



December 2, 2014

Summary of the Monetary Committee discussions on November 18, 2014 regarding the management of the foreign exchange reserves

Increasing the diversification of equities portfolio to additional markets

Background:

In 2012, the Bank of Israel began to invest in equities, against the background of low returns worldwide, changes in the Bank of Israel Law, the change in the Monetary Committee's risk profile, and due to the sharp increase in the reserves, as a result of, among other things, purchases in the past two years to offset the effect of natural gas production. In the first stage, it was decided that investment in the equities portfolio will be diversified among the major equities markets represented in the numeraire currencies—the US, Germany, France and the UK. Currently, the equities market investment allocation of the foreign exchange reserves portfolio is 5.6 percent in the US, 1.4 percent in Germany, 0.2 percent in France, and 1.1 percent in the UK.

Based on numerous empirical findings documented in research, international diversification of equities investments is likely to improve the risk-return ratio. Despite the increase over recent years in the integration between markets worldwide, international diversification of investments is still expected to contribute to improving the portfolio's risk-return ratio. Notable proof of that can be found in the marked difference in the magnitude of different markets' responses to the financial crisis and in their different performance during the process of exiting the crisis. Against this background, the Monetary Operations Department examined the worthwhileness of investment in additional equities markets and on the basis of that analysis recommended to diversify the equities investment into equity markets in Japan, Korea, and Hong Kong.

Decision:

The Committee approved the recommendation to include equities market investments in Japan, South Korea, and Hong Kong, within the framework of the annual asset allocation of the foreign exchange reserves portfolio for 2015. The Committee likewise approved investment in those markets within the framework of the Department's degrees of freedom to manage the equity investment beginning with the date of the decision. This is all with a maximum amount of 1/3 percent in each market. The recommendation was accepted by a majority of four votes, one member opposed the decision. The Committee member who opposed it was of the opinion that it is better to wait and only include investment in those markets within the framework of the asset allocation that the Department will present at the beginning of 2015.

Participants:**Members of the Monetary Committee**

Dr. Karnit Flug, Governor of the Bank of Israel, Chairperson

Dr. Nadine Baudot-Trajtenberg, Deputy Governor

Prof. Alex Cukierman

Prof. Reuben Gronau

Prof. Nathan Sussman, Director of the Research Department

Other participants

Andrew Abir, Director of Market Operations Department

Mickey Blank, Deputy Head of Dealing Unit in Market Operations Department

Francoise Ben-Zur, Head of Financial Division in Market Operations Department

Golan Benita, Head of Strategic Management Unit in Market Operations Department

Guenia De Mayo, Head of Risk Management Unit in Market Operations Department

Daniel Hofbauer, Portfolio Manager in Dealing Unit in Market Operations Department

Hagit Waknin, Economist in Market Operations Department

Mark Yohai, Senior Economist in Strategic Management Unit in Market Operations Department

Roev Levy, Economist in Risk Management Unit in Market Operations Department

Yoav Soffer, Bank of Israel Spokesperson

Ilan Socianu, Assistant to Secretary of the Monetary Committee and the Supervisory Council

Esti Schwartz, Secretary of the Monetary Committee and the Supervisory Council