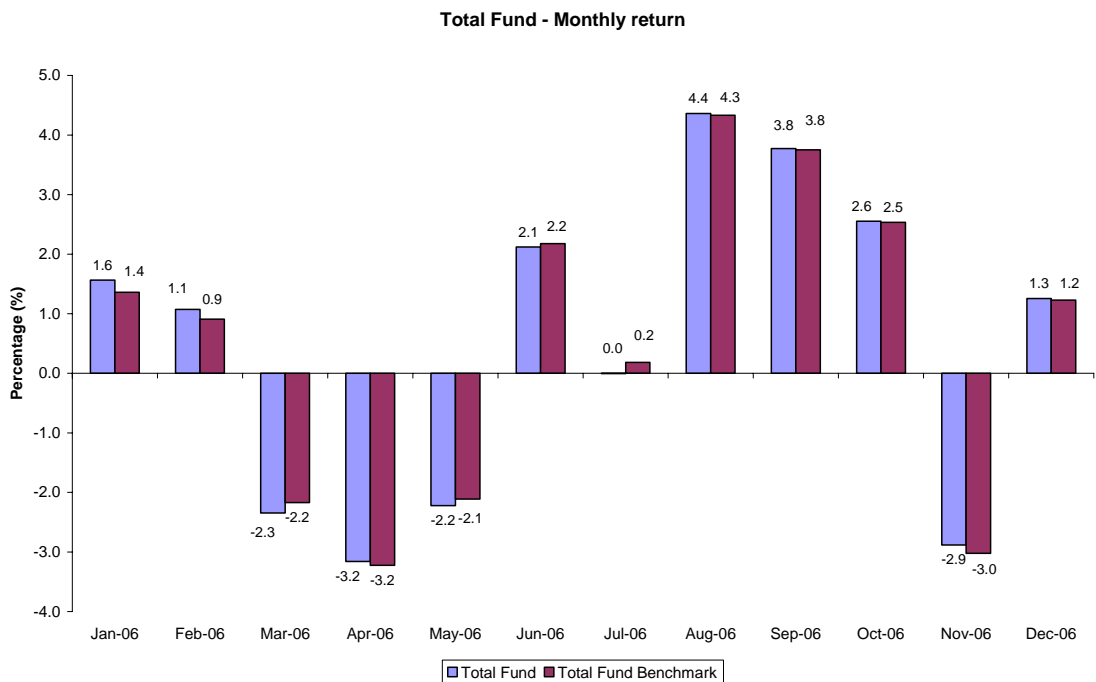
4.1.2 Pension Fund - Fixed Income Returns (Currency Basket)



Data source: Returns Calculated by Mellon Analytical Solutions Ltd. (c)
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- Over the twelve month period to 31 December 2006, the Fixed Income segment of the Pension Fund returned 1.91%, ahead of the benchmark return of 1.69% by 0.22%.
- On a month-by-month basis, the Pension Fund's Fixed Income segment exceeded the benchmark in each month, with the exception of March, June, September and October, where performance was marginally behind benchmark. Outperformance was greatest during February where performance exceeded the benchmark by 0.46%, although this was largely offset the following month in which the Fund's underperformance was greatest at 0.40% below the benchmark. Deviations of this magnitude are unusual for the Fixed Income segment. The deviations observed in February and March is as a result of a difference in transfer values reported by Norges Bank and Mellon Analytical Solutions. Please refer to Section 6 of this report for a more detailed explanation.

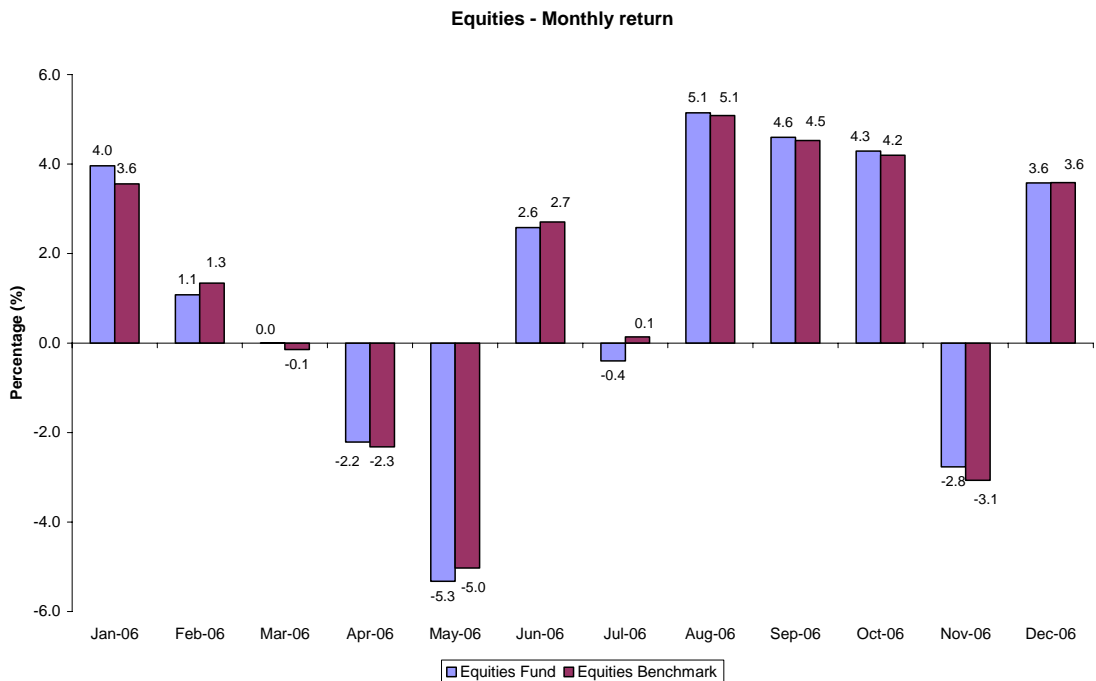
4.2 Pension Fund Returns (Norwegian Kroner)



Data source: Returns Calculated by Mellon Analytical Solutions Ltd. (c)
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- Over the twelve month period to 31 December 2006, the Pension Fund produced a cumulative return of 5.88%, outperforming the benchmark return of 5.73% by 0.15%.
- Total Fund performance exceeded the benchmark in each month with the exception of March, May, June and July where performance was marginally below benchmark. Outperformance was greatest in January and February, where performance exceeded the benchmark returns by 0.21% and 0.17% respectively. Outperformance achieved during February was however offset by underperformance of 0.17% achieved in March. Please refer to Section 6 of this report for an explanation of the return deviations experienced during February and March.

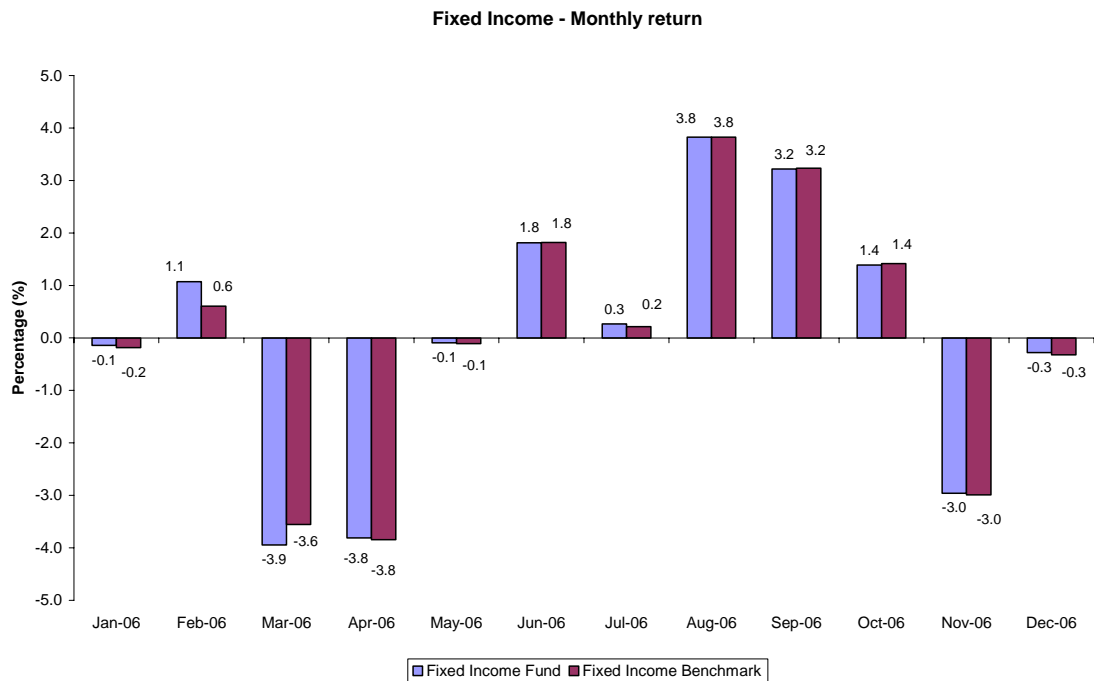
4.2.1 Pension Fund - Equity Returns (Norwegian Kroner)



Data source: Returns Calculated by Mellon Analytical Solutions Ltd. (c)
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- Over the twelve month period to 31 December 2006, the Equity segment of the Pension Fund returned 14.82%, underperforming the benchmark return of 14.89% by 0.07%.
- On a month-by-month basis, the performance of the Pension Fund's Equity segment exceeded the benchmark in each month, with the exception of February, May, June, July and December, where performance was marginally behind benchmark. Outperformance was greatest during the months of January and November, where performance exceeded the benchmark return of 3.56% and -3.07% by 0.41% and 0.30% respectively. Underperformance was greatest during the months of May and July, where performance was below the benchmark of -5.03% and 0.14% by 0.29% and 0.54% respectively.

