



Private Banking  
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"Leumi - The Best Private Banking in Israel"

(Euromoney Survey, February 2009)

### What's in "Investor's Review"

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### Select Indices

	Rate	Return in % June	Return in % 2009
TA 100	801	-0.83	42.04
TA 25	862	-2.19	31.70
DOW JONES	8,447	-0.63	-3.75
NASDAQ	1,835	3.42	16.36
NIKKEI 225	9,958	4.57	12.40

Correct to 30.06.2009

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# INVESTOR'S REVIEW

ESPECIALLY FOR LEUMI UK PRIVATE BANKING CLIENTS

## Macro Economic

By: **Eyal Raz**, Head of Economics Department, Finance and Economics Division

### *As expected, the Bank of Israel's interest rate remains unchanged*

The Bank of Israel (BoI) kept its interest rate for July unchanged at the very low level of 0.5%. The unusual degree of monetary expansion by the BoI is reflected, since the beginning of the year, in the decline in the level of real short-term interest rates.

In our opinion, the correction in the real interest rate to 2-3%, which reflects a nominal rate of 5-6% (assuming an expected inflation rate of 2-3%), is only a question of time. However, based on current data, the raising of interest rates is not expected to begin in the coming months. When the raising of rates begins, it will be expected to continue over a substantial period until return to the level of "normalization".

We also note that raising of interest rates in Israel is expected to precede a similar process in the US and Europe. This is due to the following reasons: inflation in Israel did not fall by the same degree that occurred in these other regions, where the annualized rate of price changes recently turned negative; the depth of the recession in Israel is not as severe as it is in other countries; and thirdly because the crisis in the financial sector in Israel was not nearly as sharp and as damaging as that experienced in the financial sectors of other regions of the world.

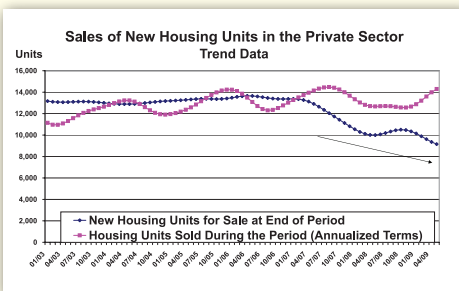
### *An increase in housing unit sales in the private construction segment between January and May 2009*

The number of housing units sold in the private construction segment increased 3% in the first five months of 2009 compared to the same period last year. An analysis of trend data from recent months shows an increase

in housing unit sales (an increase in demand) alongside a downward trend in the inventory of units remaining for sale (a reduction in supply), also against the backdrop of the small number of housing construction starts in the economy.

The ratio of the number of units remaining for sale at the end of any given month to the number of apartments sold in the same month is called the "month's supply of housing". As of May 2009, this figure indicated only an eight month's supply remained – the lowest figure since 2003. The combination of the rise in demand to a peak level (see accompanying graph) alongside the decline in the housing supply was reflected in a rise in housing prices over the last year. However, the phenomenon of the rise in demand for housing during a period of recession (negative GDP growth) and upward trending unemployment is a puzzling development.

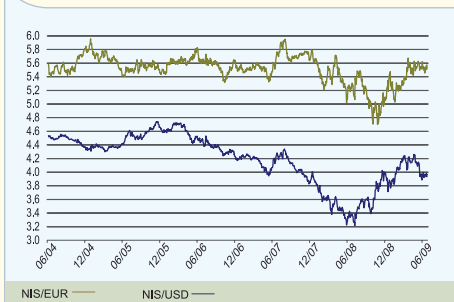
Indeed, Israel's housing market did not suffer from the "bubble" conditions created in similar markets in the US and in various European countries; yet, it was still expected that the impact of shrinking economic activity would be more acute. It may be that this special situation reflects changes in the Israeli public's preferences regarding the composition of their assets, with a greater preference for investment in housing. This comes against the backdrop of the negative yields in many financial instruments in 2008 and the drop in the short-term interest rate to almost zero.



