

CHAPTER XIX

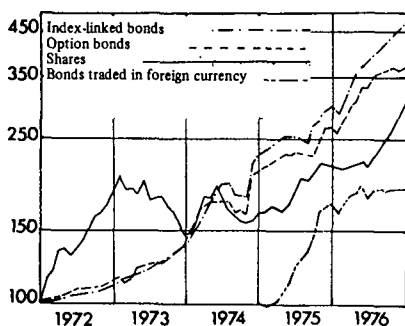
THE SECURITIES MARKET

1. MAIN DEVELOPMENTS¹

The major developments in the securities market in 1976 were the drastic drop in net capital mobilization through security issues and the considerable changes throughout the year in the volume of issues, the price level, and the trade volume in both the bond and the stock market. In general, holders of securities traded on the Stock Exchange received a considerable real yield on holdings of both stocks and bonds in Israeli currency.

Net bond issues in Israeli currency showed an unprecedented drop this year (41 percent, or 55 percent in real terms), following a slowdown in the growth of issues in the last two years. Net issues reached IL 2.5 billion this year, which is similar to the level of net issues in 1971.

FIGURE XIX-1
SECURITY PRICE INDEXES 1972-1976



The main cause of the drop in capital mobilization through bond issues was the distinct decline in the rate of private savings and its real level, following the drop in real disposable income in 1976. Another essential cause which greatly contributed to the drop in issues was the government measures taken in the capital market at the end of 1975. There were intensified fears that government measures would worsen the return on holdings of index-linked financial assets (which mainly affected the public's desire to hold bonds directly). These factors lowered the issues capacity of the government and the financial

institutions to a great extent, either directly, by lowering public demand for direct holding of bonds, or indirectly, by reducing the institutional investors' demand for bonds

¹ This chapter deals with securities issued with a prospectus (including government and Jewish Agency securities which do not require a prospectus) registered for trade on the Exchange. The discussion on fund mobilization by means of bond issues is not limited to bonds registered for trade: bonds awaiting registration for trade have also been included at their estimated market value. Short-term bonds are not dealt with here but in Chapter XVII.

TABLE

**SECURITIES LISTED FOR TRADING ON THE STOCK
AND FOREIGN SECURITIES (MARKET**

	Market values			
	1972	1974	1975	1976
	(IL billion)			
BONDS				
1) Linked to foreign currency	0.1	0.1	0.2	0.2
2) Traded in foreign currency ^b	1.2	1.6	2.7	2.9
3) Total foreign currency (1)+(2)	1.3	1.7	2.8	3.1
4) Index-linked	2.3	8.2	12.7	19.4
5) Option-type linkage	3.7	9.4	11.9	14.3
6) Total COL linked (4)+(5)	6.1	17.7	24.6	33.7
7) Subtotal (3)+(6)	7.5	19.1	27.4	36.8
8) Bonds not yet listed for trade ^c		0.7	1.7	1.4
9) Total bonds (7)+(8)	7.5	20.1	29.1	38.1
SHARES				
10) Traded in IL	2.6	3.5	5.3	9.8
11) Traded in foreign currency	0.2	0.3	0.7	0.9
12) Total shares (10)+(11)	2.8	3.7	6.0	10.6
13) Convertible bonds	0.1	0.5	0.8	0.9
14) Total convertible bonds and securities (12)+(13)	2.9	4.2	6.8	11.5
15) Foreign securities ^b	0.3	0.5	0.6	0.9
16) Total securities portfolio ^d (9)+(14)+(15)	10.7	24.8	36.5	50.5
17) Total securities linked or traded in foreign currency (3)+(13)+(17)	1.9	2.4	4.1	4.8

^a Not including securities not intended to be listed for trade, such as certain institutional bonds.

^b The market value of securities traded in foreign currency was calculated at the Natad rate (end of year).

XIX-1

**EXCHANGE (LISTED AND MARKET VALUES)^a
VALUES), SELECTED YEARS, 1972-1976**

Weight at market prices in total listed securities portfolio			Increase or (-) decrease					
			Listed values	Market values	Real market values	Listed values	Market values	Real market values
1972	1974	1976	1975			1976		
(percent)			(percent)			(percent)		
			-6.6	69.7	37.4	-5.4	10.1	-20.2
			12.3	68.5	36.4	39.5	9.6	-20.6
12.4	6.8	6.1	11.7	68.6	36.5	38.2	9.6	-20.6
			49.6	54.7	25.2	20.3	52.0	10.1
			-1.2	25.5	1.6	-8.5	20.6	-12.6
56.8	71.4	66.7	22.6	39.1	12.6	8.0	36.9	-0.8
69.4	78.2	72.9	22.5	41.6	14.6	33.3	34.1	-2.8
70.4	81.2	75.5	30.6	44.9	17.3	26.0	31.0	-5.1
			35.2	52.2	23.2	48.6	85.2	34.2
			65.4	160.5	110.9	0.6	24.8	-9.6
24.6	15.1	21.1	38.2	60.5	29.9	42.9	78.1	29.0
			55.8	75.5	42.1	-25.9	5.8	-23.3
27.3	16.9	22.8	41.7	61.8	31.0	27.8	69.4	22.7
32.0	1.9	1.7		22.2	-1.1		51.0	9.4
100.0	100.0	100.0		47.9	19.7		38.4	0.3
17.8	9.7	9.6		70.0	37.6		18.0	-14.5

^c The market value of bonds issued but not yet listed for trade estimated according to accumulate index differentials and interest.

^d Including bonds not yet listed for trade on the Stock Exchange.

(social insurance funds, savings programs, etc.), because the public reduced its long- and medium-term financial savings in these frameworks. The price increases during the second half of 1976 did raise public demand for linked assets, but this increase did not offset the restraining influences of the above-mentioned causes.

The sharp drop in the real rate of return on redemption of long-terms bonds in the secondary market was outstanding in the first half year. This drop resulted from market forces which adjusted the return on redemption to the decreased level of return on issues at source to the public at large. Until the completion of this adjustment process, no bonds were issued to the public. A decline in real rates of return on redemption takes place when bond prices rise beyond the general price increases. In general, the real rate of return on index-linked bonds was quite high during 1976, about 11 percent.² The real rise in bond prices also caused considerable growth in the real value of bonds held by the public. This increase, of course, had a negative effect on the level of issues this year.

As to the stock market, 1976 was as positive as the previous year (contrary to the preceding period). In general, the yield on stocks was relatively high — 9 percent in real terms (as against 6 percent in 1975 and 27 percent in 1974). Fluctuations in securities prices lessened in 1976, but the dispersal of yield among the various stocks increased. Stock and convertible securities issues amounted to IL 754 million in 1976. Even though this is a decrease of 5 percent as compared with 1975, the wave of issues continued in the first quarter of 1977 (IL 460 million, while bond prices increased in real terms by 17 percent on the average).