4.2.2 Pension Fund - Fixed Income Returns (Norwegian Kroner)



Data source: Returns Calculated by Mellon Analytical Solutions Ltd. (c)
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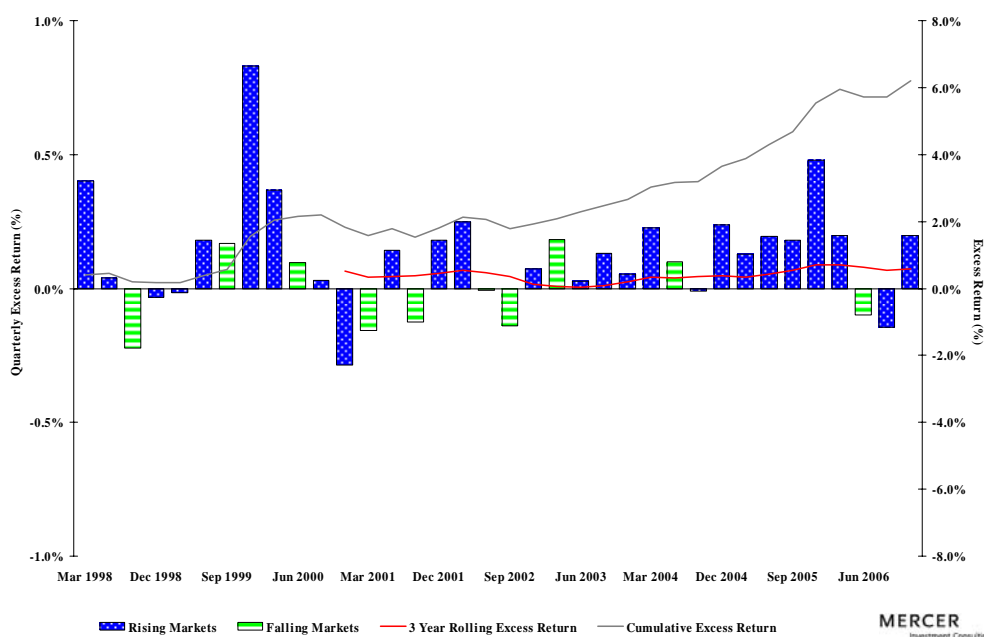
- Over the twelve month period to 31 December 2006, the Fixed Income segment of the Pension Fund returned -0.01%, outperforming the benchmark return of -0.23% by 0.22%.
- On a month-by-month basis, the Pension Fund's Fixed Income segment exceeded the benchmark in each month with the exception of March, June September and October, where performance was marginally behind benchmark. Outperformance was greatest during February, where performance exceeded benchmark by 0.46%. This was largely offset the following month during which the fund's underperformance was greatest at 0.39% below the benchmark. Please refer to Section 6 of this report for an explanation of the return deviations experienced during February and March.

4.3 Pension Fund (Currency Basket) Longer term performance

The following charts show quarterly performance relative to benchmark for the nine-year period ending 31 December 2006 for the Pension Fund and the Fixed Income segment, and the eight and three-quarter year period ending 31 December 2006 for the Equity segment. In addition, the charts illustrate the three-year rolling and cumulative excess returns over the period ending 31 December 2006. As the charts evaluate relative performance, they can be used as a measure to assess the manager's ability to add value in excess of benchmark over a period of time.

- The charts are generated using Mercer Manager Performance Analytics (MPA) and use local returns from the currency basket measure. This is done to ensure that the rising/falling market indicator is not influenced by changes in the value of Norwegian Kroner.
- Performance since 1 January 2004 has been sourced from Mellon Analytical Solutions. Prior performance has been sourced from Norges Bank.

4.3.1 Pension Fund – Total Returns (Currency Basket)

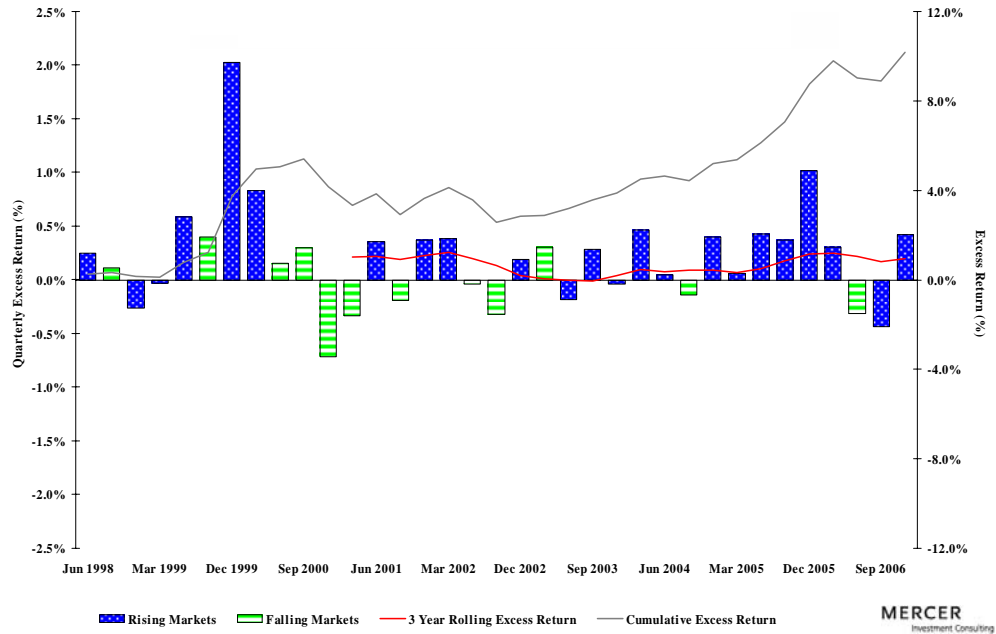


Source: Mercer MPA , Norges Bank and (c) Copyright 2007 Mellon Analytical Solutions Europe Ltd.

- The Pension Fund has outperformed its benchmark on a quarterly basis in twenty five of the thirty six quarters under review.
- Long term relative performance remains healthy and continues to improve with cumulative excess return over the nine years ending 31

December 2006 at 6.2%. Rolling three-year excess returns have been consistently positive.

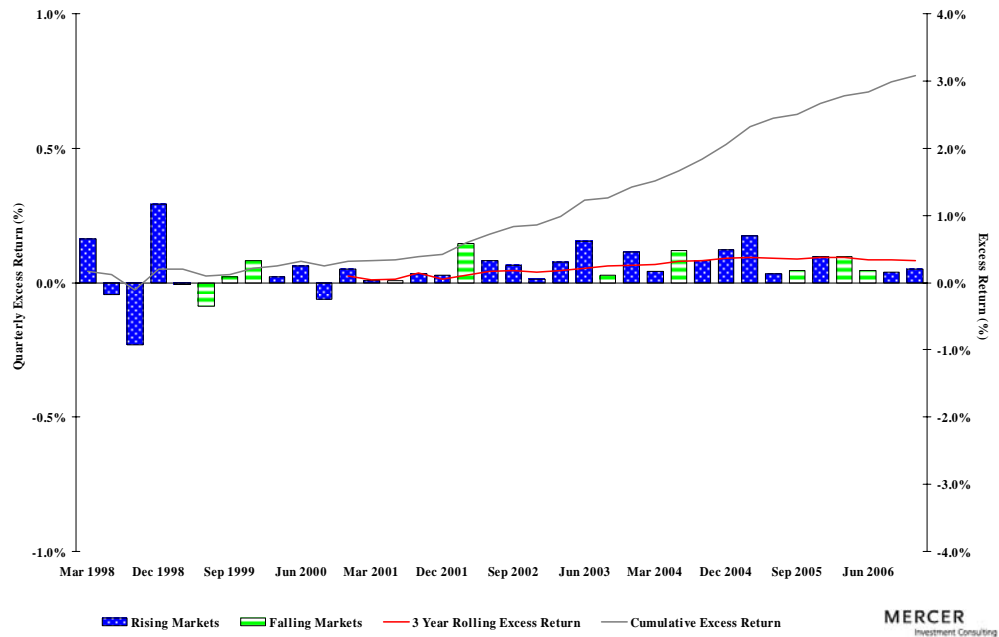
4.3.2 Pension Fund - Equity Returns (Currency Basket)



Source: Mercer MPA, Norges Bank and (c) Copyright 2007 Mellon Analytical Solutions Europe Ltd.

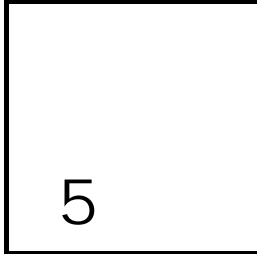
- The Equity segment has outperformed its benchmark in twenty three out of the thirty five quarters, underperforming in the remainder.
- Rolling three-year performance was strong in the periods to 2001 and the first part of 2002. Performance dipped to a low point in mid 2003 but has since been above benchmark and has risen steadily through to 31 December 2006.
- Cumulative excess returns for the period since inception, 1 February 1998, to 31 December 2006 are positive at 10.7%.

4.3.3 Pension Fund - Fixed Income Returns (Currency Basket)



Source: Mercer MPA, Norges Bank and (c) Copyright 2007 Mellon Analytical Solutions Europe Ltd.

- With the exception of the first three years, where performance was mixed, the Fixed Income segment of the Pension Fund has consistently outperformed its benchmark over the nine-year period to 31 December 2006.
- Rolling three-year excess returns have been consistently positive in the nine year period under review.
- Cumulative excess returns over the nine year period to 31 December 2006 are positive at 3.1%. Cumulative performance has risen steadily over the nine year period.