# World Macro

By: **Liora Caplan**, Capital Market Research Department, Investment Counseling Division

**Euro and USD vs. NIS**



During June, there was increasing concern over the pace of expected recovery in economic growth. Macro data continued to indicate a slow gradual recovery. Most published data continued to reflect the tough economic environment while some data showed slight improvement and further stabilization. During the month, certain indicators drew more attention than others. Interestingly, the publications that earned the most attention were those that focused on the negative aspects of the data. This would suggest that investors are again looking at the glass half empty and not solely seeing the glass half full, as they have been for the last few months.

**TA25**



The US consumer's financial condition seems to be improving. Sentiment has lifted and average income has grown; spending also increased but at a much slower pace. US personal savings as a percentage of disposable income has jumped from 0% in April 2008 to 6.9%, a level last seen in December 1993. At the same time, after contracting at an annualized rate of over 14% during Q1, consumer credit has declined further. This means that, in general, the consumer's condition has improved but also implies a smaller chance for a quick recovery in economic growth, as private consumption is crucial for GDP growth.

**Oil Prices per Barrel (USD)**



The US housing sector did not supply any dramatic news this month. Slight increases were recorded in housing starts, building permits and existing home sales alongside a slight decline in new home sales. Taking a long term perspective, none of these reflect a meaningful change in existing trends but rather indicate the market is stabilizing at very low levels. One rather troubling report published on the last day of the month was a hike in the percentage rate of seriously delinquent prime loans (considered the least risky mortgages), which constitute about two thirds of the mortgage market. The rate rose from 1.1% during Q4 2008 to 2.9% during Q1 2009. At the same time there is an ongoing rise in modified mortgages (modifications can range from interest rate reductions to extended loan life). History shows that modified mortgages have less chance of turning delinquent.

Mixed news came from the employment front. The number of jobs lost during June was considerably lower than in previous months but the unemployment rate jumped to 9.4%. Meanwhile, no signs are evident of a meaningful change in the number of initial jobless claims for unemployment benefits.

This month, the Fed convened for an interest rate decision. The language used in the ensuing statement was not as negative as in the previous one, a fact indicating less anxiety concerning potential negative developments in the economy. Additionally, the Fed made no changes to its plans to purchase \$300 billion worth of US Treasury bonds.

**Gold Prices (USD)**



In global stock markets, the positive trend seemed to subside somewhat during June. The performance of US major indices was mixed - the Dow Jones Industrial Average Index lost 0.6% while the Nasdaq Composite gained 3.4%. In Europe, indices moved less in tandem and were more influenced by local developments. Thus France, the UK and Germany declined during June, while in Spain and Switzerland the main indices registered positive returns. The MSCI World and Emerging Markets Indices both declined, losing 0.6% and 1.5% respectively.

In light of the considerable gains registered in the markets since the lows of March along with evidence of a shift in sentiment, we believe markets will either remain stable or head lower in the near future.

# Israel – From an Emerging to a Developed Market

By: Capital Market Research Department, Investment Counseling Division

On June 15, 2009, MSCI announced it was changing Israel's status from an emerging market to a developed market. This decision was made after the company investigated the issue and consulted with leading international investment institutions. It is worth noting that the Israeli market was the only one whose status was upgraded this year, despite the fact that other countries were also candidates for having their status changed to developed markets or to emerging markets (from frontier markets). The Israeli market is the 24th market to receive this status from MSCI. The last country to be upgraded was Greece in 2001. As of May 2010, MSCI will include Israel in two of its leading indices: MSCI World and MSCI EAFE (Europe, Australasia and the Far East).

This decision is further evidence and recognition of the Israeli economy's achievements, including the development of a sophisticated capital market. However, one significant negative that arose for debate, while Israel was being considered for an upgrade, was the speed of executing transactions in the domestic market and the fact that Israel would have to adapt itself to the global standard. It should be noted that this actually attests to the amazing progress in the Israeli market seen in recent years, including the diversity of products traded, accessibility to the market and development in trading of the shekel, etc.

Anticipation of this decision led to attempts to assess its impact on the volume of foreign investment in the Israeli market. The volume of financial investment (in negotiable securities) in Israel by foreign citizens was \$214 million in 2008. From the beginning of January through the end of April 2009, the accumulated volume of investments has grown to approx. \$880 million, which contributed to the Israeli market's impressive performance as compared with most developed markets throughout the world. Defining Israel as a developed market will divert capital to Israel from a greater number and wider variety of global investment institutions, which should act in favor of the domestic economy over the long run.

