



MSCI Reclassification for Israel

Road Map from an Emerging to a Developed Market

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Feb 2010

Executive Summary

In July 2009, MSCI published its decision to reclassify the Israeli market from emerging to developed. The decision was announced following an extensive market review by which MSCI validated the following criteria:

- **Openness to foreign investor ownership**
- **Ease of capital inflows / outflows**
- **Efficiency of the operational framework**
- **Market organization**
- **Market infrastructure**
- **Stability of institutional framework**

Market practices, such as clearing and settlement cycles and custodian services as well as market regulations, will not be affected by the reclassification. However, there may be an impact on TASE activity, reflecting the departure of EM index funds and the arrival of developed market funds.

MSCI's decision is viewed as an international vote of confidence for Israel's capital market and overall economy.

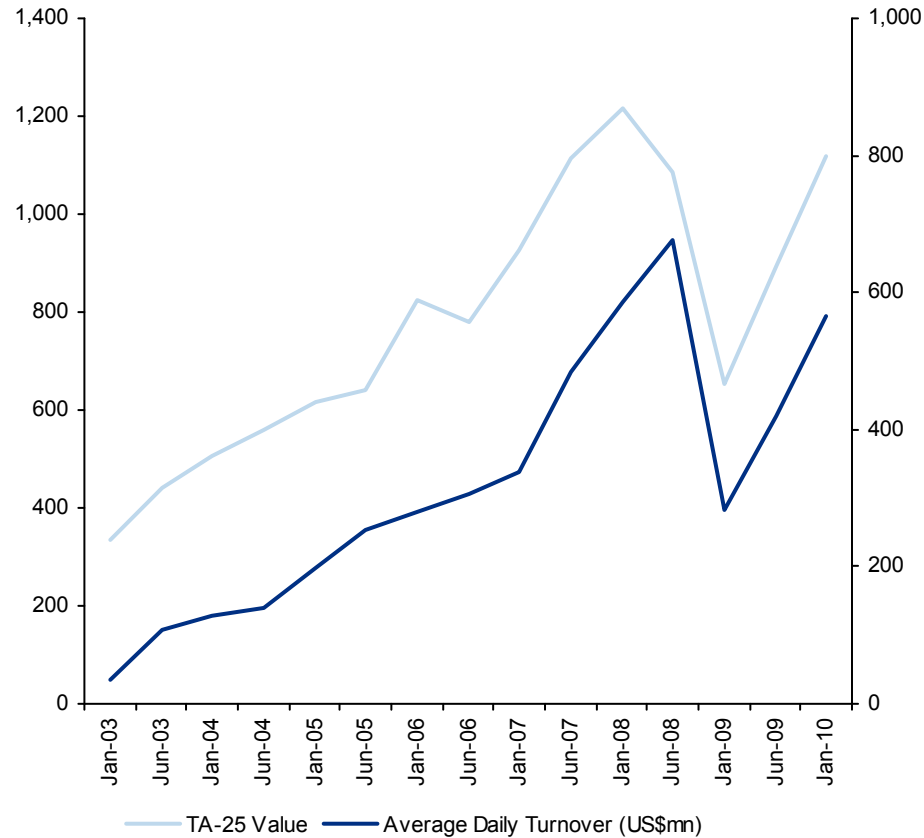
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1. Israel Market Overview

Key Market Indicators

Daily turnover up more than five-fold in the last six years!