Style Research Portfolio Analysis

5.1 Introduction

- This report takes a closer look at the style characteristics of the Equity Segment of the Pension Fund over the four quarters to 31 December 2006.
- When analysing the Equity segment's style characteristics we have used an analytical software package called Style Research Portfolio Analysis ("SRPA") provided by Style Research Limited. SRPA looks at the individual securities held within a portfolio at any one point in time (a 'snap-shot') and uses a bottom-up approach to analyse the style adopted and risk taken by the investment manager. The snap-shot analysis is based on a detailed, multi-dimensional examination of the Equity segment's composition – not on historical returns.
- The SRPA risk attribution model is different from the risk model used by Norges Bank. Norges Bank use a RiskManager risk model from Riskmetrics to measure expected tracking error.
- The charts shown in Section 5.2 highlight specific style characteristics of the Equity segment as at 31 March 2006, 30 June 2006, 30 September 2006 and 31 December 2006. The set of charts shown in Section 5.2 emphasise the key style features of the Equity segment in terms of any "value" tilts (represented by the first group of blue bars) and "growth" tilts (represented by the second group of green bars). The analysis is conducted relative to the customised benchmark of the Equity segment of the Pension Fund. When interpreting SRPA outputs, tilts (represented as Standard Deviations away from the benchmark mean) greater than ± 1 but less than ± 2 are regarded as statistically significant. Tilts great than ± 2 are regarded as statistically very significant.
- The second set of charts, shown in Section 5.3, plot the breakdown of the portfolio in terms of industry sector weightings and is again compared with the benchmark.

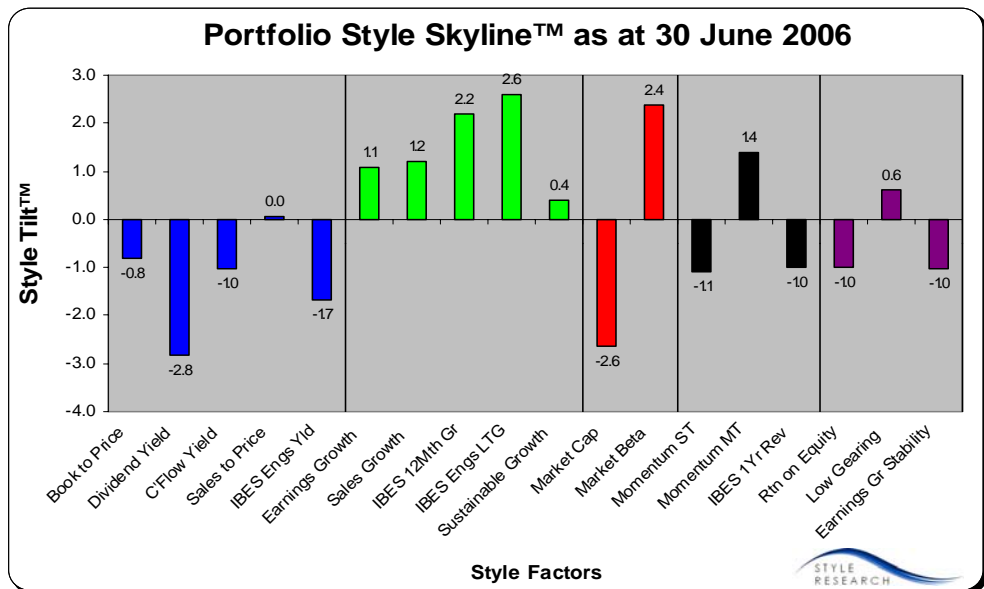
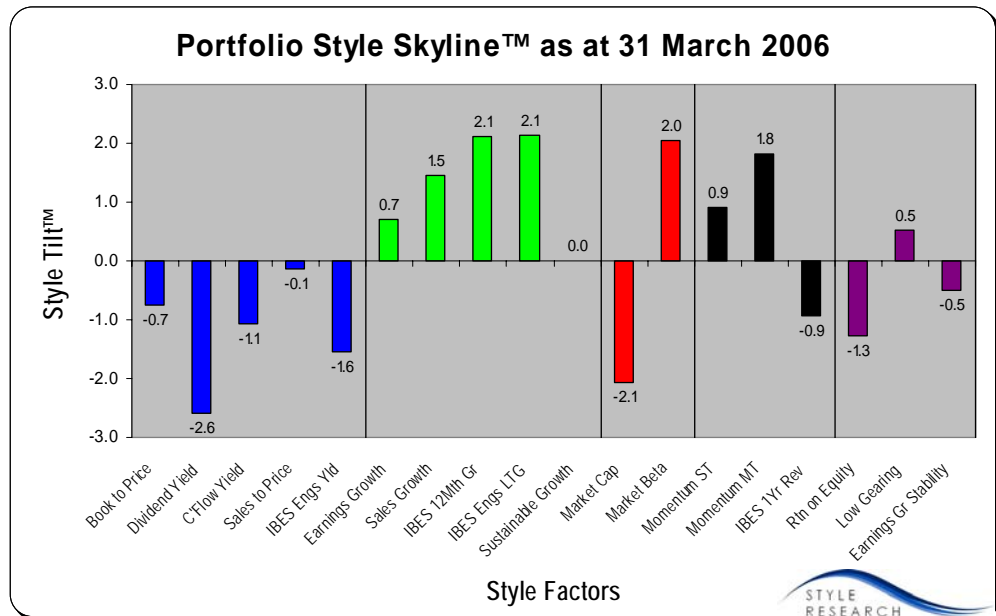
- The term “coverage” referred to in the charts contained within Section 5.3 is a measure of the Equity segment’s exposure to the indices against which it is benchmarked. The output shown in Section 5.3 indicates a coverage level of circa 77% indicating that the Equity segment has an overlap of circa 77% with the constituents of the indices against which the Equity segment is benchmarked. Please refer to Appendix C for a more detailed explanation of the term “coverage”.
- The market capitalisation distribution of the Pension Fund and benchmark is illustrated in the charts shown in Section 5.4. The first chart shows a breakdown to the largest 40%, the next 40% and smallest 20% sized companies, as measured by market capitalisation. The second chart shows a breakdown of the largest 80% and the smallest 20% size companies, as measured by market capitalisation, and broken down between value and growth.
- The final chart shown in Section 5.5 analyses the risk profile of the Equity segment of the Pension Fund as at 31 March 2006, 30 June 2006, 30 September 2006 and 31 December 2006 and breaks it down into its key risk segments. For further explanation of Style Research Portfolio Analysis definitions please refer to the Appendix.

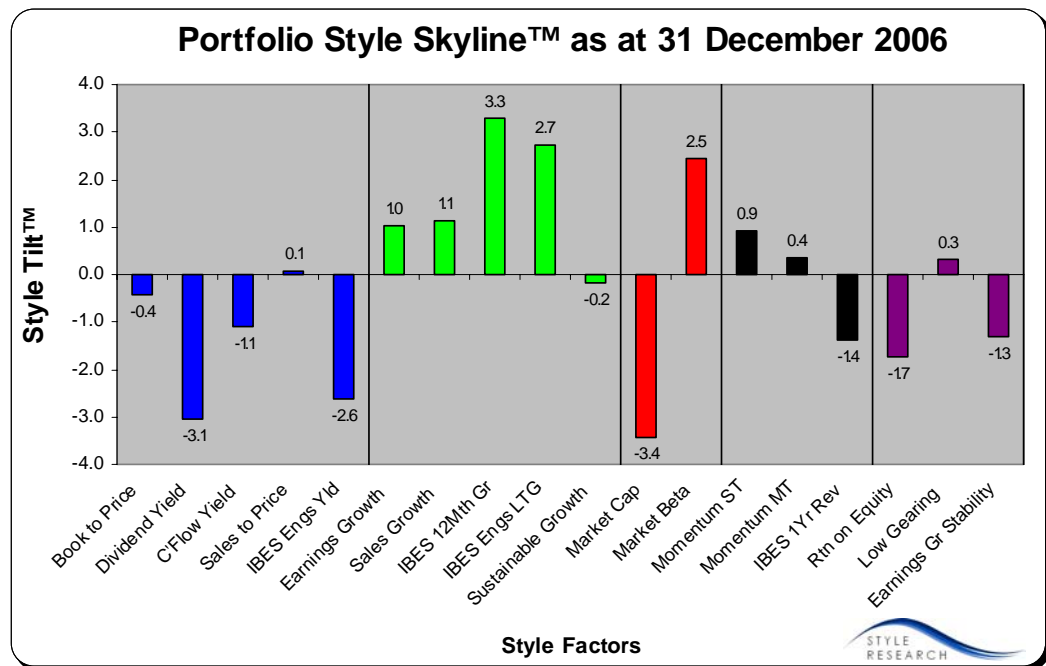
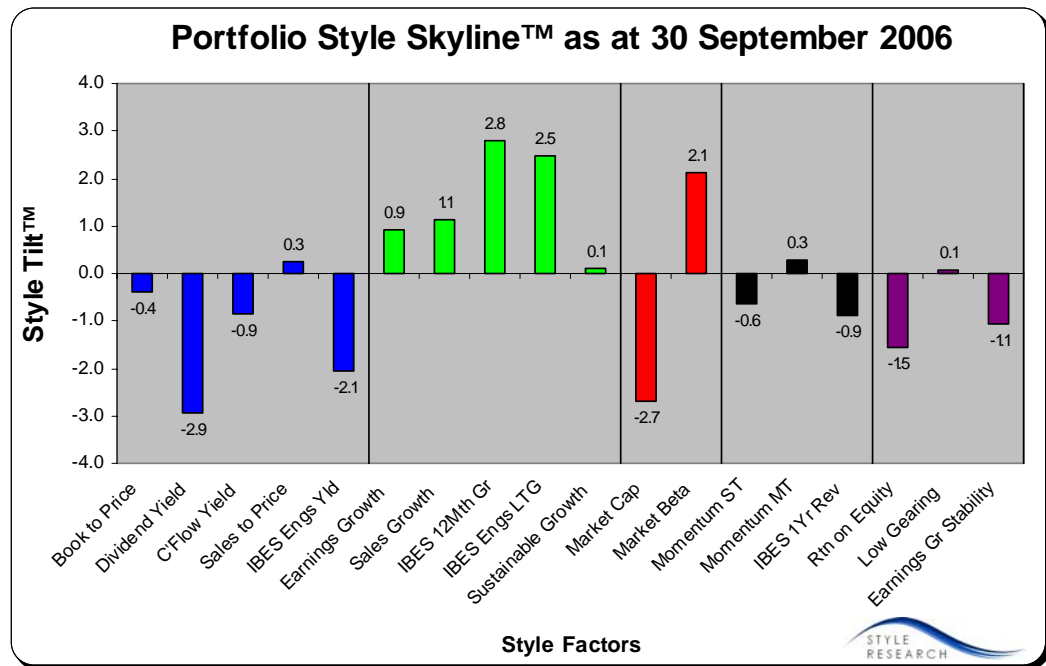
Notes on data source:

- Security holdings have been sourced from © Copyright 2007 Mellon Analytical Solutions Europe Ltd.
- Benchmark data has been sourced from FTSE and adjusted to match the regional weightings as used by Norges Bank.
- Risk Model output has been sourced from SRPA.