Examination of stock prices, trade volume, and issues in 1976, indicates a great difference between the first half and the second half of the year. In the first, the stock market showed a stagnancy which was expressed in a drop in the real level of stock prices (13 percent), and a lack of issues. In the second half of the year, this market showed signs of recovery. Stock prices rose (19 percent in real terms), and there was a relatively high level of issues. This recovery continued extensively in the first months of 1977.

The recovery in the stock market in the second half of 1976 (and the beginning of 1977) was not the result of changes in the level of economic activity, or expectations of future economic development. It was apparently connected mainly with changes in the composition of public demand for financial assets, and especially the transition of demand from bonds to the stock market. It is reasonable to assume that this corresponds with public fears that linkage terms of bonds held by it will be affected. The decline in the attraction of bonds and linked financial savings in general actually began in 1975; this was perceived in the second half of the year, with the recovery of the stock market.

² After deducting the Cost-of-Living Index rise throughout the year (38 percent) from the nominal rate of return of 53 percent.

This phenomenon stopped in the early months of 1976 and was renewed when the adjustment of returns in the secondary bond market was completed. (During this adjustment process, investment in bonds bore a considerable real rate of return, as mentioned above).

It should be noted that capital mobilization from the public through stock issues was more moderate than reflected in the data. The greater part of bank and financial holding company issues, which were responsible as in the past, for most of the annual issues, was acquired by institutions connected with the same financial concern as the bond issuer (social insurance funds and various financial institutions).³

In spite of the growing volume of stocks in the securities market, in 1976 this market was based primarily on bonds, with stocks assuming only 23 percent of the issues and 8 percent of the trade.

As to securities trades in foreign currency, this year as in the past, the net redemption of bonds continued. The price of these securities increased in 1976 by 9 and 25 percent (bonds and shares respectively), which represents a considerable real decline. In 1975, when the creeping devaluation was introduced, the real decline was 74 percent in bonds and 82 percent in stocks.

The rapid growth of mutual funds, which characterized past years, ceased in 1976: the net volume of issues of participation certificates was similar to that of 1975, representing a real decline of 26 percent. The real rate of return for holders of those certificates was only minus one percent. However, most holders of these certificates are small investors who disperse their investments, benefiting this way more than they could by direct investment.

The market value of the securities portfolio (for definition, see Table XIX-1) showed no real increase in 1976, after a 20 percent rise last year. This standstill reflects a real drop of 4 percent in the market value of bonds in Israeli currency and an increase of 34 percent in shares and securities convertible into shares in Israeli currency. The real market value of securities traded in foreign currency showed a decline of 14 percent. These trends are also reflected in the structure of the tradeable securities portfolio.

2. THE BOND MARKET

The main developments in the bond market in 1976 were a sharp decline in net issues (especially in the first half year) and the continuous decline, over the entire year, of the real rate of return on redemption of long-term bonds traded in the secondary market.

³ It can be assumed that the considerable liquidity deficits facing the banking system in the last years (see Chapter XVII) affected the desire of commercial banks to issue shares.

This process was mainly the result of the lowering of return on issues at source for the public at the end of 1975. This step caused a price rise in the secondary bond market which was faster than the general price increase, and the establishment of a relatively high real rate of return during the year: 11 percent (index-linked and option-type bonds registered on the Stock Exchange). The increase in the real value of bonds held by the public was sufficient to supply part of the additional public demand for index-linked assets in 1976, and thus it had a negative effect on the net level of issues this year.

The main cause for these developments, as will be explained, were the drop in the rate of private saving and its real level following the decline in real disposable income in 1976, as well as government measures taken in the capital market at the end of 1975, which were accompanied by public fear of further measures. These facts reduced the demand for bonds at source, both for direct holding of bonds, as well as for bonds of the institutional investors (social insurance funds, savings programs, etc.), as a result of the continuing real decline of long- and medium-term savings within these frameworks. The accelerated rate of inflation in the second half of 1976 did in fact increase public demand for linked assets. During this period, the drop in the real rate of return on redemption of long-term bonds traded on the Stock Exchange was greater than that justified by the lowering of the rate of return at source. But this increase was not nearly sufficient to offset the restricting effects of the above-mentioned factors.

The net volume of bond issues in Israeli currency dropped sharply in 1976: about 41 percent, or 51 percent in real terms. This sharp decline followed a slowdown in the growth of issues in the last two years (1974 and 1975): an increase of 17–18 percent per year, which represents a drop of 15–16 percent in real terms. A special factor causing an increase in issues in 1975 and a steeper decline in 1976 was the advanced purchase of bonds by the public and the institutional investors in December 1975 in anticipation of government measures in the capital market.

In mid-December 1975 the government took several measures in the bond market whose effect was felt in 1976: the issue to the public of 100 percent linked bonds was stopped, and the linkage rate was lowered to 90 percent. The issue of fully linked bonds to institutional investors continued; since their investment portfolio was “frozen” they (with the exception of mutual funds) diminished their activity on the Stock Exchange. Measures against concealed capital were taken as well: no more bearer bonds were issued, and an obligation to report on cash transactions exceeding IL 15,000 was imposed. Furthermore, an intention to impose a turnover tax of 1.5 percent was declared, though this was not realized. Cash transactions are in fact registered, but there is no current reporting on them to tax authorities.

Lowering the return on new bonds issued from December 1975, as well as the worsened terms of bonds issues in recent years apparently created the fear that older bonds would also be affected. This fear was based on declarations of high officials and

public debates on the need for such a step. Furthermore, government measures in the capital market in December 1975 probably removed from the bond market capital which had previously been concealed from the tax authorities.

TABLE XIX-2
NET ISSUE OF BONDS IN ISRAELI CURRENCY, 1973-1976
(annual data)

Year	Net nominal issue (IL million)	Change	
		Nominal	Real ^a (percent)
1973	3,040	63	36
1974	3,562	17	-16
1975	4,196	18	-15
1976	2,473	-41	-55

^a Discounted by the annual average rise of the Cost-of-Living Index.

Real disposable private income declined in 1956 as did the rate of private saving, and this reduced demand for bonds. The real drop in public deposits in savings programs indirectly reduced the demand for bonds by causing a decline in purchase of bank bonds against savings programs. Purchases of other institutional investors apparently dropped as well.

On the other hand, the accelerated inflation in the second half of 1976 caused a rise in the alternative price of holding unlinked assets, this increasing the desirability of purchasing index-linked bonds. To a certain extent this moderated the above-mentioned negative effects.

The changes in taxation introduced in 1975 also affected the market. "Laundering of books", a loophole that allowed avoiding tax payments, was almost completely prevented at the end of September 1975. This measure reduced the return for the "laundering" investor. With the direct tax reform in 1975, the rate of tax deducted at source from interest on bonds was raised from 25 to 35 percent, reducing the net return. The direct tax reform decreased the desirability of obtaining credit for investment in bonds by firms whose major business is not securities trade.

We shall conclude the discussion on factors affecting the demand for bonds by examining the return data (the monthly average increase rate of the bond price index),⁴ and

⁴ We measure here the return over time (*ex post facto*) on securities as differentiated from the rate of return on redemption, which can be calculated exactly at any point of time. The significance of the data we possess is limited, due to the employment of the securities price index, which is not an inclusive rate of return index, because it does not include cash dividend payments to the shareholders nor interest (accumulated or actually paid) for bond holders.

