The Domestic Market

February 4th 2010

Weekly Review of the Israeli Capital Market

31/01/2010-4/02/2010

A Summary of the Recommendations in the Review

Equities	The positive trend is expected to continue in view of the improvement in the macroeconomic picture and the low yields expected in the conservative channels. Nevertheless, the current low price level in the equities market (which is reflected from the predicted earnings multiplier) is not low from a historic aspect and, consequently, it appears that even if price hikes persist in the market, their rate is expected to be measured and subject to a high volatility level
Bonds	In both the unindexed and indexed channels, we recommend maintaining a medium average expected lifespan in the portfolio. The attractiveness of investing in the corporate channel has remained weak.
Forex	We believe that the moderation in the risk appetite that commenced recently and the continuing apprehension regarding the economies of various countries in the Euro Zone will provide short-term support for the dollar. Over the longer term, the greenback's strengthening will be affected by the American economy's recovery

Major Events in the Capital Market during the Past Week

- **The disengagement is continuing**
  Similarly to previous weeks, the TASE has continued to exhibit impressive solidity compared with overseas markets.

- **Inflationary expectations are moderating out**
  In view of the expectation of low indices over the forthcoming months, inflationary expectations derived from the capital market are continuing to decrease. This trend has had a positive effect on both the government and corporate unindexed channel this week.

- **High yields in the 1-year Treasury bill issue? Capital gains later in the week.**
  The high volume of 1-year Treasury bill raisings prior to closing the tender at a relatively high yield, because of the relatively sharp yield decline in the unindexed channel this week, the tender participants benefited from making handsome capital gains within a few days.

- **Going overseas**
  A report published by the BoI on incoming and outgoing capital movements, indicates an increase in outgoing Israeli investor capital in favor of overseas.

- **The effective shekel is at a peak**
  This week, the effective shekel rate published by the BoI recorded a peak since January 2008. Globally, the dollar has continued its appreciation against most currencies.

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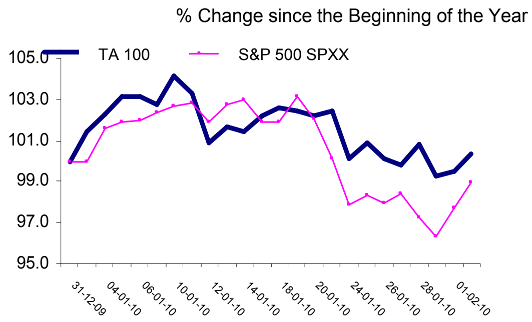
The Stock Market

This week, trading on the TASE was again characterized by impressive solidity, compared with the overseas markets. This was noticeable in both the stability recorded by the share indices and the decreased standard deviations embodied in the Moaf options to only approx. 16%. Against the background of the TASE's stability, real estate shares stood out with price hikes, while realizations of bank shares continued.

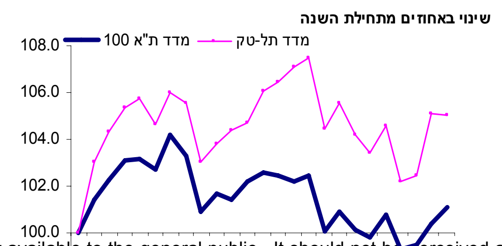


This week, trading volumes continued to decline amounting to a daily average of approx. NIS 1.6 billion, compared with NIS 1.8 billion last week and NIS 2.3 billion during the first fortnight of 2010.

On summarizing the week, most of the leading share indices remained unchanged. The Maof and TA 75 indices declined by approx. 0.1% and 0.3% respectively, the Tel-Tech 15 and Real Estate 15 rose by approx. 0.1% and 1% respectively, while the banks closed the week losing approx. 0.9%.

Despite the surplus returns exhibited by the TASE recently, a BoI report published this week on outgoing and incoming capital movements indicates increased outgoing Israeli investor capital in the overseas direction. In 2009 Israeli investment in shares overseas amounted to approx. $6.9 billion, compared with $2.4 billion in 2008. Simultaneously, foreign investments in Israeli shares also increased to approx. $1.8 billion on 2009, compared with similar realizations in 2008. However, in December there was moderation in the trend and a substantial decrease in the sum of foreign investments in Israeli shares, compared with previous months.