5.2 The Portfolio Style Skyline

To give a better impression of the development of the Equity segment's style and risk characteristics, the portfolio style skylines as at the end of each quarter during 2006 are shown below. Please note that each quarter's analysis is based on a historical 'snap-shot' of the stocks held in the Equity segments at an aggregate level as at the end of the quarter.



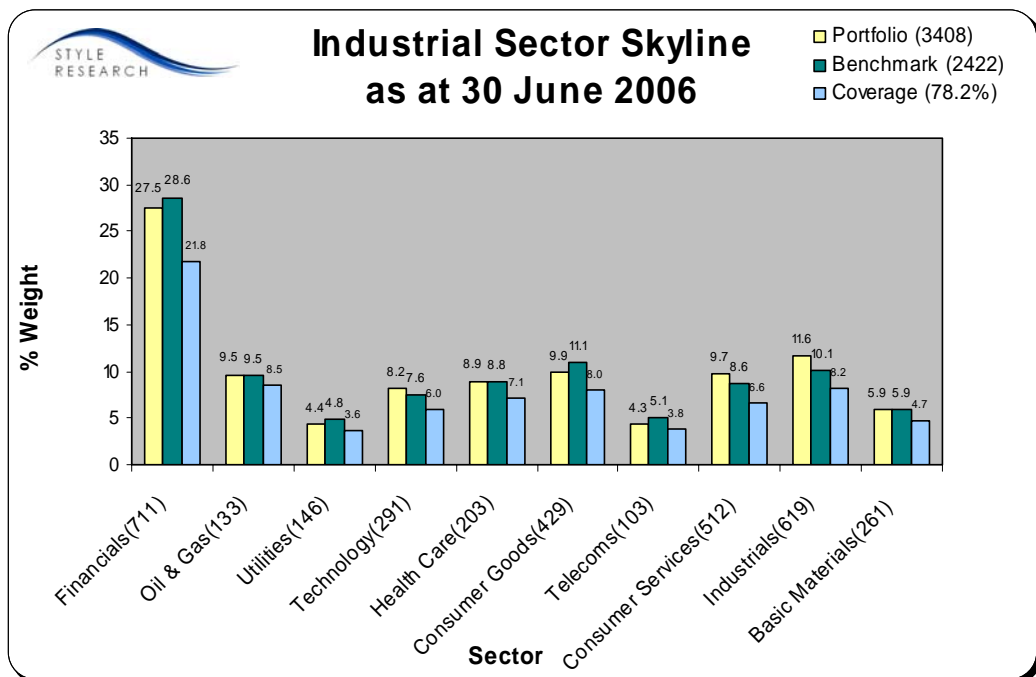
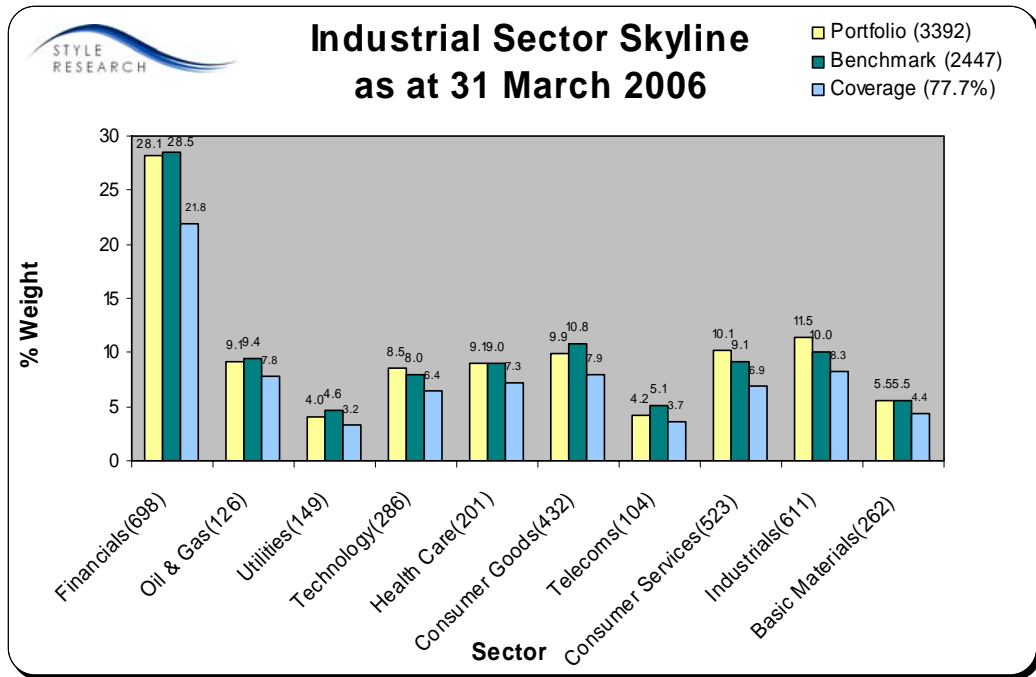


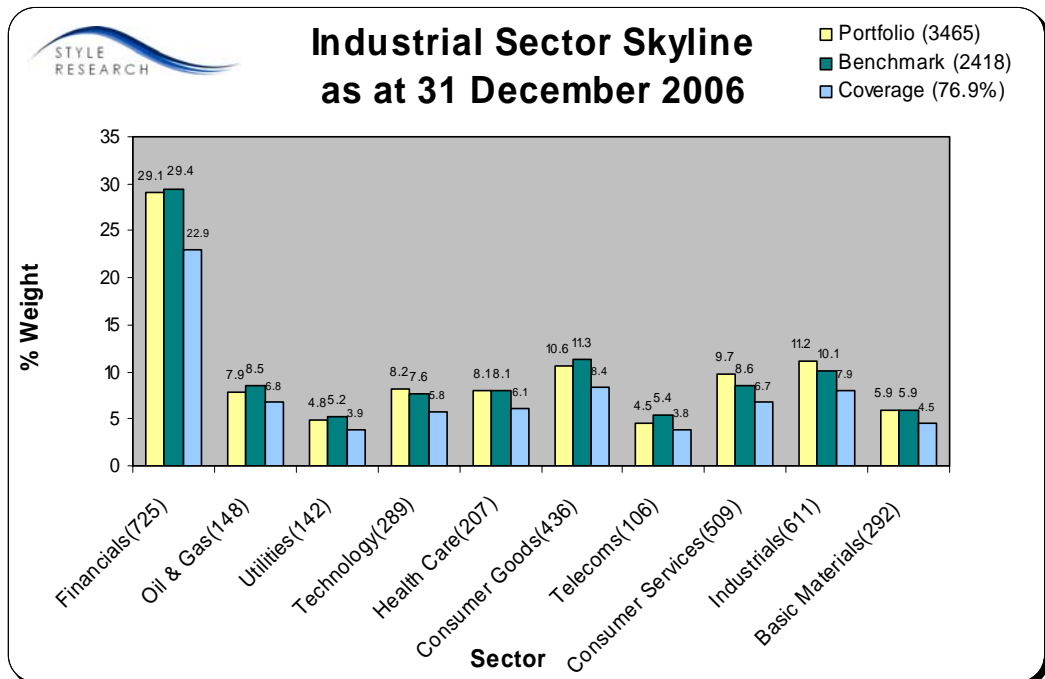
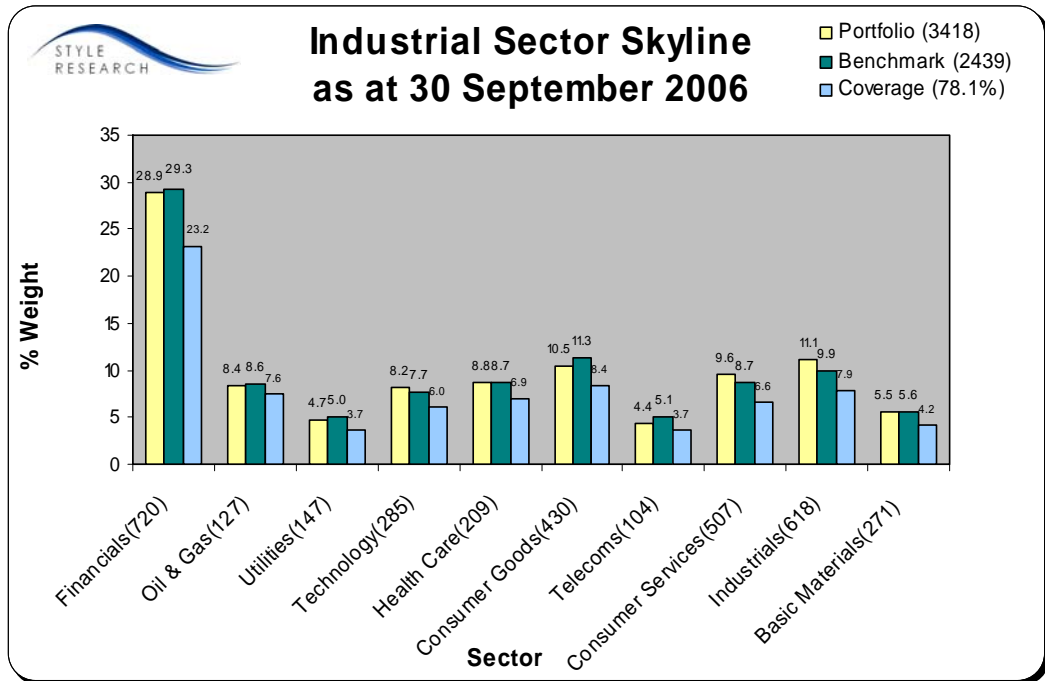
- Throughout 2006, the Equity segment's tilt towards growth stocks was more pronounced compared to this tilt in 2005, which was highlighted in the 2005 annual report.
- The results of the analysis indicate that over the course of the year, there have been a number of statistically significant tilts (illustrated by standard deviations of greater than +/-1 but less than +/-2) away from the benchmark mean and a number of very significant tilts (illustrated by standard deviations of greater than +/-2) away from the benchmark mean.
- At each quarter end over the course of the year, the Equity Segment has had a very significant negative bias to the value factors Dividend Yield and IBES Earnings Yield compared with the benchmark mean.