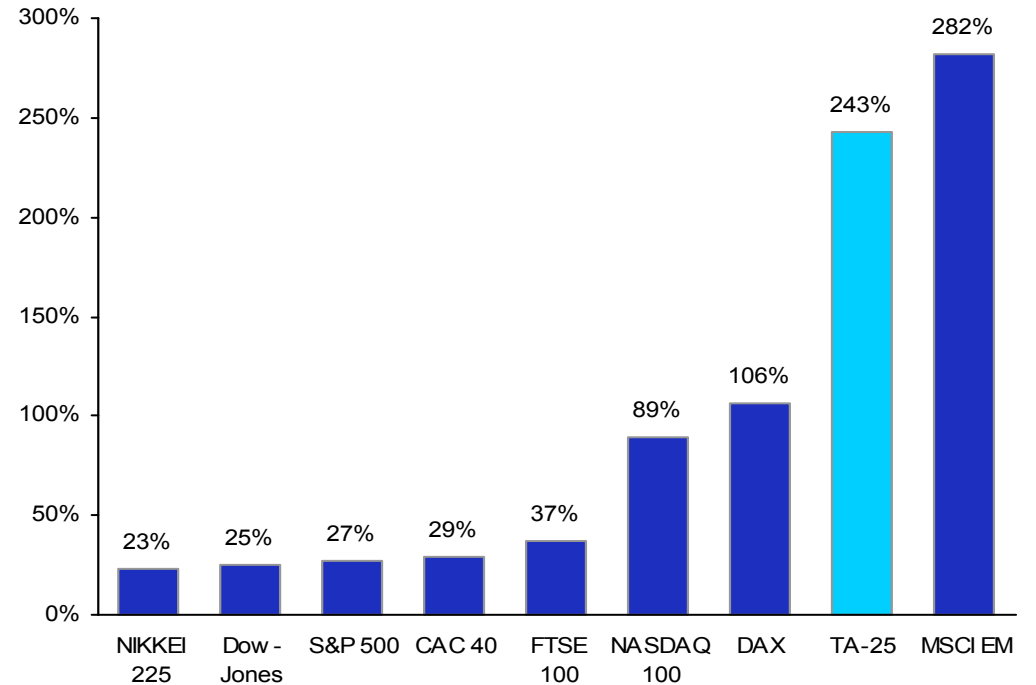


Equity Market Cap	US\$367 billion (Jan 2010)
Average Daily Turnover (Single-sided)	US\$567 million (Jan 2010)

Source: TASE Market Data

TA-25 vs. Other World Indices (2003–2009)

(% Change in US\$)



Capital	Jerusalem
Language	Hebrew
Currency	New Israeli Shekel (ILS)
Time Zone	GMT+2 (DST applies)
Population (July 2009)	7.4 million
GDP Per Capita (2009, US\$)	28,400

Capital Markets Infrastructure and Regulators in Israel

Trading Exchange



TEL-AVIV STOCK EXCHANGE

Tel-Aviv Stock Exchange (TASE)

- One-stop-shop venue for trading equities, fixed income and derivatives
- Over 1,200 securities traded on TASE
- Tel Aviv Continuous Trading (TACT) system launched in 1997
- Member of International Federation of Stock Exchanges (FIBV) and International Options Markets Association (IOMA)
- Trading Days: Sun–Thurs
- Trading hours: 08:30–16:30

Depositories



TEL-AVIV STOCK EXCHANGE

Tel-Aviv Stock Exchange Clearing House (TASECH)

- Clearance, settlement and safekeeping of equities and bonds (On-Ex and OTC)
- Book-entry
- ISIN numbering system (ANNA member)
- Cash settlement with Bank of Israel
- Communication of corporate actions
- Settlement days: Sun–Fri
- Compliance with ISSA G-30 recommendations

Regulatory Bodies



Israel Securities Authority (ISA)

- Ensures fair and orderly trading on TASE
- Approves TASE directives and rules and amendments thereto
- Monitors issuer disclosure requirements
- Regulates mutual funds, investment advisors and portfolio managers

Israel Tax Authority



- Drafts and enforces tax legislation

Other Regulatory Bodies



Bank of Israel (BOI)

- Regulates monetary policy and supervises the banking system
- Serves as banker for the government and central bank for the banking system

Ministry of Finance (MOF)

- Plans and implements government economic policy
- Manages revenues and collects taxes
- Regulates capital markets, savings and insurance

Key Market Highlights

Local market practices attuned to foreign investors.

Settlement Cycle

- T+0 for equity and fixed income
- T+1 for government bonds and T-Bills
- T+2 standard for foreign investors
- * One concern raised by MSCI was the short settlement cycle for equities. This differs from the one generally applied in developed markets and many investors would welcome better alignment.