Many dual listed companies, especially those in the technology sector, were traded under the influence of their 2009 financial statements, this week. Thus, the shares of Check Point, Nes Technologies, Audiocodex and



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Radvision benefited from results that surpassed expectations, raising their 2010 forecasts and, in their wake, from updated recommendations.
In contrast, Alvarion stood out negatively. Despite the increased WiMAX revenues, an operating loss was recorded.

The pharmaceutical sector was also traded against the background of the financial statements publications. Periggo reported excellent results, compared with forecasts, especially in the earnings entry. At approx. 17% of revenue, compared with 12.2% in the corresponding 2008 quarter the operating profit was especially impressive and has had a positive effect on forecasts for 2010.

Teva benefited from a status improvement in the contest for acquiring Ratiopharm following Pfitzer's withdrawal from the race. This deal should reinforce Teva's status in the European market in general and in Germany in particular.

In the macro arena, the BoI published the Q4/09 inflation report this week, which indicated that the Bank believes that real activity is likely to expand by approx 3.5% over the coming year with an unemployment rate decline to a yearly average of approx. 7.1%. This means that towards the end of 2010, the unemployment rate is expected to drop below 7%, the same level as prior to the crisis.

A Look to the Future

We believe, the positive trend is expected to continue, in view of the improvement in the macroeconomic picture and the low yields expected in the conservative channel, which support the domestic equities market (because of both the low capitalization rates and the rise in the risk appetite). Nevertheless, the current low price level in the equities market (which is reflected from the predicted earnings multiplier) is not low from a historic aspect and, consequently, it appears that the price hike rate is expected to be measured and volatility in the market is expected to be high.

The Bonds Market

Trading in the government bond market was conducted in a positive trend this week, against the background of reducing the inflationary forecasts amongst forecasters and the decrease that has commenced in inflationary expectations derived from the capital market (primarily as a result of the sharp

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reduction expected in electricity tariffs). This decease in inflationary expectations led to strengthening assessments that the bank rate will not be raised by any material rate over forth coming months. These assessments caused sharper price hikes in the long segment of the yields curve. On summarizing the week, the unindexed and indexed government bond indices rose by approx. 0.7% and 0.2% respectively. Yields on both non-indexed and indexed government bonds with average lifespan expectations of approx. 10 years are currently approx. 5.37% and 2.73% respectively, compared with approx. 5.45% and 2.77% recorded at the end of last week. The current spread between 10-year unindexed government bonds and similar American bonds narrowed this week to approx. 1.3%, compared with 1.5% at the end of last week, because of the inverse trading trend that took place in bonds overseas. In contrast to the change trend in the CDS margins in countries with a similar credit rating to the that of Israek, Israel's risk premium overseas as measured by the 5-year CDS margin narrowed this week to approx. 120 basis points from 122 basis points at the end of last week.

This week, inflationary expectations derived from the capital market decreased across the yields' curve, with the decrease in expectations for one year more significant than those for medium and longer terms.

This decline in inflationary expectations took place in view of the expectation of low and even negative CPIs during Q1/10, inter alia, because of the electricity tariff declines that will take place during this period.

Despite the aforementioned, in its inflation report for Q4/09, the BoI has assessed that, over the short run, forces for price hikes in the economy are acting (even though these seem to be at a rate that corresponds with the price stability target). This assessment is based on both the anticipated increase in economic activity, which would support demands and the expected global appreciation of commodities prices.

The BoI assesses that, during 2010, the CPI will rise by 2.5% (similarly to private forecasters' forecasts, which on an average were 2.3% for the forthcoming year at the end of January). The inflation moderation this year, according to the report, will be accompanied by a gradual bank rate raising process and will derive from a number of causes, the most important of which are: The slow recovery of the global economy, the reduction of VAT at the beginning of the year, the effective appreciation recorded recently in the

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shekel exchange rate and the negative GDP spread (the economy's production capability exceeds the demand level for domestic products), which was created because of the zero growth of the GDP last year. This spread is expected to remain negative throughout the coming year.

The increase in the monthly Treasury bill volumes continues to benefit those participating in them. Thus, the 1-year Treasury bill issue that took place this week closed with a yield of 2.05%, and was traded at the end of the week with a yield of only 1.95%. It should be noted that the decrease in inflationary expectations also contributed to the Treasury bill yield decline, which currently embodies a bank rate of 2.5% in the economy in another year.