- Similarly, in terms of the growth factors, IBES 12 Month Growth and IBES Earnings Long Term Growth, the Equity Segment has consistently had a very significant positive bias away from the benchmark mean.
- The negative 'Market Cap' indicator shows that the Equity Segment has consistently held a bias to stocks with lower market capitalisations than the benchmark mean. The extent of the bias has become more significant as the year has progressed.
- The consistent and positive 'Market Beta' indicator shows that the Equity Segment has been biased towards stocks with a beta higher than the benchmark mean; this position is consistent with the position in 2005. Market Beta can be characterised as sensitivity to movement in the total market. The impact of the above average Beta is reflected in the performance of the Equity segment in eight out of the twelve months (i.e. when returns have exceeded the benchmark return, both more positive on the upside and more negative on the downside). This was not the case for the months of February, June, July and December. The bias towards smaller companies is against a market backdrop where smaller companies (based on world market indices) had a tendency to outperform the broader market index during 2005, but to underperform during 2006.
- As at 31 December 2005, momentum indicators over both the short-term (six months) and medium-term (twelve months) were significant, indicating stocks held in the portfolio at that point had experienced positive momentum i.e. above average performance. As at 31 December 2006 neither momentum indicator was significant in value, with short-term momentum having reduced each quarter end compared to the previous quarter.
- As at 31 December 2006, there was a significant tilt away from the benchmark mean for the Quality indicators 'Return on Equity' and 'Earnings Growth Stability'.
- More detailed explanations of the terms 'Dividend Yield', 'IBES Earnings Yield', 'IBES 12 Month Growth Earnings targets', 'IBES Earnings Long Term Growth', 'Market Beta', 'Market Cap', 'Long-term Momentum', 'Short-term Momentum', 'Return on Equity' and 'Earnings Growth Stability' can be found in Appendix C.

5.3 The Portfolio Sector Skyline

To give a better impression of the development of the sector characteristics of the Equity segment, industrial sector skylines as at the end of each quarter during 2006 are shown below. Please note that each quarter's analysis is based on a 'snap-shot' of the stocks held in the Equity segment at an aggregate level as at the end of every quarter.



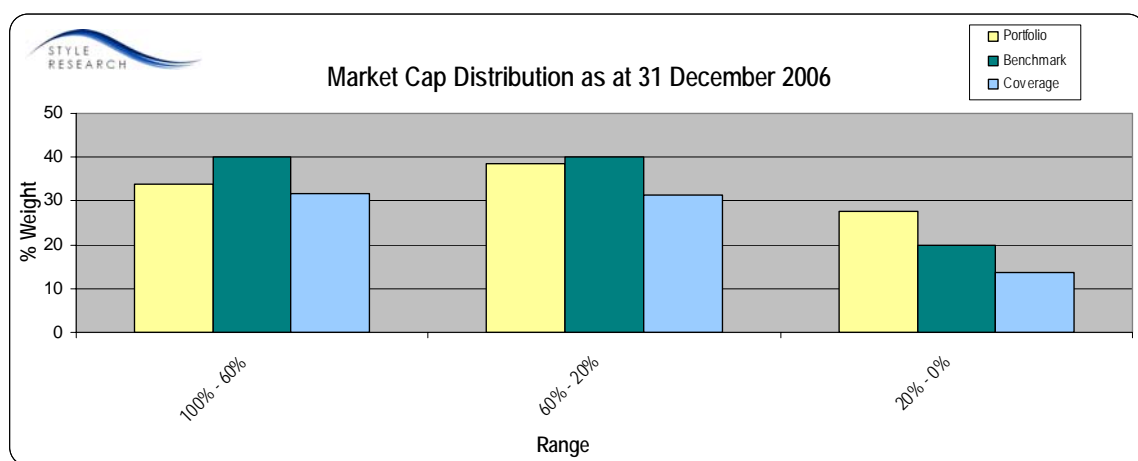


- The number of stocks held within the Equity segment at the end of each quarter exceeds the number of holdings within the benchmark; this corresponds with Norges Bank's exposure to Smaller Company holdings, which are not contained within the benchmark. This is consistent with the picture in 2005.
- Throughout 2006, the industrial sector skyline has remained largely unchanged; furthermore, the charts illustrate that Norges Bank is not taking significant sector positions away from the benchmark in the management of the Equity segment of the Pension Fund. Relative sector positions are similar to those taken during 2005.

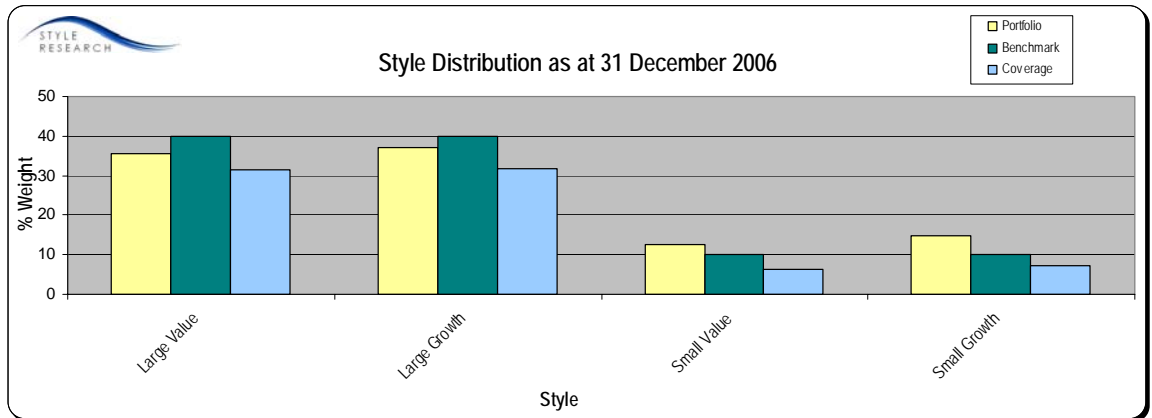
- As at 31 December 2006, the largest sector weight differences from the benchmark included the Consumer Services (+1.1%) and Industrials (+1.1%) sectors. Overweighting Consumer Services is a continuation of the Equity segment's position during 2005.
- Throughout 2006, the Financials sector represented over a quarter of the Equity segment's benchmark weight; consistent with 2005, an underweight position in the sector was held throughout 2006.

5.4 Market Capitalisation Distribution

- The chart below describes the market capitalisation distribution of the Pension Fund and the benchmark. Smaller cap companies, as defined by SRPA, are the smallest 20% of companies held within the portfolio, as measured by market capitalisation. As at 31 December 2006, in this instance, a company with a market capitalisation of below NOK circa 72bn would be classified as being a Small cap company.



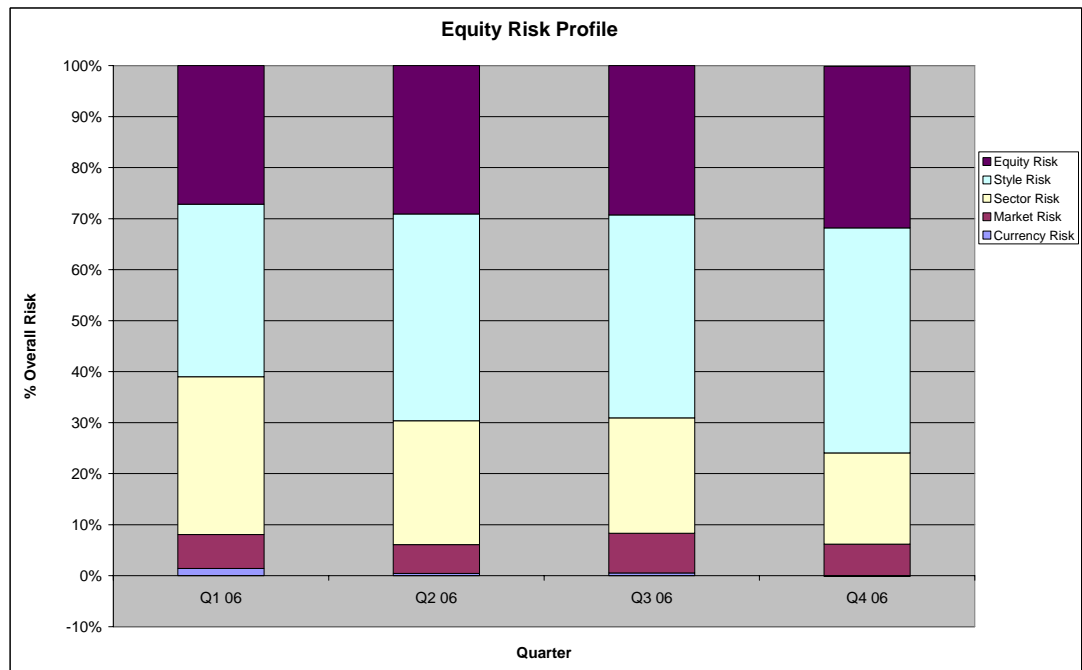
- As at 31 December 2006, the Pension Fund was overweight small cap stocks by 7.5%. This small cap bias was also observed earlier within the Portfolio Skyline analysis.
- The chart overleaf describes the market capitalisation distribution of the Pension Fund and the benchmark in value and growth terms. Consistent with what has been described above, small cap companies, as defined by SRPA, are the smallest 20% of companies held within the portfolio, as measured by market capitalisation. Conversely, large cap companies, as defined by SRPA, are the largest 20% of companies held within the portfolio, as measured by market capitalisation.