TABLE
DOMESTIC ISSUES OF SECURITIES AND
(IL

Gross sales of IL securities				
	Total bonds (1)	Savings schemes (2)	Provident fund insurance, and pension institutions (3)	Others ^b (1)-(2)-(3) = (4)
1974	6,346	1,679	2,718	1,949
1975	8,044	2,135	3,751	2,158
1976	9,350	2,452	5,240	1,658
January	396	120	273	3
February	448	170	276	2
March	658	190	461	7
April	465	85	376	4
May	538	140	320	78
June	889	430	443	16
July	585	182	359	44
August	843	200	389	254
September	1,186	250	459	477
October	1,309	240	605	464
November	1,012	185	559	268
December	1,021	260	720	41

^a Rounded figures.

^b To the public, mutual funds, etc.

^c The parent company of one of the commercial banks undertook to purchase IL 154 million worth of the issues of its bank (IL 72 million in 1975), while the

NET MOBILIZATION OF CAPITAL, 1974-1976

million)^a

Net estimated mobilized capital						
Shares ^c	Convertible bonds	Redemption of tradeable loans ^d	Net Bank of Israel acquisitions on Stock Exchange and over-the-counter	Total bonds less redemptions and Bank of Israel acquisitions on Stock Exchange (1)-(7)-(8) = (9)	Total net IL capital mobilized (5)+(6)+(9) = (10)	Net foreign currency bonds
(5)	(6)	(7)	(8)			
304	127	2,742	40	3,562	3,993	-139
467	325	3,697	145	4,196	4,988	-135
660	94	6,231	646	2,473	3,198	-107
—	—	276	120	0	0	21
—	—	160	261	27	27	-9
—	—	282	105	271	271	-17
—	—	543	13	-91	-91	-26
—	—	461	2	75	75	-20
294	38	545	41	302	634	-11
40	—	344	40	200	240	-8
15	14	503	-5	345	374	-29
25	—	536	-5	655	675	-18
30	7	847	19	444	486	18
—	30	837	46	130	160	5
256	5	897	9	115	347	-13

parent company itself issues shares worth even more. In order to prevent double calculation of this issue, the sum has been deducted from the value of the share issue.

^d Maturity of principal and interest and linkage payments are included in redemptions.

SOURCE: Tel Aviv Securities Exchange; Ministry of Finance, Foreign Exchange Department.

the involved risk (the return fluctuations, as measured by its standard deviation).⁵ The real return on index-linked bonds increased in 1976, but it also involved increased risk (see Table XIX-4), so that the combined effect of these two elements is not clear. The ratio between the return and the standard deviation increased in 1976 (the return increased at a higher rate than the risk). This element may therefore have counteracted restricting effects on demand in 1976.

The effect of lowering linkage rates on bonds from 100 to 90 percent did not in itself reduce the return for the purchaser to any great extent, though one can get that impression at first glance. The linkage calculation is not made by crediting partial linkage each year until the due date, but rather by calculating accumulated price increases from the time of issue until payment is due and then taking the appropriate percentage. It appears that even with a definite rate of inflation, a bond bearing 80 percent linkage will still have a net positive return. For example, lowering the linkage rate from 100 to 90 percent on a 10-year bond bearing a net return of 2.6 percent would decrease the rate of return to 1.6–1.8 percent, at an annual average inflation rate of 20 to 15 percent. At the same time, the price of fully linked bonds would rise by 7–9 percent in the secondary market.⁶

Prices of bonds did in fact show a real increase of 10.8 percent in 1976. This means a real growth in bonds held by the public, adequate to supply part of the additional public demand for index-linked assets. This had a negative effect on the net level of issues.

The drop in demand for bonds in 1976 caused a change in the distribution of purchasers at source: the share of the public in purchases decreased (directly and through the mutual funds – see Table XIX-3), the share of the banks in acquisitions for holdings against savings programs remained stable, and the share of the social insurance and pension funds and insurance companies increased. One cannot draw significant conclusions from these data due to the lack of redemption classification. This prevents classifying net purchases according to purchasing sectors, as does the possibility that bonds can be transferred from one group of holders to another.

Acquisitions of the social insurance and pension funds and insurance companies at source are subject to annual fluctuations. Besides higher purchases at the end of the year, apparently due to the funds' obligations towards the controlling authority, their purchases intensify when policy measures are taken which cause an increase in the COL Index and also when there are expectations of worsening bond terms.

⁵ Calculation of the return and risk is based on the real prices of the securities examined (their price index divided by the Cost-of-Living Index), since we do not assume money illusion of investors in securities. Therefore, a bond price change parallel to the general price change involves no return or risk in holding the security.

⁶ A further lowering of the linkage rate from 90 to 80 percent will increase the price of fully linked bonds by a further 8–10 percent under the same inflationary conditions as designated.

The decline in the real return rate on redemption of bonds in the secondary market (see Table XIX-6)⁷ was connected with the adjustment of rates of return on redemption in this market to the lowered return of issues at source (to the public), and with the accelerated rate of inflation in the second half of the year. The adjustment of the returns was relatively slow in the secondary market, due to the drop in demand for bonds and the uncertainty in the market. On the other hand, it seems that the accelerated rate of inflation in the second half of 1976 intensified the demand for bonds and caused a downward trend in the real return on redemption, which was sharper than that indicated by the lowering of the return at source. The intensifying inflation causes the holding of unlinked assets to be costlier, and investors are therefore prepared to accept a lower yield.

As regards the rate of net return on redemption in 1975 and 1976, one should note the decline deriving from the higher tax deducted at source (from 25 to 35 percent) following the direct tax reform in 1975.

The return on redemption of 8–9 year bonds dropped in 1976 while the desirability of acquisition at source increased. In months of expectations of changes in the rate of inflation, there was a similar change in net issues and a change in the opposite direction in the return for investment in most series.

The slump in acquisitions at the beginning of the year, as mentioned previously, was connected with early acquisitions at source as a result of expectations of worsened terms for issued bonds.

The recovery in net sales in March (IL 271 million) is related to the diminishing of subsidies and the increase in fuel and electricity prices. In June, prior to the implementation of VAT, net issues rose (IL 302 million). In May–June and following, an anticipated inflation of 25–36 percent was assumed, so that acquisition of bonds with long-term maturity dates on the secondary market was lower than their acquisition at source. In June–December, the intensification of acquisition and the net volume of sales was similar to the average in 1975.

Issues reached a peak in September (IL 655 million). In this month, the period between the bond issue and its registration for trade was shortened from 6 to 4 months. In October, prior to price increases on vital items, net issue was still high (IL 444 million). In November and December, issues were lower: IL 120 million per month. In November rumors spread regarding the possibility of a package deal, causing expectations for a slowdown in the rate of inflation, and in December there was a further worsening in the linkage rate of acquisitions at source.

