TEL-AVIV STOCK EXCHANGE

2010: Review of Events

'2010 saw the end of the global crisis and the beginning of the recession', many a financial commentator summarize the events in these words. Indeed, 2010 can be characterized as a year of hesitant recovery for many western economies, as reflected in sluggish growth rates, high unemployment and in government endeavors to bring order to national budgets.

In comparison, Israel's economy fared well, although apprehensions that the global recession will slow down exports and growth here gained momentum this past year as well.

Against this backdrop, it's easy to comprehend the relatively mild performance coloring Israel's financial markets in 2010. After spiking 90% in 2009, the TA-100 index had to settle for relatively modest gains in 2010. Towards the end of the year, index and trade volume figures reached levels similar to those of the end of 2007, however in an entirely different economic environment – an environment in which interest rates and growth rates were significantly lower than in 2007.

Stock market performance was uneven over the two semesters, sending mix messages to investors. During the first half of the year, trading volume and primary market activity was considerably higher than in the second half, which was characterized by relatively higher price returns than in the first half. The impact of the oil and gas exploration sector on the market also differentiated the two six-month periods, as did the impact of Israel's upgrade by MSCI to developed market status.

In addition to the 'normal' factors affecting the market in 2010, two 'extraordinary' developments are particularly noteworthy:

The first is the discovery of gas, which caused a spike in exchange activity in gas exploration shares. Price increases contributed to approximately one fourth of the increase of the TA-25 and TA-100 indices, while the turnover of these shares and limited partnership units were responsible for approximately 12% of the annual turnover in shares (as opposed to 0.2% during the years 2006-2008).

The second development, TASE'S upgrade to developed market status by MSCI, precipitated, as anticipated, a large sell-off of Israeli shares apparently by emerging market investors during the second quarter of the year. Market data suggests, however, that the hit sustained from the upgrade was short and mild. First, Bank of Israel figures indicate that as early as July, there was a renewal of net purchases of Israeli shares by foreign investors. Second, against the many foreign sellers stood an equally large number of buyers (Israeli and foreign alike), and at the end of the day, the decline in prices was relatively modest throughout May and June. Subsequently, prices not only rebounded but increased substantially.

In this context, it is worth mentioning that on May 26th, the day the upgrade went into effect, trading volume on the equity market came to US $ 4.4 billion, eight times the average daily turnover for the entire year. Trading was conducted seamlessly throughout the day without interruption and the only TASE 'intervention' necessary was an extension of trading hours. Years of development and continual upgrade were vindicated, as the TACT trading system admirably withstood the stress test. The decades of man years and substantial budgets that were invested in TACT paid off and for this we extend our gratitude to TACT's developers and the maintenance personnel at TASE and at its members.

In the regulatory realm, the two most important legislative initiatives were legislation initiated by the Israel Securities Authority regarding administrative [civil] enforcement, and the establishment of a court specializing in corporate affairs and securities law.

In addition to TASE's various current activities, work on long-term projects continued this year at an accelerated pace. The most prominent project completed and "entering production" in July 2010 is the comprehensive reform of TASE indices, i.e. adaptation of TASE indices to the advanced methodology developed by FTSE. The new methodology has rendered the construction and management of indices more rational and transparent.

In 2010 the preparation of new capital adequacy rules for non-bank members was completed. The new model replaces existing TASE rules, which are unable to address the radical changes that have occurred within Israel's financial services industry since implementation of the 'Bachar reform' some five years ago. The new model was approved by the Israel Securities Authority towards the end of the year.

Throughout the year TASE embarked on various activities supporting its evolution into a financial hub for high-tech enterprises. Becoming a financial center for high-tech companies - Israeli and foreign alike - is a strategic goal for which TASE intends to spare no effort in its attainment. We will continue implementing the measures launched this year as well as additional activities still in various stages of conceptualization and planning.

In 2010 additional foundations were laid to further develop the derivatives market in the coming year. First, a new set of incentives for designated market makers was devised for the nascent stock option market (comprised of options on Teva Pharmaceutical Industries, Bank Leumi, Bank Hapoalim and Israel Chemicals shares).

Second, the Ministry of Finance (the Treasury) and TASE have formulated a new and improved format for options on “Shahar” bonds that will replace the futures launched in 2006, a product which did not succeed to gain popularity. In 2011 the Treasury and TASE intend to issue cash-settled options on select large “Shahar” bond series that will help institutional investors on the one hand and the planning of Treasury auctions on the other.

One cannot summarize TASE activity in 2010 without mentioning two important initiatives undertaken in the area of clearing house risk management. First, the Bank of Israel will become “lender of last resort” for the TASE clearing houses, should the need arise. The need to reach an understanding with the Bank of Israel on this matter is not new, however the global financial crises sharpened awareness on this matter and the new Bank of Israel Law provided the opportunity to rectify the situation.

Second, clearing and settlement of TASE-traded securities took another step forward at the end of November with the transition to T+1 settlement of non-government bonds. From this time on, clearing of most of TASE-traded securities is carried out in a delivery versus payment (DVP) regime. In the coming year, the historical step will be completed, with the transition to T+1 for shares. As a result of these actions (among others), we were recently notified by the Thomas Murray, the leading rating firm for clearing agents, that the rating of TASE Clearing Houses has been upgraded to A+. We are certain that the measures already undertaken and those in pipeline for 2011 will make an important contribution to the stability of the Tel Aviv Stock Exchange and to investor confidence, at home and abroad, in Israeli securities investments.

The key areas of activity were mentioned above and joining these are a number of important issues, which cannot be discussed in detail within the limited scope of this summary review. These include advances in computer infrastructure, the establishment of a sophisticated backup facility, the foundation-laying for the new TASE headquarter, the handling of distressed corporate bonds, the upgrade of risk management and control systems, the handling of applications submitted by three foreign investment houses for TASE membership, the shepherding of legislative amendments, and more.

This is also the opportunity to thank all the parties that supported and assisted our activity – the Board of Directors, the executive management and employees, the Israel Securities Authority, the Ministry of Finance and the Bank of Israel.

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