Registration

- Securities are registered in the name of one of four nominee companies
- TASECH manages registration records
- Book-entry system
- ISIN numbering system
- Omnibus account structure allowed

FX

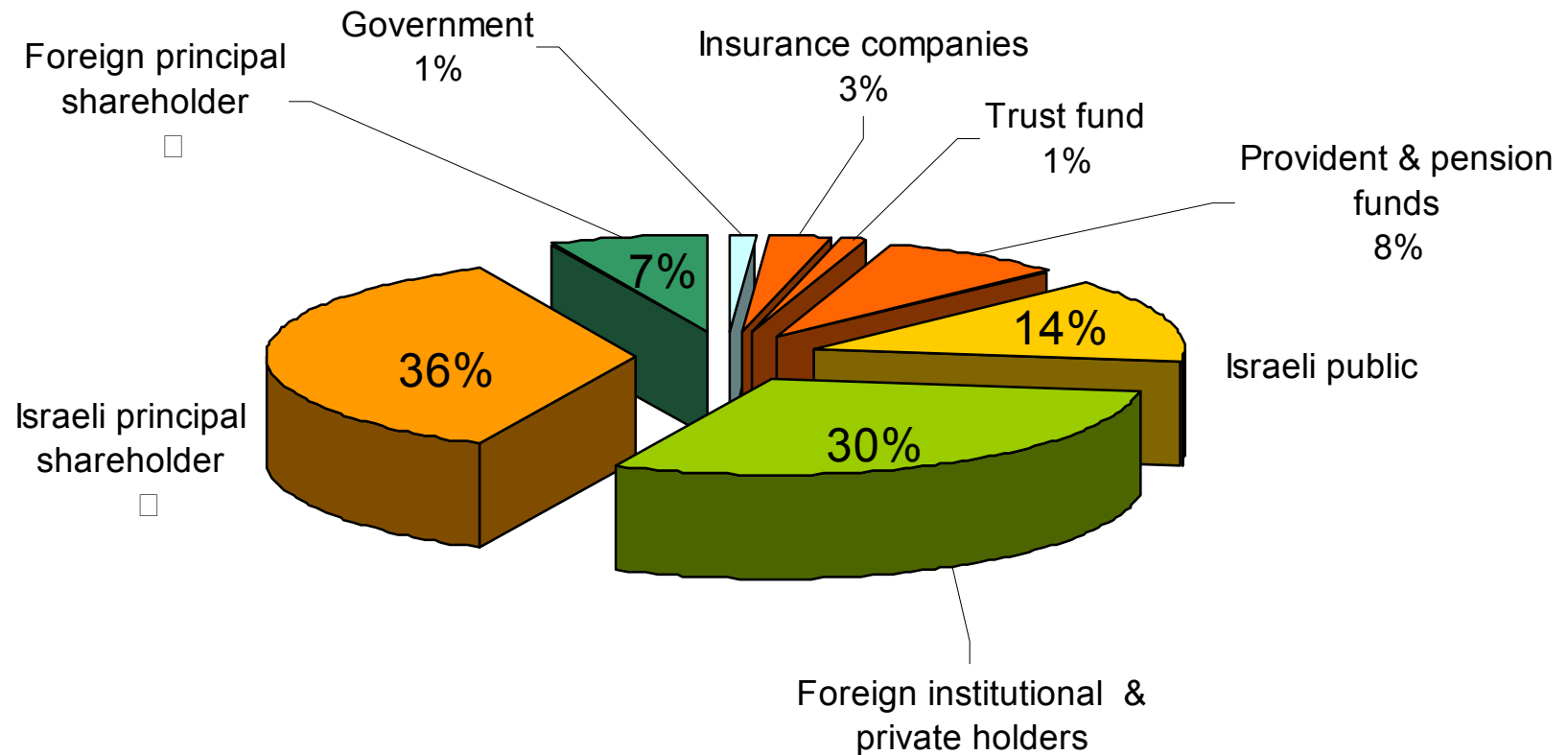
- Currency: New Israeli Shekel (ILS)
- Exchange rate regime: ILS is free floating, fully convertible. Foreign participation in FX market is not restricted.
- Currency derivative instruments: Forwards, Options, Swaps
- Overdraft permitted, facilities provided by Citi Israel