⁷ In calculating the return on redemption it was assumed: (a) that prices do not increase from the publication of the index until the day of calculation, and (b) that prices will not increase during the month of redemption, or that the increase will be equal in both cases. Assumption (a) underestimates the rate of return in months of rapid price increases. Assumption (b) ignores the linkage loss suffered by the redeemer because of an index rise from the day of publication of the index until the redemption day.

In October 1976, savings certificates amounting to IL 1,184 million (including interest and linkage) became due for redemption. Holders of these certificates were offered the possibility of continuing to hold them for an additional four year period at the terms designated on the bonds (5 percent unlinked interest and full index linkage of the principal), with no negotiability. Those continuing to hold the bonds also benefit from continuous linkage of the principal to the COL Index, even though the October redemption was carried out by linking the principal to the June index. It is difficult to learn from public behavior about the propensity to accept this offer. The public's consciousness of the cost of delayed presentation of the certificates increased due to years of experience gained under inflationary conditions and the publicity given to it by the Bank of Israel. Out of the bonds redeemable in October 1974, 80 percent were presented for redemption (in monetary terms), within 13 months of their reaching maturity, as against 3 months for bonds redeemable in 1975. The tendency to shorten the redemption period did not continue in 1976: public reaction was similar, and even a bit slower, than its reaction in the previous year. Assuming the tendency to shorten the repayment period were to continue, this might indicate a slight degree of public willingness to continue holding the bonds.

The growth rate of bonds trade was slower than in the previous years, though it was quite high — 60 percent (see Table XIX-5). The exclusion of institutional investors from trade on the Stock Exchange at the end of 1975 apparently caused this slowdown. The fast turnover of bonds continued this year. The bonds' registered value for trade increased (in market prices) by only 34 percent, and hence the turnover velocity increased by 19 percent. There was apparently a difference in the expectations of the various investing groups, and that caused the increase in the volume of bond trade.

About 52 percent of the trade in bonds on the Stock Exchange was in option-type loans, even though the weight of those loans was only 39 percent of the bonds registered for trade in market prices at the end of 1976.⁸ (In 1975 their weight in the trade was 43 and 44 percent respectively). Trade concentrated in those securities because of their approaching redemption and their resulting higher liquidity.⁹ It was reasonable to expect that their price increase would be more stable than index-linked bonds, redeemable after a longer term. In fact, the situation was the reverse (see Table XIX-4 and Figure XIX-3). It would seem that the cause is the adjustment of market prices, which previously had been based on the estimated index rise after the monthly publication of consumer prices. The intervention of the Bank of Israel in the trade of index-linked securities, contributed to their lower fluctuations as compared with option-type loans. (The share of the

⁸ In the negotiable portfolio (not including the part frozen in the institutional investors' portfolio), the proportion is apparently lower than 39 percent.

⁹ The difference between the option-type and index-linked loans (besides the unlinked option which is inferior to linkage) is in their distance from maturity.

Bank of Israel in the trade of these loans was 4 percent, and in other bonds in Israeli currency, 17 percent).

The price increase of linked option-type bonds were faster than the COL Index rise. During the entire year the price index of the linked bonds¹⁰ (option-type and linked) increased by 10.8 percent in real terms. The price increase also reflected the interchange in demand for stocks and bonds. In order to show this interchange, in spite of the increase in both stock and bond prices, Figure XIX-2 presents the price increases of both, after deducting the average upward trend during the year.

TABLE XIX-4

**ARITHMETIC AVERAGE AND STANDARD DEVIATION OF MONTHLY
CHANGES IN BOND AND SHARE PRICES AND BOND YIELDS, 1972-1976**

(Real data^a)

		Index- linked bond prices	Option- type bond prices	Regular bond prices	Monetary & insu- rance share prices	Industrial share prices	Natad rate	Index- linked bond yields ^b
1972 average	(1)	-0.1	0.1	4.4	4.13	—	0.96	5.2
Standard deviation	(2)	1.3	1.5	4.7	3.64	—	1.41	0.2
1973 average	(1)	0.0	-0.2	4.2	3.0	3.7	1.3	5.8
Standard deviation	(2)	1.2	1.2	5.4	6.0	5.3	1.5	0.6
1974 average	(1)	0.3	-0.1	-2.6	-2.2	-4.0	-1.2	3.4
Standard deviation	(2)	3.5	5.2	6.9	7.0	8.6	5.9	1.3
1975 average	(1)	0.5	0.5	0.9	0.2	1.8	1.3	2.6
Standard deviation	(2)	3.1	2.1	3.8	3.0	7.3	2.8	1.0
1976 average	(1)	1.0	0.3	0.5	0.6	0.03	-1.8	1.0
Standard deviation	(2)	3.6	5.2	2.9	3.0	4.69	2.2	1.3

^a Calculated after dividing by the COL Index.

^b The arithmetic average and standard deviation of yields to maturity, not of rates of change, as with the other items.

¹⁰ After addition of interest paid on the bonds, as interest is deducted by the Central Bureau of Statistics when calculating the index. To obtain the real value of the price increase, the COL Index rise was deducted from the nominal increase.

In order to regulate prices of government bonds, the Bank of Israel also participates in trade in the secondary bond market, taking into consideration monetary policy as well. In general, injections by the Bank of Israel¹¹ through these transactions increased extensively in 1976. In the first quarter of 1976 (following government measures in the capital market) the injection of the Bank of Israel through securities transactions reached a monthly average of IL 160 million, though this dropped gradually during the year (see column 8 in Table XIX-3). Over half the transactions were in bonds with longer-term maturity dates.

FIGURE XIX-2

BOND AND SHARE PRICES, 1976
AFTER CORRECTING FOR THE UPWARD
TREND DURING THE YEAR

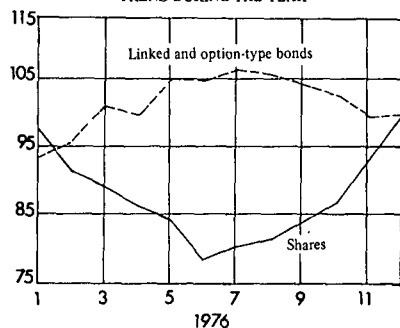
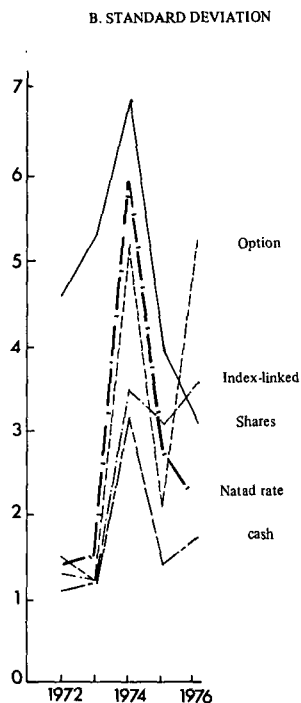
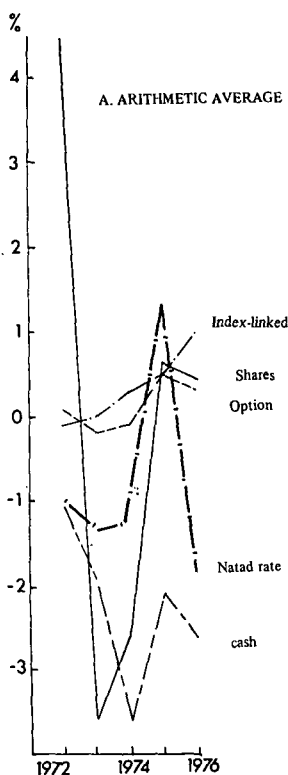


FIGURE XIX-3

RATE OF MONTHLY CHANGE IN PRICES OF BONDS,
SHARES, AND NATAD, 1972-1976



¹¹ The Bank of Israel acquisitions surplus after deducting principal redemption, interest payments, and linkage to securities. This amount includes purchases of bank defense loans (not registered on the Stock Exchange) totaling IL 284.5 million.