- As at 31 December 2006, the Pension Fund was overweight both value and growth small cap companies, and underweight both value and growth large cap companies.

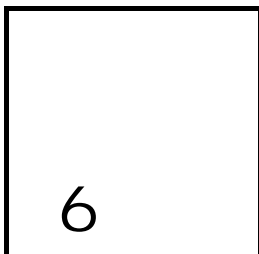
5.5 The Pension Fund – Equity Risk Profile

- The following chart shows the risk in the Equity segment broken down into different factors or segments as at the end of each quarter. Details of the methodology behind the analysis are set in Appendix C.
- The analysis is prepared according to a SRPA risk model for multi-market risk attribution and provides a snapshot breakdown of the different segments of portfolio risk relative to benchmark.



Note : Security holdings are sourced by (c) Copyright 2007 Mellon Analytical Solutions Europe Ltd. Benchmark data sourced from FTSE; Risk model output sourced from SRPA.

- Portfolio risk can be decomposed into contributions from Stock Selection (“Equity Risk”), Style Tilts, Sector Allocation, Market Allocation and, for multi-currency portfolios Currency Allocation. The Equity Risk Profile chart above decomposes the Tracking Variance (the square of Tracking Error) into these components and expresses them as percentages of the overall Tracking Variance. The actual risk level is dependent on the level of deviation from the benchmark and the correlation between the position the Equity segment has taken and the benchmark position.
- A brief explanation of the risk terms referred to are as follows:
 - Currency Risk is the risk created by holding assets denominated in different currencies in different proportions to the benchmark.
 - Market Risk is the risk created by investing in different markets, or asset classes, in different proportions to the benchmark.
 - Sector risk is the risk created by taking different industrial sector positions to the benchmark.
 - Style Risk is the risk created by investing in stocks with different style attributes to the benchmark. For example, overweight growth stocks would cause style risk.
 - Equity Risk is stock specific risk from individual stocks and is the residual risk after assigning risk to the categories described above.
- Over 2004 and 2005, Equity Risk was the largest component of risk of the portfolio. Throughout 2006, Style Risk was the largest component of risk and became more prominent over the course of year at the expense of Sector Risk.
- Similar to 2004 and 2005, Currency Risk remains the smallest component of total risk over 2006.
- Throughout 2006, the main contributor to risk (as calculated by SRPA), from a size and style perspective, was the growth tilt (both large cap and small cap).
- Throughout 2006, the main contributor to risk from a sector perspective (as calculated by SRPA) was the Financials sector.



Pension Fund Assets Under Management

The table below shows the market value of the Pension Fund as at the end of every month during 2006.

Month	Market Value (NOK Millions)		
	Equity	Fixed Income	Total Fund
January	600,392	851,678	1,452,070
February	606,869	888,063	1,494,932
March	606,890	877,035	1,483,925
April	593,482	865,062	1,458,544
May	586,079	864,280	1,450,359
June	609,879	895,185	1,505,063
July	620,131	908,953	1,529,084
August	652,038	967,724	1,619,761
September	687,887	1,024,406	1,712,292
October	717,731	1,068,624	1,786,355
November	700,789	1,060,656	1,761,445
December	725,860	1,057,691	1,783,552

Data source: Calculations by Mellon Analytical Solutions Ltd. (c) Copyright 2007 Mellon Analytical Solutions Europe Ltd.

Norwegian Ministry of Finance – Explanation of differences

The majority of differences in market values reported between Mellon Analytical Solutions and Norges Bank can be explained by one or a combination of reasons which include:

- Norges Bank discounting income from sell / buy backs and buy / sell backs whilst Citibank is using accrued income accounting methodology.
- Changes in swap prices which occurred after Citibank closed their books.

- Citigroup using their own systems to calculate accrued interest whilst Norges Bank's performance systems use Bloomberg.

February and March

For the months of February and March, there was a difference in transfers reported by Mellon Analytical Solutions and Norges Bank for the fixed income segment. This led to an unusually high difference in returns reported for the fixed income segment as highlighted in the report (c.0.44%).

In February, 3,700 million Norwegian Kroner (NOK) of bonds were booked by JP Morgan using an inverse foreign exchange rate; this has the effect of an unrealised gain being booked. The correct inflow should have been 5,431 million NOK. This position was corrected in March.

April

In April there was a 225 million NOK difference in market values reported between Mellon Analytical Solutions and Norges Bank for the Equity segment. This can be explained as follows:

The deviation due to dividends from security Ladbrokes being incorrectly reflected for account no 15140 (NOK 199.8 million) and only part of C&W for security Lions Gate was cancelled for account 15140 (NOK 55.4 million) amounting to the Equity segment being overstated by NOK 255.3 million.

This discrepancy led to a difference in returns reported between Mellon Analytical Solutions and Norges Bank for April and May of c.0.04%.

August

In August there was a 354 million NOK difference in market value reported between Mellon Analytical Solutions and Norges Bank for the fixed income segment. This difference can be largely explained as follows:

In August the Citibank NAV was overvalued by 276.5 million NOK.

This discrepancy led to a difference in returns reported between Mellon Analytical Solutions and Norges Bank for August and September of c.0.04%.

November and December

In December there was a difference of 62 million NOK in market values reported between Mellon Analytical Solutions and Norges Bank for the Equity segment. The difference was due to Norges Bank adding estimated security lending income for December based on 3 month average.

There was a further deviation of 70 million NOK difference in market values reported between Mellon Analytical Solutions and Norges Bank for the fixed income segment. This difference can be largely explained as follows:

30 million NOK being added to Norges Bank value and external fund shares being adjusted by 26 million NOK.

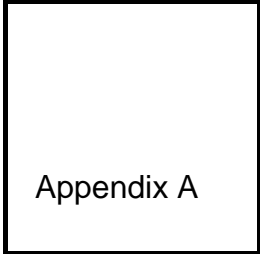
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Mercer gives no representations or warranties as to the accuracy of information provided to us by Mellon Analytical Solutions, Norges Bank or any third party, and accepts no responsibility or liability (including for indirect, consequential or incidental damages) for any error, omission or inaccuracy in such information other than in relation to information which Mercer would be expected to have verified based on generally accepted industry practices.

In addition:

- Past performance cannot be relied upon as a guide to future performance.
- The value of stocks, shares, bonds and other fixed income investments, including unit trusts, can go down as well as up and you may not get back the amount you have invested.
- Investments denominated in a foreign currency will fluctuate with the value of the currency.




Appendix A

Calculation Methodology

Mellon Analytical Solutions employs the “time-weighted” rate of return as the base performance statistic. This return takes into account investment income as well as realised and unrealised capital profits or losses. The use of this statistic minimises distortions due to cash flows into and out of a portfolio which are, in general, outside the control of the investment manager.

Exact calculation of the time-weighted rate of return requires a full valuation of the portfolio whenever a cash flow occurs. As a practical alternative Mellon Analytical Solutions employs an approximation to the time-weighted return, using monthly valuations, monthly/daily transaction details and monthly/daily cash flows. The method used is based on the Regression Method, recommended by the Bank Administration Institute in their definitive report on the topic of performance measurement published in 1968, and which gives an excellent approximation of the time-weighted rate of return.

At the total fund level Mellon Analytical Solutions calculates a day-weighted, money-weighted return using market values at the start and end of the month and net injection details.



Appendix B

Mercer's Role and Control Function

The purpose as set out in the Public Procurement document is for Mercer to verify Norges Bank's internal performance measurements and to strengthen the Ministry's basis for evaluating the competence and actions of Norges Bank. Mercer outsources the role of performance verification to Mellon Analytical Solutions, an independent performance measurer appointed by Mercer.

Mercer has, in conjunction with Mellon Analytical Solutions, performed control and verification functions throughout 2006, in accordance with the terms of the contract awarded by the Ministry.

The objective of this process has been to check Norges Bank's internal performance measurements and to perform wider verification checks, both at portfolio and benchmark level according to instructions received from the Ministry of Finance.

Mellon Analytical Solutions' Role and Control Function:

Mellon Analytical Solutions' Role

The function of calculating and verifying Norges Bank's internal performance measurement is carried out by Mellon Analytical Solutions under the guidance of Mercer who retains overall responsibility for the process. Mellon Analytical Solutions calculates performance for the Pension Fund based on portfolio data and market values supplied by the custodians JP Morgan Chase and Citibank.

Mellon Analytical Solutions employ the "time weighted" rate of return as the base performance statistic. This return measure is consistent with the one employed by Norges Bank and takes into account investment income, as well as realised and unrealised capital profits or losses. The use of this statistic minimises distortions due to cash flows into and out of a portfolio which are, in general, outside the control of the investment manager.