This week, corporate bonds benefited from the positive trend in the government channel and from the decreased inflationary expectations. Thus, while the Tel-Bond 20 and Tel Bond 40 Indices recorded hikes of approx. 0.5% and 0.9% respectively, the Unindexed Tel Bond Index rose at the sharper rate of 1%. On summarizing the week, average yield spreads between the bonds constituting the indices and similar government bonds narrowed to approx. 1.5%, 2.4% and 2.0% respectively this week, compared with approx. 1.5% 2.5% and 2.1% last week.

Since the beginning of the year the Unindexed Tel-Bond Index has presented outperformance against the indexed corporate bond indices. We believe that its rise, has reduced the attractiveness of an individual investment in bonds included in it, especially in view of the fact that the yields spread above government bonds embodied in them are low in comparison with those offered in indexed corporate bonds.

A Look to the Future

In view of the expectation of a bank rate hike, we expect a creeping upward yields hike in the government channel. However, the current interest rate received on medium-and long-term bonds, the expectation of a low government debt raisings over the forthcoming year and the high yields spread relatively between long and short government bonds are likely to compensate for this yields hike and, we believe, even imparts a preference for an investment in medium-high from long-term bonds. Investors who do not wish to increase there exposure to risk are currently forced to suffice with short-term investments at lower yield levels

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The indexed channel We believe that an average expected lifespan of 4-7 years should be maintained in this section of the portfolio.

The unindexed channel We believe that an average expected lifespan of 3-6 years should be maintained in this section of the portfolio.

Corporate bonds - We believe, should economic indicators continue to portray an improvement in the domestic and global economies during the forthcoming months as well, the existing yield spreads between the corporate and government channels are expected to narrow throughout the forthcoming year.

The Forex Market

This week, the dollar remained almost unchanged against the shekel in a relatively narrow trading range.

Globally, the dollar strengthened this week, breaking through the 1.4 dollar to the euro level and recording a six-month peak against the euro. The greenback's appreciation derives from the publication of a number macro data in the Anmerican market including the ADP review, which indicated a more moderate than expected decrease in the numbers of jobs in the US private sector. At the end of the week, the American economy's unemployment figures, which are expected to have an effect on trading, will be published.

Another factor that supported the greenback this week was the continued apprehension regarding the economic situation in various Euro Zone countries. This apprehension was also amongst the primary factors for the sharp weakening at rates of 9/0% and 3.5% that the euro has recorded against the dollar since the beginning of December and the beginning of 2010 respectively.

This week, as anticipated, the ECB and the BOE left their main refinancing rate and bank rate respectively unchanged at 1% and 0.5%, which firmly established the interest rate spread between them and the US.

On summarizing the week, the dollar weakened by 0.2% against the shekel and strengthened by 0.6% against the euro.

According to Central Statistics Bureau data, in 2009 a current account surplus of approx. $7.2 billion was recorded after the $2.1 billion in 2008. This development was affected, inter alia, by the fact that commodities and services imports moderated at a sharper rate than commodities and services

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exports. A major factor in the moderation of the import surplus during the past year was the decline recorded in energy products and other raw material prices, the global price of which declined together with the crude oil price decline.

In the BoI's Q4/09 inflation report published this week, the Bank indicates that the current account surplus of the balance of payments is expected to decrease to approx. only $3.0 billion in 2010. According to the Bank, this will derive from the consumption of durable goods and the investment in the economy that are expected to increase over the coming year at a high rate, the major part of which will derive from imports. Furtjhermore, in the report, the Bank claims that commodities prices and especially the crude oil price are expected to increase this year against the background of the economic recovery. In this context, the bank quotes the expectations of the IMF that fuel prices will rise during 2010 by an annualized 22.6%. This trend will also support the expected increase in imports.

This expected reduction in the current account surplus will contribute to reducing the flow of forex overseas this year, which is likely to prejudice the strength of the domestic currency.

A Look to the Future

We believe that the moderation in the risk appetite that commenced recently and the continuing apprehension regarding the economies of various countries in the Euro Zone will provide short-term support for the dollar. Over the longer term, the greenback's strengthening will be affected by the American economy's recovery

Translated by the products Marketing Department

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