Tax

- Foreign Investors exempt from capital gains tax and income tax on interest paid on corporate bonds and most government bonds
- No stamp duty
- Dividends – 20%, Interest – 25% (subject to preferential DTT rates)

Market Holdings

Public companies holding distribution in 2009



Source: TASE

2. Rating upgrade history and rationale

Rating upgrade history

Milestones leading to upgrade decision

OECD INVITES FIVE COUNTRIES TO MEMBERSHIP TALKS

OECD countries agreed to invite Chile, Estonia, Israel, Russia, and Slovenia to open discussions for membership

OECD, May 2007

THE FINANCIAL TIMES STOCK EXCHANGE ADVANCES ISRAEL'S STATUS TO DEVELOPED FROM EMERGING

FTSE new classification lists Israel as the first Middle East country in a group of 24 developed nations

FTSE, October 2007

ISRAEL IS LEADING INNOVATOR

WIPO Report 2008: 1 patent out of a 100 in the world is Israeli

* innovation level is one of OECD required standards

World Intellectual Property Organization (WIPO), Nov 2008

BANK OF ISRAEL GOVERNOR FISCHER VOICES CONFIDENCE IN ISRAEL'S ECONOMIC SITUATION

Israel's economy expands 5.3% in the first half of 2008, following four consecutive years of 5% annualized growth.

Bank of Israel, September 2008

FITCH, MOODY'S GIVE ISRAELI BONDS TOP RATING

Fitch Ratings in March assigned the State of Israel's upcoming 10-year USD sovereign bond an 'A' rating

April 2009

MERRILL LYNCH CONFIDENT IN ISRAELI ECONOMY

International brokerage applies to join Israeli bourse as remote member

In a clear vote of confidence for the Israeli economy, the international investment firm Merrill Lynch applied for remote membership to the Tel-Aviv Stock Exchange (TASE).

December 2008

MSCI TO UPGRADE ISRAEL TO DEVELOPED MARKET STATUS

Morgan Stanley Capital International to reclassify Israel to developed market. – *July 2009*