TABLE XIX-5
VOLUME OF BOND TRADE, 1974-1976^a

	Bonds (on the Stock Exchange)						Shares on the Stock Exchange	Total securities on the Stock	Total trade on the Stock Exchange and over-the- counter ^c	
	Linked to exchange rate	Linked to the price index	Option- type loans	Traded in foreign currency	Convertible	Total			Shares	Bonds ^d
(IL million)										
1974	17	786	2,007	172	75	3,057	519	3,576	959.2	10,000.0
1975	55	1,338	1,873	251	103	3,620	780	4,440	1,363.0	19,677.3
1976	39	1,558	2,017	230	178	4,022	1,432	5,454	2,830.3	31,389.2
Percent annual change										
1974	41.8	213.8	196.9	47.3	5.5	168.5	-18.3	109.0	-5.7	110.1
1975	230.7	70.2	-6.7	46.2	37.6	18.4	50.4	23.1	42.1	49.2
1976	-29.1	16.5	7.7	-8.3	72.7	11.1	83.6	24.0	107.7	59.5
Weight in total Stock Exchange turnover (percent)									Over-the-counter trade as percent of total trade	
1974	0.5	22.0	56.1	4.8	2.1	85.5	14.5	100.0	44.5	70.1
1975	1.2	30.4	42.6	5.7	2.3	82.3	17.7	100.0	42.7	81.6
1976	0.7	28.7	37.0	4.2	3.3	73.7	26.3	100.0	49.7	82.3

a Excluding trade in unlinked bonds and the Short-Term Loan.

b From this, IL 3,369 million (84 percent) is government loans.

c Over-the-counter trade data is based on reports of the licenced Stock Exchange brokers.

d Including convertible bonds.

SOURCE: Tel Aviv Securities Exchange.

TABLE XIX-6

**AVERAGE REAL NET YIELDS TO MATURITY OF BONDS
TRADED ON THE STOCK EXCHANGE, MONTHLY, 1975-1976**
(percent)

Years to redemption		Option- type loans 1-1/2-2	6-1/2% linked 3-1/2-4	4% fully linked 8-9	Absorption Loan, 1966-67 5-1/2	Traded in foreign currency 4
1975	October	0.60	3.06	2.94	1.66	2.85
	November	-0.40	2.89	2.94	1.36	2.08
	December	-0.40	1.73	2.33	1.99	1.95
1976	January	1.83	2.64	3.03	3.38	2.28
	February	1.79	2.69	2.87	2.82	2.11
	March	-1.23	0.64	1.67	0.39	2.84
	April	-1.33	0.16	1.58	0.52	3.95
	May	-0.91	0.28	1.61	0.26	3.50
	June	-1.28	-0.41	1.48	-0.19	2.77
	July	-3.37	-1.08	1.06	-0.98	3.63
	August	-2.13	-1.65	0.87	-0.80	3.09
	September	-2.72	-1.67	0.86	-1.93	2.88
	October	-2.72	-1.51	0.82	-2.51	3.04
	November	-2.12	-1.01	0.72	-1.22	3.48
	December	0.43	0.44	0.60	0.10	2.97

NOTES:

1. The yield shown in this table is an average of end-of-week data for government bonds.
2. The yield is calculated according to the last price index published before the monthly calculations.
3. Hollis' bond represents the tradeable bonds in foreign currency.

SOURCE: Bank of Israel computations.

Since the beginning of December 1976 bonds with 80 percent linkage to the COL Index have been issued to the public. At the same time, the interest rate on bonds to social insurance funds, savings programs and insurance companies was lowered by one percent (on new savings and policies only). The interest rate on bonds issued to social insurance funds, dropped to 5.5 percent (20 year bonds) and to 5 percent, and the insurance companies, 5.2 percent. Net issues registered in December were rather low, reaching IL 115 million, while in the first quarter of 1977 they totaled IL 937 million.

TABLE XIX-7

MONTHLY INDEX OF SECURITY PRICES ON THE TEL AVIV STOCK EXCHANGE, 1976^b
(DECEMBER 1975 = 100),
And Natad and Black Market Dollar Agio
(Monthly average)

End of period	Index linked IL bonds			Bonds traded in foreign currency corrected for Natad rate ^b	IL shares		Dollar agio	
	Total	Linked to index only	Option-type		Ordinary and preferred	Convertible bonds	Natad	Black market
1973	50.2	47.4	52.0		68.1			
1974	78.2	76.5	79.2		76.3			
1975	100.0	100.0	100.0	100.0	100.0	100.0	22.7	42.5
1976								
January	97.2	96.3	97.4	96.8	99.1	97.9	17.3	40.5
February	103.5	103.4	103.1	100.2	98.6	96.4	15.5	37.5
March	112.7	112.5	112.4	105.2	99.8	96.8	20.2	36.7
April	115.9	116.2	115.7	106.7	100.4	97.6	22.9	32.1
May	124.9	125.2	124.0	112.1	101.9	102.7	25.4	28.0
June	128.8	130.1	126.9	104.9	99.5	100.0	21.8	24.2
July	134.1	136.0	131.5	108.3	105.0	105.2	21.9	19.9
August	137.5	140.8	133.7	109.7	109.8	110.2	20.8	13.3
September	140.1	143.5	136.1	108.2	116.0	115.7	18.5	14.6
October	142.6	146.1	137.9	109.4	122.4	120.8	16.3	14.0
November	143.2	148.6	136.4	107.9	132.7	133.9	14.1	10.4
December	147.4	153.6	139.7	109.0	142.4	139.4	11.0	12.8

a Rate indexes were calculated by the Central Bureau of Statistics discounted by the interest which the bond entitles the owner to. For every month in 1976 the option-type and index linked bond rates were discounted by 0.32 percent. The bonds trades in foreign currency were discounted by 0.42 percent every month, and convertible bonds by 0.32 percent.

b The index of rates for bonds traded in foreign currency was multiplied by the Natad dollar rate index (December 1975 = 100).

SOURCE: Central Bureau of Statistics. Agio rates – Bank of Israel computations.