Mellon Analytical Solutions' Control Function

Market value reconciliation check

Having constructed performance data, Mellon Analytical Solutions will check that the total values for the various segments of the fund agree with those values calculated by Norges Bank. Mellon Analytical Solutions also check that the total value for the fund agrees with Norges Bank's calculated value.

Any significant reconciliation errors here may indicate that there are accounts omitted from the data supplied. If the overall difference is more than a 0.01%, Mellon Analytical Solutions will raise queries with the data providers.

Transfers

When transfers occur at the month end Mellon Analytical Solutions ensure that the transfers into the fund shown in the data agree with those detailed in the letter supplied by Norges Bank.

Fund return checks

In addition to the data checks above, Mellon Analytical Solutions carry out sense checks on individual asset class and total returns.

Asset class return check

Mellon Analytical Solutions carry out sense checks on returns for individual asset classes against the relevant index return. If the asset class return is unexpectedly divergent from the index return then Mellon Analytical Solutions will raise a query with the relevant data provider.

Total return check

After constructing data for individual portions of the fund, Mellon Analytical Solutions produces a consolidated data set for the fund as a whole. Mellon Analytical Solutions check that the total return calculated for each month is no more than one basis point different to the total return quoted by Norges Bank.

Benchmark checks

Pension Fund Benchmark

Fixed Income benchmark

Following provision by Norges Bank of the methodology for calculation, from first principles, of the Fixed Income benchmark weights, Mellon Analytical Solutions set up their own independent verification spreadsheet calculations.

Mellon Analytical Solutions have independently sourced the Lehman Aggregate indices that constitute the fixed income benchmark. These have been sourced directly from the Lehman Live website. Using monthly weights and Lehman indices, Mellon Analytical Solutions will calculate Fixed Income benchmark returns in NOK terms.

On completion of the reconciliation exercise Mellon Analytical Solutions will verify agreement to the Fixed Income benchmark weights and benchmark returns by email notification. If returns and/or weights cannot be agreed then Mellon Analytical Solutions will communicate their findings with commentary.

Equity benchmark

Following provision by Norges Bank of the methodology for calculation, from first principles, of the Equity benchmark weights, Mellon Analytical Solutions have set up their own independent verification spreadsheet calculations.

Customised regional benchmark index values in US\$ terms up to November 2003 calculated by FTI have also been forwarded by Norges Bank. FTSE took over provision of customised benchmark indices from December 2003 onwards. From December 2003 onwards Mellon Analytical Solutions have received customised benchmark indices directly from FTSE.

On completion of the reconciliation exercise Mellon Analytical Solutions will verify agreement to the Equity benchmark weights and benchmark returns by email notification. If returns and/or weights cannot be agreed then Mellon Analytical Solutions will communicate their findings with commentary.

Overall Pension Fund benchmark

Following provision by Norges Bank of the methodology for calculation, from first principles, of the overall benchmark weights, Mellon Analytical Solutions have set up their own independent verification spreadsheet calculations.

Using monthly weights and Fixed Income and Equity benchmark returns calculated above, Mellon Analytical Solutions will calculate overall benchmark returns.

On completion of the reconciliation exercise Mellon Analytical Solutions will verify agreement to the overall benchmark weights and benchmark returns by email notification. If returns and/or weights cannot be agreed then Mellon Analytical Solutions will communicate their findings with commentary.

Environmental Fund Benchmark (prior to 1 December 2004)

From December 2003 onwards Mellon Analytical Solutions have received customised benchmark indices directly from FTSE. Benchmark returns are calculated by dividing out customised total return indices in NOK.

As of end November 2004 the Environmental Fund was merged with the Pension Fund and hence since 1 December 2004 this control function ceased to exist.

Combined Total Fund Benchmark

Prior to 1 December 2004, Mellon Analytical Solutions calculate the Combined Fund total return benchmark on a monthly basis by weighting the Pension Fund and Environmental Fund total benchmark returns by their respective start market values. Since then the Total Fund benchmark is the same as the overall Pension Fund benchmark.



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2007

The Norwegian Government Pension Fund - Global – Mellon Analytical Solutions role during 2006

Our role in 2006

During 2006, Mellon Analytical Solutions “MAS” have provided independent performance measurement in respect of the Norwegian Government Pension Fund – Global.

To perform this task MAS collect data on a monthly basis from three data sources namely: JP Morgan Chase, Citigroup and Norges Bank “the data suppliers”.

MAS undertake a number of reconciliation checks on the data, at asset class level and where available at security level, ensuring that data reconciles from the previous month, and at the total level. Any questions that arise from these checks will be raised with the data suppliers and where appropriate the client.

Reconciled data is run through our internal performance system to calculate returns. At the asset class level MAS employs the “time-weighted” rate of return as the base performance statistic. This return takes into account investment income as well as realised and unrealised capital profits or losses. At the total fund level MAS calculate a day-weighted, money weighted return using market values at the start and end of the month and net injection details.

MAS also carry out a number of independent checks on Norges Bank’s benchmark return calculations. We independently source FTSE-AW indices and Lehman customised indices in order to carry out a check on the Equity and Fixed Income benchmark returns. We then apply

relative Fixed Income and Equity weights within the Norwegian Government Fund - Global to calculate the overall benchmark. Following provision by Norges Bank of the methodology for calculation of the Fixed Income, Equity and Overall benchmark weights we have now set up our own independent spreadsheet checks to verify these weights. MAS also independently calculate the fund and benchmark returns in the currency basket.

Performance discrepancies in 2006

Different valuation methodologies between Norges Bank and Citigroup in respect of money market instruments may give rise to differences in market value between MAS and Norges Bank reporting. These in turn may lead to small differences in return between MAS and Norges Bank. These are usually no more than 0.01% to two decimal places.

The different methodologies in the calculation of currency rates between MAS and Norges Bank may give rise to differences in currency returns. Essentially this problem stems from the fact that Norges Bank is using a different base currency in their calculations from MAS. The small differences are usually no more than 0.01% to two decimal places.

For a number of individual months there were return discrepancies between MAS and Norges Bank (measured in both Norwegian Kroner and the currency basket measure) of greater magnitude than 0.01% for reasons other than those set out above. Despite these monthly differences, twelve month returns for the Norwegian Government Fund - Global were no more than 0.01% to 2 decimal places.

Yours sincerely

Charles Ward

Appendix C

Style Research Portfolio Analysis Definitions

VALUE CRITERIA

Book to Price

The ratio of the company's Book Value (the sum of Shareholders' Equity plus accumulated Retained Earnings from the P & L Account) to its Share Price.

This Factor has been one of the most successful measures of the intrinsic Value of company shares.

Dividend Yield

The annual Dividend Paid per Share divided by the Share Price.

This Factor measures the Value of company shares according to the stream of dividend income resulting from share ownership.

Cash Flow Yield

Annual Cash Flow per Share divided by the Share Price.

This Factor is related to the earnings yield but also includes other items, specifically: depreciation, amortisations, and provisions for deferred liabilities. It is intended to capture the cash availability of the company as a multiple of the share price, and offers a Value criteria based on the stream of accessible cash earnings.

Sales to Price

Net Sales per Share divided by the Share Price.

This Factor measures the worth of a company's shares according to the annual sales volume supporting the company business. The item is considered by many analysts to be less susceptible to manipulation than other

valuation criteria; it is, however, a less comprehensive measure of a company's range of activities.

IBES Earnings Yield

The consensus 1 year forecast annual earnings per share divided by the share price.

GROWTH CRITERIA

Earnings Growth

The average annual growth rate of Earnings over a trailing three years.

Earnings Growth is, perhaps, the clearest of the Growth criteria. However, it is subject to the distortions of reporting conventions and manipulation and, particularly in some markets, only known after a considerable lag.

Sales Growth

The average annual growth rate of Net Sales per Share over a trailing three years.

Although growth in sales per share might be only a narrow measure of a company's business growth, and may be subject to a number of distortions, it is less subject to differences in reporting conventions or manipulation than many other Balance Sheet or Profit and Loss items.

Earnings Growth

IBES 12Mth Growth – The IBES consensus forecast growth over the next 12 months. This is calculated on a pro-rata basis from the forecasts for each company's next 2 annual reporting periods.

IBES Earnings Long Term Growth – This factor takes the longest available 2 year earnings growth forecast for a stock. For stocks with a 5 year forward consensus forecast the growth rate will be calculated from fiscal year 3 to fiscal year 5. For stocks with a 4 year forward consensus forecast the growth rate will be calculated from fiscal year 2 to fiscal year 4. For stocks with a 3 year forward consensus forecast the growth rate will be calculated from fiscal year 1 to fiscal year 3. If forecasts are not available for fiscal years 3 to 5, then the factor is set to null.

Sustainable Growth – This is defined as follows:

$\text{Sustainable Growth Rate} = [\text{RoE}] * (1 - (\text{DPS}/\text{EPS}))$

RoE = Return on Equity, DPS = Dividend per share, EPS = Earnings per share

This Growth factor aims to provide an insight into the future growth potential of a company. The rationale behind this is that the growth rate one can reasonably expect from a

company, assuming it is able to generate a return on equity similar to the recent past, is related to how much of its profits are reinvested back into the company.

SIZE & RISK CRITERIA

Market Cap

The market capitalisation of a stock.

The Market Cap statistic of the portfolio is the weighted (by holding value) average size of the securities held. The Market Cap statistic of the benchmark (or total market) is the weighted (by holding value) average size of the securities within the benchmark (or total market).

Market Beta

The "slope coefficient", (β), from the simple regression:

Security Monthly Return = α + β * Market Monthly Return + Random Error

The regression is carried out over rolling 36 month periods; where sufficient information is not available, $\beta=1$ is assumed.