Further recognition

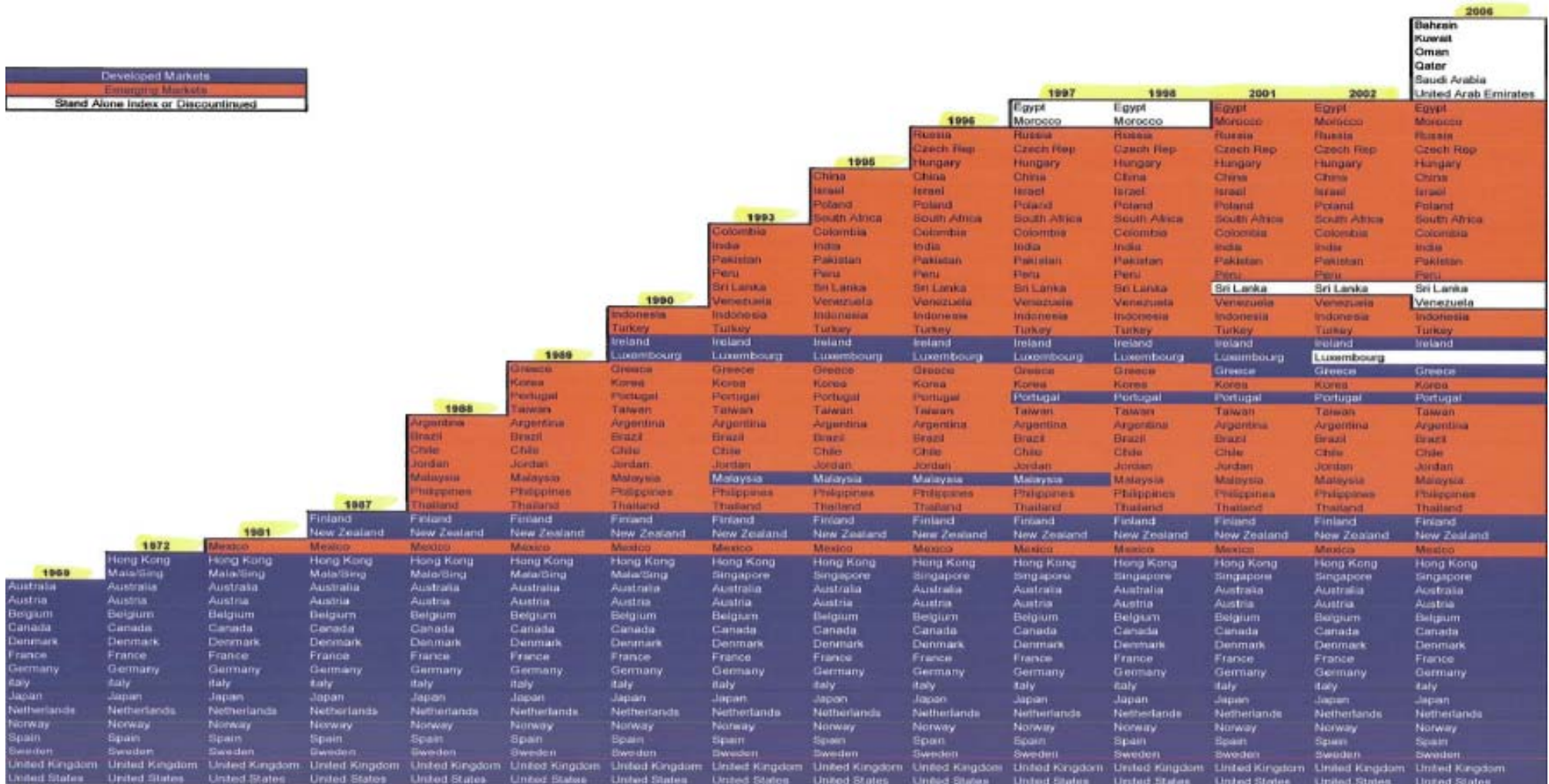
Joining OECD organization

- In May 2007, Israel was officially invited to apply for OECD membership.
- The approval process typically takes 2–3 years and will include multiple visits to Israel.
- Currently, Israel holds an observer role and is playing an active role on 68 committees.
- Israel already complies with most OECD requirements:
 - ✓ Free market economy
 - ✓ Democratic regime
 - ✓ GDP level
 - ✓ Tax treaties
 - ✓ International treaties (e.g., BASEL, KYOTO)
 - ✓ Innovation (e.g., patents)

3. New indices and weightings

New indices and weightings

Evolving global markets



New indices and weightings

MSCI will upgrade Israel starting from 31 May 2010

Category	Emerging market	Developed market
Overall country ranking	9 out of 26	20 out of 24
Avg. market weight	3.17%	0.55%
Indices	<ol style="list-style-type: none">1. EFM – Emerging and Frontier Market2. EFM EMEA3. EM	<ol style="list-style-type: none">1. MSCI WORLD2. MSCI EAFE (Europe, Australia and Far East)3. MSCI Kokusai (World ex. Japan)

- The new market weighting is similar to Denmark and Belgium
- It is estimated that 40-50% of foreign investors in Israel are MSCI index tracking funds. Of those, about 1/3 are passive and expected to sell their holdings by Q2 10.
- The expected outflow will be ~USD 2.3B, while the inflow from developed market funds should be ~USD 3B, creating a net inflow of USD 700MM (Citi). However, investment distribution may be more concentrated (i.e., Teva).