TABLE XIX-8
BANK OF ISRAEL ACTIVITIES IN THE SECONDARY
SECURITIES MARKET, 1974-1976

Year	Net injection (IL million)	Volume of business (IL million)	Share in IL bond trade (Percent)
1974	40	765	3.3
1975	145	1,191	3.0
1976	646	1,524	2.4

SOURCE : Bank of Israel computations.

3. THE STOCK MARKET

In the first half of 1976 there was a standstill in the stock market expressed by a considerable drop in the real level of stock prices¹² (about 13 percent), and no issues of shares or convertible securities.¹³ The second half of the year showed a considerable recovery. Stock prices increased by 19 percent, the volume of trade on the Stock Exchange and outside it grew, and the level of issues was higher. This recovery also continued at the beginning of 1977.

In sum, 1976 was a positive year for the stock market (similar to 1975 and contrary to the preceding period). The real total rate of return on shares traded on the Stock Exchange was fairly high, about 9 percent (as compared with 6 percent in 1975 and -27 percent in 1974). The fluctuations of share prices also decreased, but there was a rise in the dispersal of return among the various shares. The volume of stocks and convertible securities issued amounted to IL 754 million in 1976, a drop of 5 percent as compared with 1975. The extensive issuing of stocks continued at the beginning of 1977, at high prices, contrary to the developments observed at the beginning of 1976. Issues in the first quarter of 1977 reached IL 460 million, with a real increase of 17 percent in the stock price index.

The stock market recovery in the second half of 1976 did not follow a change in the level of economic activity or expectations for such a change. 1976 was a year of moderate economic activity with no growth. It also seems that expectations for developments in economic activity did not contribute to the recovery of the stock market, at least not to an extent justifying actual developments in the second half 1976, and definitely not those at the beginning of 1977. Neither did the considerable drop in private savings in 1976 help to explain the developments in the stock market. The reawakening of the market is apparently the result of structural changes in public demand for financial assets, and espe-

¹² A nominal nongrowth in the average level of stock prices against general price increases of 14 percent.

¹³ During the first five months of the year.

cially the transition of demand from bonds to the stock market. These changes are related to fears of effects on index-linked bonds (see Section 2 above). Those fears began in 1974, and the transition to the stock market was already perceived in the second half of 1975, when the stock market began to recover. This development, which halted in the first months of 1976, renewed upon completion of the adjustment of return on the secondary bond market to the lower rate of return on bonds issued at source (following the 1975 measures); during this process investment in bonds bore a considerable real rate of return (15 percent in the first half of 1976).

TABLE XIX-9
SHARE ISSUES^a, 1971-1976

	1971	1972	1973	1974	1975	1976
Volume of issues (IL million)	53	199	626	433	792	754
Volume of issues in 1970 prices (IL million)	47	157	413	205	267	195
Change in issues in 1970 prices (percent)	b	234	163	-50	30	-27
Weight of issues in total securities at end of previous year (percent)	5	14	21	14	19	11

^a Including convertible bonds.

^b In 1970 no shares were issued.

Even though the rapid increase in share prices and volume of trade encompassed all stock groups, the issue of stocks and convertible securities was carried out mainly by the banks and the financial holding companies, which sell a substantial part of their issues to the concerns with which they are connected. This means that mobilization of capital from the public, which was made possible thanks to the flourishing of the stock market, was in fact more modest than reflected in the data presented here. The continued flourishing of the stock market and the increase of its share in domestic capital mobilization require a further extension of the circle of investors in stocks mainly from the saving public.

As to the marketing of securities by the issuers, this year as well there were cases of selling "packages" of securities, namely stocks and options issued together, or packages of stocks, options and convertible securities, which are traded separately after their allocation. Apparently, the issue of a variety of securities related to one another enables the issuer to sell preferred securities together with inferior ones. This year as well deferred capital notes (options) which do not bear interest were issued, and some issuers allocated "rights" to shareholders in order to encourage acquisition of shares from new issues.

TABLE XIX-10

**MARKET VALUES OF SHARES ISSUED, BY ISSUING GROUP, AND NEW ISSUES
OF SHARES AND CONVERTIBLE SECURITIES, 1976**

	Market value of shares and convertible securities listed on the Stock Exchange			Issue of new shares for cash ^a of shares and convertible securities, 1976				
	Share of group in total market value, end of 1976	Rise in market value of shares in 1976		Shares	Convertible promissory notes and bonds	Total	Share of the group in total issue	Share of new issue in total market value of the group's shares at end 1976
	(IL million)	(percent)		(IL million)			(percent)	
Commercial banks and companies	5,993.8	52.1	72.7	524.0	80.2	604.2 ^b	80.2	17.4
Mortgage banks	779.0	6.8	78.1	52.0	0.0	52.0	6.9	11.9
Specialized financial institutions	975.7	8.5	25.5	0.0	0.0	0.0	0.0	0.0
Insurance	192.5	1.7	36.5	19.1	0.0	19.1	2.5	23.4
Commerce and services	281.7	2.4	53.8	12.7	14.0	26.7	3.5	14.5
Land, building, development and citrus	479.8	4.2	51.0	2.4	0.0	2.4	0.3	0.8
Industry	1,351.4	11.8	206.0	49.2	0.0	49.2	6.5	7.5
Investment and holding companies	1,439.3	12.5	222.4	0.0	0.0	0.0	0.0	0.0
Total	11,493.2	100.0	169.5	659.4	94.2	753.6	100.0	11.1

^a Excluding bonus issues, conversion of convertible bonds, issues not for cash and registration for trading of existing shares.

^b See note c in Table XIX-3. This correction was not made in the calculation of the total shares listed for trade.

SOURCE: Tel Aviv Stock Exchange.

TABLE XIX-11

WEIGHTED MONTHLY INDEXES OF QUOTED SHARE PRICES, 1972-1976

	Finance and insurance									Shares traded in
	General Stock Exchange index	Total	Commer- cial banks	Mortgage banks	Specializ- ed finan- cial insti- tutions	Invest- ment compa- nies	Industry	Commerce and services	Land, building, develop- ment	foreign currency:
										Price index correct- ed for Natad agio ^a
ANNUAL AVERAGE (December 1973=100)										
1972	66.6	59.6	—	—	—	69.9	—	—	95.5	—
1973	82.9	82.5	82.4	84.2	100.2	88.8	77.2	51.4	103.6	—
1974	77.0	77.9	77.1	82.1	93.5	77.8	75.2	50.8	90.3	—
1975	88.2	90.2	89.7	91.0	96.6	86.4	86.7	81.0	86.3	60.0
1976	108.1	111.4	109.5	121.6	115.2	107.9	110.9	99.2	108.7	118.3
END OF QUARTER (December 1975=100)										
March	100.6	100.2	99.2	102.7	98.1	100.5	89.3	92.3	11.0	109.6
June	99.5	100.0	99.1	100.4	110.3	99.8	98.9	89.1	89.4	117.4
September	116.0	117.4	114.6	138.6	119.1	112.6	114.2	104.6	115.8	124.6
December	142.4	143.8	139.1	178.1	140.4	138.5	136.9	125.4	153.1	124.8

^a Index of rates for shares traded in foreign currency multiplied by the Natad agio index (December 1975=100).