PERFORMANCE RECORD CRITERIA

Momentum ST

Short Term Momentum is calculated using a 6 month "memory" of monthly total returns. The past period returns are weighted using a "decay ratio" of 2/3, per month. This weighted historic return factor measures the degree of performance trend following. It is useful in recognizing trading character of specific markets and in noticing occasional changing patterns through the market cycle.

Momentum MT

Medium Term Momentum is the 12 month total return of the stock.

Historic Relative

The Historic Relative Return is calculated using a 6 month **Return** "memory" of monthly relative returns. The past period returns are weighted using to a "decay ratio" of 2/3, per month.

This weighted historic relative return factor measures the degree of simple price performance trend following. It is useful in recognising the trading character of specific markets and in noticing occasional changing patterns through the market cycle.

The international equity analysis shows short-term and medium term momentum factors.

IBES 1 Year Earnings Revisions IBES balance of Earnings forecast revisions for the next annual reporting period. It is calculated as the difference between the upwards revisions minus the downwards revisions (as sampled over the past 3month period), expressed as a percentage of the number of estimates.

QUALITY CRITERIA

Return on Equity

Net Income before Preferred Dividends divided by the Book Value of Shareholders' Common Equity.

Return on Equity measures the profitability of the operations of the company as a proportion of the total amount of equity in the company. Since Return on Equity multiplied by the reinvestment rate (the proportion of earnings not paid as dividends but reinvested in the company) gives the warranted growth rate of a company, Return on Equity is a very usual measure of a company's growth potential.

Low Gearing

The negative of Debt to Equity. Low geared companies can be regarded as being of higher 'Quality' as they are less burdened by debt repayment costs.

Earnings Growth Stability This 'Quality' factor is calculated as the negative of the standard deviation of Earnings Growth over the most recent 3 years of growth data.

Risk Terms

Currency risk (the extent to which currency exposure differs from the benchmark)

Market risk (the extent to which the portfolio's exposure to different equity markets differs from the benchmark)

Sector risk (the extent to which the portfolio's exposure to different industries differs from the benchmark)

Style risk (the extent to which the portfolio's style biases (see graph on previous page) introduce risk relative to the benchmark)

Equity risk (risk arising from stock-specific factors)

However, the different segments of risk are not independent. For example, sector risk can itself introduce currency risk if the sector has a bias to companies with non-domestic currency exposure.

Coverage

The term “coverage” is a measure of the portfolio’s exposure to the indices it is benchmarked against i.e. if a benchmark index had only 2 stocks, both of equal weighting, each stock would have a market capitalisation of 50%. If a portfolio worth 100 NOK held 50 NOK in each stock its coverage would be 100%. If the portfolio invested all the 100 NOK in just one stock its coverage would be 50% as it is only exposed to the movements of the 50% of the benchmark index. Further, if the portfolio was invested 60 NOK in one stock and 40 NOK in the other the coverage would still be 50% in the first stock, but 40% in the other making a total of 90% coverage.

Multi-Market Risk Attribution

The return of stock j may be written in terms of its currency, market, industry, style and specific returns (dropping subscript t for convenience)

$$r_j = R_{C(j)}^\phi + R_{M(j)} + R_{I(j)}' + R_{S(j)}' + r_j'$$

Where company j belongs to market $M(j)$, industry $I(j)$ and style $S(j)$. The Portfolio base currency is ϕ and the currency of market $M(j)$ is $C(j)$. Industries are according to the 10 economic sectors as defined by FTSE International. Styles are defined within each economic sector according to Large Value, Large Growth, Small Value, Small Growth. Size is the primary sort, where Large is the top 80% by capitalization and Small the bottom 20%. Value is taken to be the top half, by capitalization, of each size category, sorted by a measure which is 60% normalized Book Value per Share to Share Price and 40% normalized Dividend Yield, and rebalanced every 6 months; Growth is simplified as the other half within each size category.

The month t currency return is defined as:

$$R_{C(j)}^\phi = \frac{er_{C(j),t}^\phi - er_{C(j),t-1}^\phi}{er_{C(j),t-1}^\phi}$$

Where the exchange rate of currency ϕ to currency $C(j)$, at the end of month t , is $er_{C(j),t}^\phi$.

In matrix notation the Equity returns are:

$$\mathbf{r} = \mathbf{R}_C^{\phi} + \mathbf{R}_M + \mathbf{R}'_I + \mathbf{R}'_S + \mathbf{r}'$$

The covariance matrix is then:

$$\begin{aligned} Cov(\mathbf{r}) &= Cov(\mathbf{R}_C^{\phi} + \mathbf{R}_M + \mathbf{R}'_I + \mathbf{R}'_S + \mathbf{r}') \\ &= Cov(\mathbf{R}_C^{\phi}) + Cov(\mathbf{R}_C^{\phi}, \mathbf{R}_M) + Cov(\mathbf{R}_C^{\phi}, \mathbf{R}'_I) + Cov(\mathbf{R}_C^{\phi}, \mathbf{R}'_S) + Cov(\mathbf{R}_C^{\phi}, \mathbf{r}') \\ &\quad + Cov(\mathbf{R}_M, \mathbf{R}_C^{\phi}) + Cov(\mathbf{R}_M) + Cov(\mathbf{R}_M, \mathbf{R}'_I) + Cov(\mathbf{R}_M, \mathbf{R}'_S) + Cov(\mathbf{R}_M, \mathbf{r}') \\ &\quad + Cov(\mathbf{R}'_I, \mathbf{R}_C^{\phi}) + Cov(\mathbf{R}'_I, \mathbf{R}_M) + Cov(\mathbf{R}'_I) + Cov(\mathbf{R}'_I, \mathbf{R}'_S) + Cov(\mathbf{R}'_I, \mathbf{r}') \\ &\quad + Cov(\mathbf{R}'_S, \mathbf{R}_C^{\phi}) + Cov(\mathbf{R}'_S, \mathbf{R}_M) + Cov(\mathbf{R}'_S, \mathbf{R}'_I) + Cov(\mathbf{R}'_S) + Cov(\mathbf{R}'_S, \mathbf{r}') \\ &\quad + Cov(\mathbf{r}', \mathbf{R}_C^{\phi}) + Cov(\mathbf{r}', \mathbf{R}_M) + Cov(\mathbf{r}', \mathbf{R}'_I) + Cov(\mathbf{r}', \mathbf{R}'_S) + Cov(\mathbf{r}') \end{aligned}$$

The covariance between r_i and r_j is:

$$\begin{aligned} Cov(r_i, r_j) &= Cov(R_{C(i)}^{\phi}, R_{C(j)}^{\phi}) + Cov(R_{C(i)}^{\phi}, R_{M(j)}) + Cov(R_{C(i)}^{\phi}, R'_{I(j)}) + Cov(R_{C(i)}^{\phi}, R'_{S(j)}) + Cov(R_{C(i)}^{\phi}, r'_j) \\ &\quad + Cov(R_{M(i)}, R_{C(j)}^{\phi}) + Cov(R_{M(i)}, R_{M(j)}) + Cov(R_{M(i)}, R'_{I(j)}) + Cov(R_{M(i)}, R'_{S(j)}) + Cov(R_{M(i)}, r'_j) \\ &\quad + Cov(R'_{I(i)}, R_{C(j)}^{\phi}) + Cov(R'_{I(i)}, R_{M(j)}) + Cov(R'_{I(i)}, R'_{I(j)}) + Cov(R'_{I(i)}, R'_{S(j)}) + Cov(R'_{I(i)}, r'_j) \\ &\quad + Cov(R'_{S(i)}, R_{C(j)}^{\phi}) + Cov(R'_{S(i)}, R_{M(j)}) + Cov(R'_{S(i)}, R'_{I(j)}) + Cov(R'_{S(i)}, R'_{S(j)}) + Cov(R'_{S(i)}, r'_j) \\ &\quad + Cov(r'_i, R_{C(j)}^{\phi}) + Cov(r'_i, R_{M(j)}) + Cov(r'_i, R'_{I(j)}) + Cov(r'_i, R'_{S(j)}) + Cov(r'_i, r'_j) \end{aligned}$$

The component parts of the covariance matrix are:

Pure Currency term: $Cov(R_{C(i)}^{\phi}, R_{C(j)}^{\phi})$

Market cross terms: $Cov(R_{C(i)}^{\phi}, R_{M(j)}) + Cov(R_{M(i)}, R_{C(j)}^{\phi})$

Pure Market term: $Cov(R_{M(i)}, R_{M(j)})$

Industry cross terms:

$$Cov(R_{C(i)}^{\phi}, R'_{I(j)}) + Cov(R_{M(i)}, R'_{I(j)}) + Cov(R'_{I(i)}, R_{C(j)}^{\phi}) + Cov(R'_{I(i)}, R_{M(j)})$$

Pure Industry term: $Cov(R'_{I(i)}, R'_{I(j)})$

Style cross terms:

$$\begin{aligned} &Cov(R_{C(i)}^{\phi}, R'_{S(j)}) + Cov(R_{M(i)}, R'_{S(j)}) + Cov(R'_{I(i)}, R'_{S(j)}) + Cov(R'_{S(i)}, R_{C(j)}^{\phi}) \\ &+ Cov(R'_{S(i)}, R_{M(j)}) + Cov(R'_{S(i)}, R'_{I(j)}) \end{aligned}$$

Pure Style term: $Cov(R'_{S(i)}, R'_{S(j)})$

Equity cross terms:

$$\begin{aligned} &Cov(R_{C(i)}^{\phi}, r'_j) + Cov(R_{M(i)}, r'_j) + Cov(R'_{I(i)}, r'_j) + Cov(R'_{S(i)}, r'_j) + Cov(r'_i, R_{C(j)}^{\phi}) \\ &+ Cov(r'_i, R_{M(j)}) + Cov(r'_i, R'_{I(j)}) + Cov(r'_i, R'_{S(j)}) \end{aligned}$$

Pure Equity term: $Cov(r'_i, r'_j)$

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