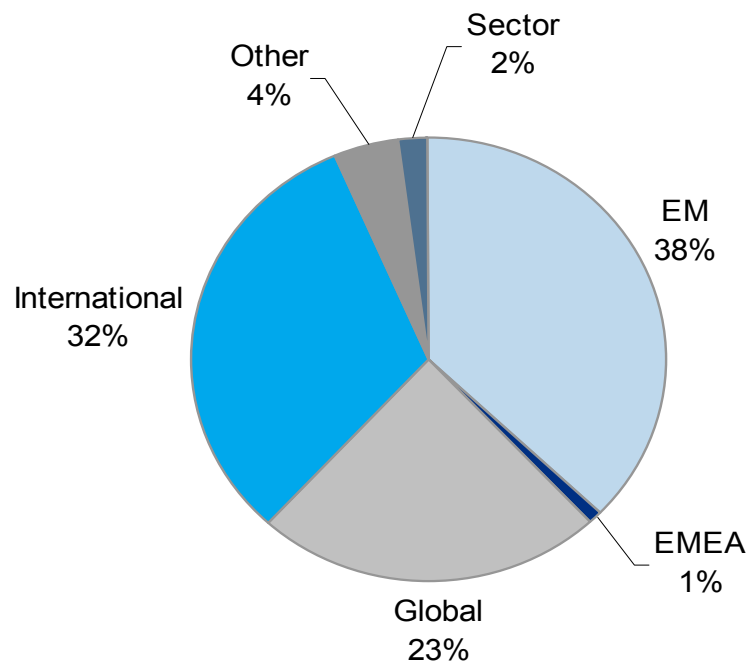
4. MSCI upgrade - market predictions

Emerging Market Investors

Emerging Market-focused investors represent a significant proportion of the institutional ownership structure of Israeli companies. This presents a challenge in the next 6-12 months for Israeli corporates.

Example: Ownership of TA-25 Israeli Corporate

- A detailed fund analysis of one Israeli TA-25 corporate shows that c. 40% of the institutional ownership is held in Emerging Market funds



Example: Top 20 Funds Holding TA-25 Israeli Corporate

- Of the top 20 funds, 9 are emerging market funds

Fund Name	% O/S
Dodge & Cox International Stock Fund	2.63
Vanguard International Growth Fund	2.22
American Funds New World	1.99
iShares MSCI Emerging Markets Index Fund	1.28
American Funds Capital World Growth & Income	1.20
T Rowe Price Emerging Markets Stock Fund	0.80
Fidelity Funds SICAV - Emerging Europe, Middle East and Africa	0.54
Vanguard Emerging Markets Stock Index Fund	0.46
Mellon Investment Fds. ICVC - Newton Managed Fund	0.43
The Government Pension Fund - Global	0.42
T Rowe Price Emerging Europe & Mediterranean Fund	0.34
DJE - Dividende & Substanz	0.33
MFS International New Discovery Fund	0.27
Schroder ISF - Middle East	0.27
DeAM (Japan) DWS World Agribusiness Mother Fund	0.21
Mellon Investment Fds. ICVC - Newton Balanced Fund	0.21
Bernstein Emerging Markets Portfolio	0.21
Newton Bridge Fund	0.19
Russell Investment Company Plc - The Emerging Markets Equity	0.19
Mellon Investment Fds. ICVC - Newton 60-40 Global Equity Fund	0.19

Source: Factset 2009

Note: Yellow highlights Emerging Markets Funds



Market predictions

Wall Street analysts mostly predict short-term negative effect and longer-term benefit.

“The overall positive effect of the new inflows may take a while to be felt, since Emerging Markets fund managers will sell very quickly, but Developed Markets fund managers will build their positions over time, so that the short term effect may be negative.”

“Reclassification will bring \$2.8 billion into the local market through passive investments managed through ETFs over time. This seems like a tidy sum indeed, but 75% of the money will be invested in just three stocks: 60% in Teva, or about \$1.7 billion, and the rest in Israel Chemicals and Check Point Software Technologies.”

- *Merrill Lynch/Bank of America*

“The biggest risk is that developed market investors ignore Israel, or perhaps more likely only look at the largest MSCI names. Although we can expect short-term weakness on most Israeli stocks this could offer selective buying opportunities.”

- *UBS*

“We expect a net negative impact on the TA-25 as emerging market funds exit Israel. Some developed market funds may enter, but will probably only partially compensate for the outflows. Moreover, while we expect the outflow to start immediately, the inflows will commence only after May 2010 when the implementation starts officially. This could quickly create a significant downward pressure on the index.”

“Domestic-orientated stocks, as opposed to global cyclicals, are expected to suffer the most. Companies such as Bezeq, Cellcom and Partner offer exposure to a stable and affluent domestic market, they are cash generative and offer a high dividend yield. While these qualities stand out in the emerging markets universe, they are similar to high-quality companies such as France Telecom or Deutsche Telekom, without offering the scale and liquidity of the latter.”