TABLE XIX-12

NET OVERALL RATES OF RETURN ON LISTED ORDINARY STOCKS, 1975-1976
(percent)

Period	Overall rate of return					Distribution of shares by rate of return by deciles					Distribu- tion index ^c	Number of stocks	Number of companies
	Arith- metic average	Weight- ed by listed capital ^a	Weight- ed by annual volume of trade ^b	Minimal	Maximal								
						10	25	50	75	90			
1. Banking, finance, insurance													
1975	21.8	24.2	27.7	-35.1	70.5	0.3	7.7	18.4	32.9	40.1	0.34		
1976	56.1	50.7	62.0	4.0	126.8	18.9	39.9	49.3	74.4	92.0	0.49		
1976, first half	3.8	5.1	10.0	-18.3	26.4	-10.5	-2.0	4.0	10.1	18.6	0.28		
1976, second half	51.0	44.5	47.6	0.0	102.3	17.3	32.6	48.6	72.9	79.5	0.42	35	22
2. Land and development													
1975	50.1	46.1	49.6	-16.7	110.7	4.2	28.1	49.7	72.5	78.0	0.57		
1976	73.5	69.8	74.0	16.0	122.5	16.7	66.1	71.4	93.0	114.2	0.56		
1976, first half	-0.5	-1.1	-3.0	-20.8	24.8	-15.5	-8.4	-2.5	7.5	17.3	0.34	17	13
1976, second half	75.6	73.0	81.1	19.3	133.5	36.0	63.4	72.5	92.1	103.2	0.39		

3. Industry and commerce

1975	50.3	55.6	54.6	-8.4	167.0	16.3	23.3	47.0	73.7	84.2	0.46		
1976	60.0	42.6	68.3	-18.8	211.7	4.0	25.3	53.6	83.2	105.0	0.68		
1976, first half	0.9	-2.2	1.8	-29.2	29.1	-22.7	-11.5	2.2	13.7	23.1	0.45		
1976, second half	58.0	44.5	63.8	2.2	190.9	17.5	28.5	45.5	76.4	109.4	1.33	38	27

4. Investment companies

1975	64.9	37.6	54.2	3.0	174.7	5.5	35.5	53.0	74.0	126.1	0.79		
1976	145.4	49.1	139.9	2.3	903.9	26.7	36.7	52.3	128.9	458.0	2.83		
1976, first half	23.6	4.1	26.7	-23.7	207.6	-12.4	-7.8	-1.5	10.6	156.0	0.72		
1976, second half	77.6	39.6	70.9	-2.2	257.1	16.9	49.8	57.5	98.9	126.8	0.70	25	20

5. Total companies listed

1975	45.4	31.4	39.1	-35.1	174.7	8.2	18.8	42.5	64.5	84.2	0.53		
1976	79.4	50.2	76.6	-18.8	903.9	16.7	34.6	58.8	83.9	126.1	0.69		
1976, first half	6.5	3.5	10.7	-29.2	207.6	-15.2	-7.9	1.1	10.6	23.1	0.54		
1976, second half	62.7	45.3	56.1	-2.2	257.1	19.0	36.0	56.9	82.6	103.9	0.39	115	82

^a Weighted by listed capital at market value, at end of previous calendar year.

^b Weighted by Stock Exchange trade volume over the calendar year.

^c The distribution index is calculated as follows: The index of return per 10 percent share is subtracted from the general rate of return per 90 percent share, by percentile. This remainder is divided by 1 + the return rate per share (when the percent of return in the index is about 0.01).

Generally speaking, 1976 was a year of great increase in the volume of stocks traded and in their prices, following a certain slowdown in the activity of the market in the first part of the year. The volume of trade, which was relatively low at first, grew during the year. Over the whole year the registered volume growth was 108 percent (Table XIX-5). The turnover velocity of stocks traded¹⁴ showed an increase, from 25 percent in 1975 to 31 percent this year. About half the trade in stocks was carried out outside the Stock Exchange in 1976¹⁵, as against 43 percent last year. In bonds about 80 percent of the trade takes place outside the Stock Exchange.

The fluctuations of stock prices declined in 1976 (see Table XIX-4 and Figure XIX-3). Fluctuations in the increase of the stock price index were lower than in the bond price index in 1976, contrary to previous years. Examination of the measure of fluctuations indicates that the change from year to year is greater in stocks than in bonds.

The fluctuations of each group of stocks were larger than the fluctuations in price of all stocks, hence the prices of the various kinds of stock groups showed contradictory fluctuations. The financial and insurance group stock prices showed fluctuations in 1974-1976 similar to those of total stocks, which gave this group preference over the other shares.

Examination of the profits of companies issuing the various groups of shares indicates that the net accounting profit in the years 1972 to 1975¹⁶ increased relative to the market value of the shares. This, to a certain extent, justifies the many share price increases, which acted to adjust this ratio (though with a lag). Even following the price increases, the ratio between the companies' profits and the market value of the total shares (and most of the groups) remained high relative to the 1973 data. This claim is rather limited, since only the criterion of accounting profit was used.

The total real rate of return for the investor in stock increased by 3 percent in 1976 (Table XIX-12 presents nominal data). The real return was 9 percent in 1976 and 6 percent in 1975. The return for holders of shares in financial and insurance companies increased considerably, after their return dropped in 1975 more than that of other shares. The return dispersal among shares increased; this dispersal was larger in investment companies, and smaller in financial and insurance companies in both 1975 and 1976. Division of the stocks according to their yield reveals that generally trade was stronger in stocks whose yield was higher and whose registered capital for trade lower.

The increase in stock prices¹⁷ was 42.4 percent this year, and after discounting

¹⁴ The ratio between stock trade and the market value of the capital registered for trade on the Stock Exchange (average for end year 1975-1976).

¹⁵ See Bank of Israel Annual Report, p.442.

¹⁶ In most stock groups, also in 1971-1975.

¹⁷ The difference between the price increase discussed here and the overall rate of return mentioned above, is that the rate of return takes into account payment of dividends.

the COL Index, there was a real increase of 3.2 percent (6.1 percent last year). The increase in prices of mortgage shares¹⁸ is outstanding; the increase was sharp both during 1976 (87 percent, see Table XIX-11), and in comparing the average of 1976 with previous years. The increase in prices of real estate, building and development shares (53 percent) was also higher than the rise in index of total stocks (42 percent), even though the branch did not prosper in 1976. The companies that issued shares in this branch did not represent the entire branch, either in their profitability or in the weight of their activity in the branch. The prices of the financial group increased slightly more than total stocks. The annual average prices of this group also indicate that its prices are higher than the total index and the prices of other groups.

4. SECURITIES TRADED IN FOREIGN CURRENCY

The market of securities traded in foreign currency showed a slowdown in 1976; real decreases occurred in the index of securities prices adjusted to the Natadagio and the balance of market value of these securities. In contrast, the Natad and foreign exchange deposits in the banking institutions increased considerably.