Over the short term, there are a number of areas that will be affected by this decision. Among them, the movement of money linked to the MSCI indices is expected to have the greatest impact on the Israeli market.

- The weight of the Israeli market in relation to the emerging markets was significantly higher than it is expected to be in relation to the developed markets (2.5% of the emerging markets compared with approx. 0.38% of the developed markets).
- The volume of money linked to the developed markets is significantly larger than the volume of money invested in emerging markets. Also, we note there are financial institutions that limit themselves to only investing in developed markets.
- The rate at which money flows to developed economies changes slowly as compared to what is typically seen in money invested in emerging economies. This will result

in decreased volatility on the Tel Aviv Stock Exchange (TASE).

- The Israeli market's entry into the developed markets indices will only take place in a year's time, while the withdrawal of money by institutions that only invest in emerging markets is expected to take place over the short term.
- It should be noted that we expect a gradual inclusion of the Israeli market in the investment portfolios of institutions that invest in developed markets. We note that an investment in a developed market is more conservative than an investment in an emerging market. However, the geopolitical situation in Israel is still a risk factor that will not disappear with the change in Israel's classification, and it is expected to have a more material effect on investors' decision-making process.
- A positive effect is expected on the government bonds market. As a developed market, the risk of Israel's credit ranking being lowered has lessened substantially. Among developed countries, which also have different rankings, yields play a central role in decision-making. At this time, the Israeli bond yields are relatively more attractive than those in other developed markets.
- Regarding active investments, foreign investors prefer to invest in a relatively limited number of Israeli stocks (e.g., Teva, Check Point, Hapoalim, Leumi, ICL and Bezeq). This issue has two facets. On the one hand, it is expected that there would be a preference for investing in companies with international operations over those with only domestic operations. On the other hand, less of an effect is expected on dual listed stocks, the prices of which are determined overseas.
- Israel's ability to raise capital has improved. Major companies in Israel can also raise money at a slightly lower cost.
- Small Israeli companies with limited operations will have difficulty raising money overseas. They might even need to "disguise" themselves and register as being foreign based in order to register for trading on the international markets.
- Finally, most of the forces active in the forex market, mainly a global weakening of the dollar and a surplus in Israel's balance of payments, are pushing towards a strengthening of the shekel. The withdrawal of investors' money over the short term is expected to moderate these forces.

In conclusion, it must be taken into account the possibility of a short-term negative effect on the Israeli market as a result of MSCI's decision. Nevertheless, we believe the decision to be a positive one and estimate that it will support the Israeli market's standing in the long run. This is in light of the Israeli market's favorable position compared with other developed markets, especially given its relatively strong growth potential.

# Going Further – Bank Leumi (UK) plc\*

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Leumi Private Banking is proud to protect and enhance the wealth of its international clients and their families through a comprehensive range of private banking, investment and trust services.

We welcome new clients.

### Banking Services

We offer a full range of banking services in all major currencies, accept deposits for sums of £50,000 and above (or equivalent in other currencies), and provide payment services, cheque books and charge cards.

### Investment services

For sums of £250,000 and above (or equivalent in other currencies) we offer both Advisory and Execution Only Services. We can offer investment advice on fund choice and also asset allocation and portfolio valuations in all the major currencies. Invested cash can be held in the currency of your choice.

### Wealth Planning Solutions and Fiduciary Services

We structure, establish and administer trusts, private investment companies registered in various locations, and foundations, through our subsidiary in Jersey.

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We provide lending facilities against portfolios of securities, bank guarantees, UK properties, cash deposit, and on a back-to-back basis (a loan backed by a deposit held in the same or different jurisdiction).

### Executive Mortgages

We offer a flexible five-year, interest only mortgage with a multi-currency option intended for UK and expatriate high net worth individuals for the purchase of their residential property in the UK.

\*Bank Leumi (UK) plc is authorised and regulated by the Financial Services Authority.

### Leumi Private Banking

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\*\*Bank Leumi (Jersey) Limited is regulated by the Jersey Financial Services Commission.

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