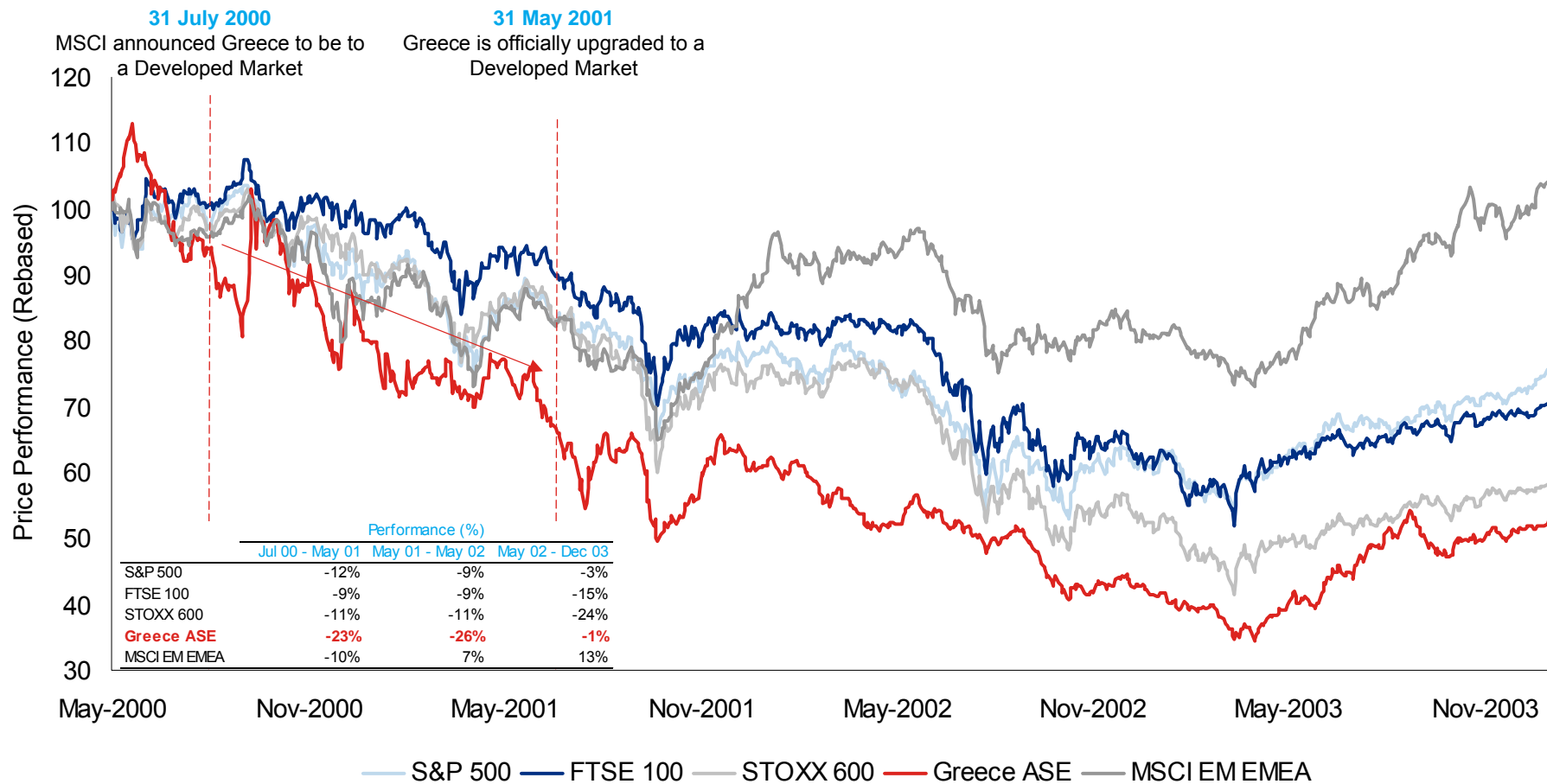
- *Excellence Nessuah*



What happened to Greece?