These changes are to be regarded in view of the market's strong reaction to the creeping devaluation introduced in 1975. The share price index increased then by 74 and 82 percent in bonds and stocks respectively, as against 9 and 25 percent respectively in 1976. The balance of market value of securities traded in foreign currency dropped by 14 percent (in real terms) in 1976, as against an increase of 38 percent in 1975, and stands at about 10 percent of the market value of total securities. It should be borne in mind that these securities have a rigid supply. There was a net redemption of Israeli bonds traded in foreign currency, amounting to IL 107 million this year and IL 135 million last year.

Securities purchased from Tamam and Pazak funds (Israeli and foreign bonds and stocks) amounted to \$ 13 million (IL 124 million) as against \$ 19 million (IL 154 million) last year. In contrast, there was a very rapid growth in Natad deposits: 116 percent in dollar terms, or 140 percent in terms of Israeli currency.

The demand for securities related to foreign currency dropped in 1976 and their prices increased only slightly, in comparison with the changes in exchange rates. This caused an increase in the rate of return on redemption of bonds traded in foreign currency, after a decline in the previous year.

¹⁸ Comparison of the 1976 average of prices of the various stock groups with the general index of stock prices shows surprisingly that nearly every group of stocks has a price index higher than the general index. This is due to changes over time in the weights of the different stock groups within the total share capital.

The increase in Natad deposits continued this year relative to investments in securities traded in foreign currency (this process has continued for 4 years). This increase indicates that this year as well, the weight of short-term investments rose in this market. Through Natad deposits it is possible to acquire securities traded in foreign currency, which give the investor interest or a dividend, in addition to the rate of exchange differentials; in contrast, investment in Natad does not bear interest.

The agio on the Natad dollar was 22.7 percent at the end of 1975 and reached its peak in May 1976: 25 percent. From there on, the agio began falling (11 percent at the end of 1976). The agio on the black market dollar, which was much higher than the agio on the Natad dollar at the end of 1975, reaching 42 percent, fell during 1976 and eventually reached a rate similar to the agio on the Natad dollar (13 percent — see Table XIX-7). The decline in the agio during the year reflects the declining expectations for a large devaluation once the public got accustomed to the creeping devaluation systems. It seems also that the accelerated rate of price increases (which was connected with the taxation policy) and the flourishing of the stock market, which was concentrated in the second half of 1976, reduced the relative profitability of assets related to the dollar, and therefore it pushed the agio rates into a decline. The agio on the black market dollar was affected by the search for those dealing in it, by the discovery of forged dollars, and the threats to black capital, which is apparently held in dollars as well.

Comparing the return to holders of index-linked bonds with the return to holders of securities tied to the exchange rate, one should remember that part of the increase in the COL Index in 1976 was due to changes in taxation. These changes were reflected in the COL Index, but holders of securities tied to the exchange rate did not benefit from them, since they did not involve any change in the exchange rate.

5. MUTUAL INVESTMENT FUNDS

The activities of the mutual investments funds in the securities market were characterized by their size and the centralization of their management. About five managements steer the activities of the 27 funds (out of which three managements control 92 percent of the assets of all the funds). The share of the funds in total securities registered for trade reached 18 percent in 1976, and their share in the active portfolio even exceeded that. Based on this, it is clear that the funds do not operate under conditions of perfect competition, and that their managements cannot regard the securities prices on the Stock Exchange as given data, so that their ability to change the composition of their portfolio in a short period through the Stock Exchange is limited.

It is more reasonable to expect that the activity of the funds will be concentrated in acquisitions (and sales) of securities which have, due to supply (or demand) surplus created higher (or lower) returns than customary on the market, at a given level of risk.

In other words, it is reasonable that the funds will regulate activity on the Stock Exchange and will absorb supply surplus, or will supply demand surplus, against an adequate compensation in the price (by swimming against the current). Their activity is made easier by the low commissions imposed on them for trading on the Stock Exchange.

It is clear that the funds can change their portfolio structure by acquisition at source, especially of bonds in Israeli currency, which have a completely flexible supply (which is not so in the supply of assets connected to foreign currency).

TABLE XIX-13
MUTUAL FUND ACTIVITY, 1974-1976
(percent)

Year	Net issue ^a (IL mil- lion)	Net change in issue	Net issue divided by funds' asset at end of previous year	Share of fund's assets in secu- rities portfolio registered for trade at end of year	Structure of fund's assets portfolio at end of year		
					IL secu- rities	IL shares	Assets con- nected for foreign currency
1974	1,000	317	108 ^b	9	74.1	7.7	18.2
1975	1,869	87	80	15	72.5	8.2	19.6
1976	1,822	-3	35	18	68.5	7.5	22.7

^a Net issue is defined as issue of participation certificates at issue price, less redemption of participation certificates at redemption value.

^b An approximation. This datum was calculated using the sum of fund assets at the end of 1973, according to a set of data which is not exactly the same as our data for the following year.

SOURCE: Computations of the Research Department, Bank of Israel.

Another resource for the profitability of the fund managements is the movement of the certificates: the issue of participation certificates and their redemption, and the off-setting of purchase and sale orders. Purchasers of certificates pay an additional rate above the value of the certificate they purchase, whereas the redeemers of certificates pay the management a sales commission.

The combined asset portfolio structure of the mutual funds is determined jointly by their managements and the investors in the funds. The managements present to the public a variety of funds. The regulations of each fund define in advance the composition of its investments: generally, with a margin of possible flexibility. The public "votes"

by way of acquiring certificates of the funds whose asset structure seems preferable. The role of management lies in changing the portfolio structure in the margins allowed by the regulations.

The accelerated growth of mutual investment funds through the issue of participation certificates was halted in 1976. This followed a slowdown in the rapid growth of 1975. This apparently resulted from the fact that since December 1975 the mutual funds have been entitled to issue registered participation certificates only. Parallel to that, growth slowed in the share of the fund assets in total securities registered for trade in the Stock Exchange.

Examination of the composition of the fund assets in recent years indicates that the share of bonds in Israeli currency is declining, even though it constitutes over 2/3 of their portfolio. The share of stocks in Israeli currency does not show any changing trend, but it is less than half the total weight of stocks registered for trade on the Stock Exchange. On the other hand, the share of assets connected to foreign currency held by the funds has shown an upward trend in the last two years, and is almost double the weight of these securities in the portfolio registered for trade.

The rate of return for holders of participation certificates in the funds was low relative to assets on the market, reaching 37 percent, or a minus one percent real return. However, the holders of certificates, who are normally small investors, enjoyed a dispersal exceeding what they could have obtained by direct investment, thus diminishing risk.

The group of funds giving a high yield to holders of its certificates in 1976, was the group investing in stocks in Israeli currency (a yield of 86 percent). We should note that this is a small group whose assets equal about one tenth of the total assets of the mutual funds. The group of funds investing in securities connected to foreign currency obtained the lowest yield (23 percent). The mixed funds, investing in stocks and bonds in Israeli currency, and the funds also investing in foreign currency assets (70 percent of the total fund assets are under their management) obtained a yield of 34 to 38 percent.