Following its upgrade in May 2001, the Athens Stock Exchange (“ASE”) significantly underperformed both Emerging and Developed Market Indices. This occurred as appetite from European investors was not sufficient to compensate for the outflow from EM-focused funds.

Greek Equity Market Underperformance Following Inclusion in MSCI’s Developed Market Index

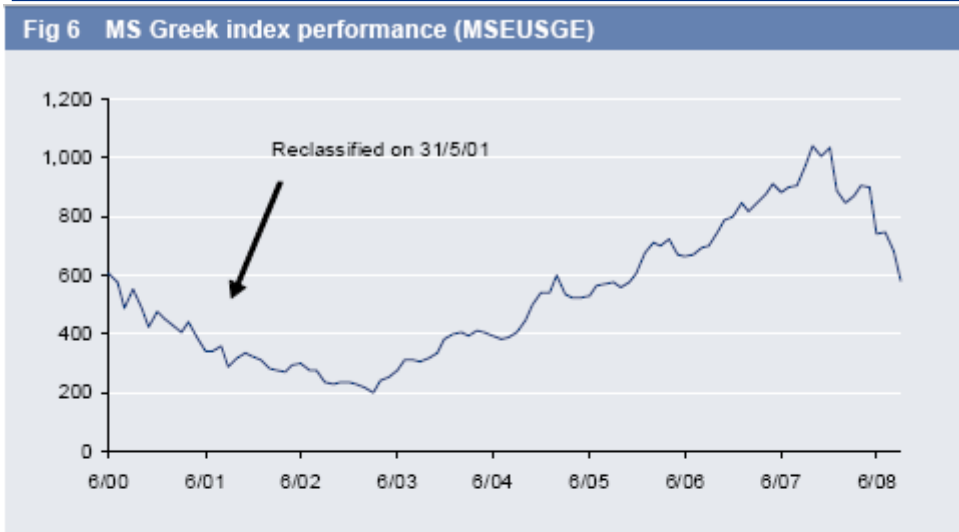


Source: Factset

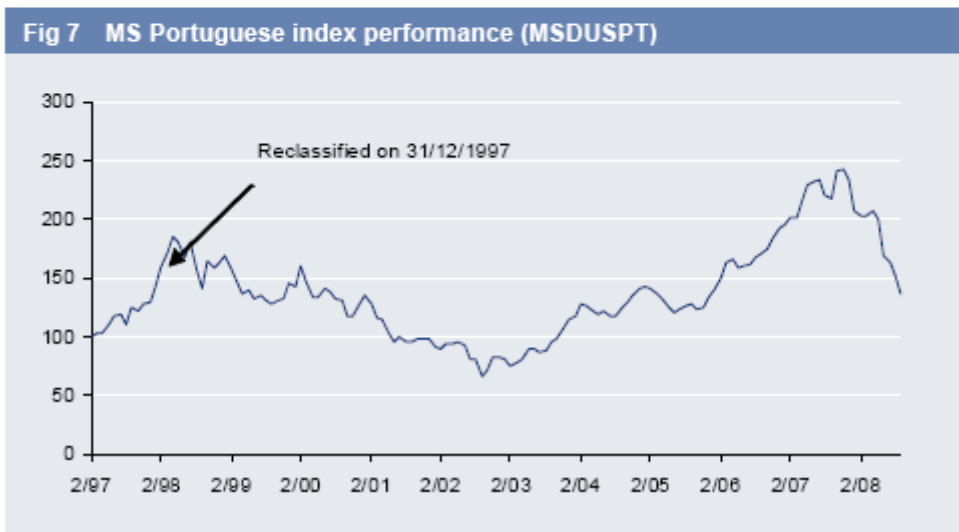


Longer term stability

The next 12 months offer a significant potential challenge for Israeli corporates.



Source: Bloomberg



Source: Bloomberg

Investor opportunities:

- Leverage the passive EM fund selling to enter the market
- Utilize MSCI EAFE indices to focus on Israel
- Become familiar with leading Israeli companies that have fallen off the radar for passive EM investors



Thank You



Questions & Answers

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