



OECD Membership: A Milestone for Israel, but Troublesome for the Stock Market

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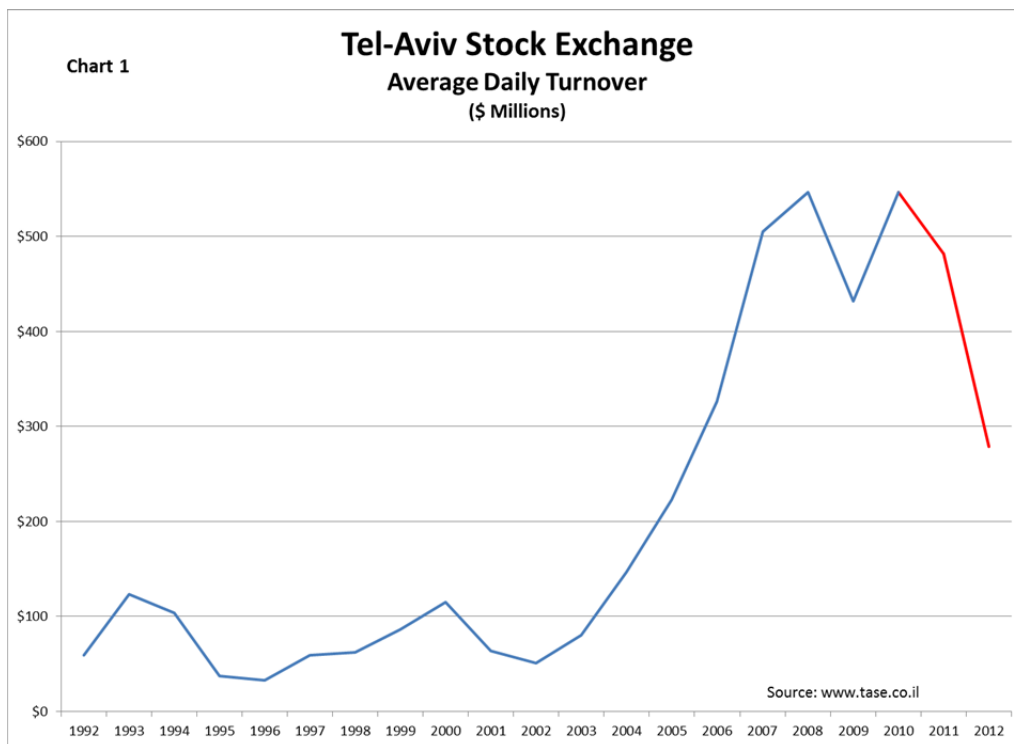
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We launched Israel Investment Advisors, LLC (IIA) to coincide with Israel's accession into the Organization for Economic Cooperation and Development (OECD) in July of 2010. We believed at the time that OECD membership would prove positive for Israel as a nation, but could pose problems for foreign investment in Israel's stock market. OECD membership marked Israel's graduation from an emerging market to an economically developed country. When classified as an emerging market, Israel was a nice sized fish in a small pond. As a developed market, however, Israel moved into a vast ocean of capital where it remains a very small fish. In the process, emerging market mutual funds and ETFs sold their Israeli equities, but developed country funds did not replace the lost investment. We launched Israel Investment Advisors, LLC to capitalize on and help rectify this unfortunate situation.

The OECD is sometimes referred to as the "rich man's club". It is comprised of 34 member countries, most of which are wealthy free-market democracies. The goal of the OECD is to promote and coordinate growth oriented economic policies. For Israel, OECD membership is a big deal. Israel now, quite literally, has a seat at the elite table of powerful, industrialized nations. From a geopolitical point of view, therefore, Israel gains clout and legitimacy from OECD membership.

For the Tel-Aviv Stock Exchange (TASE), however, OECD membership and the concurrent upgrade from emerging market has been problematic. We now know that the majority of Israel's foreign stock market investment was tied to emerging market index funds. As illustrated by the red portion of the line in Chart 1, liquidity on the TASE declined significantly since Israel's removal from the emerging market indexes in July 2010. Prior to its removal, Israel accounted for 2.7% of the MSCI Emerging Markets Index which included countries whose total stock market capitalization was approximately \$7 trillion. Now

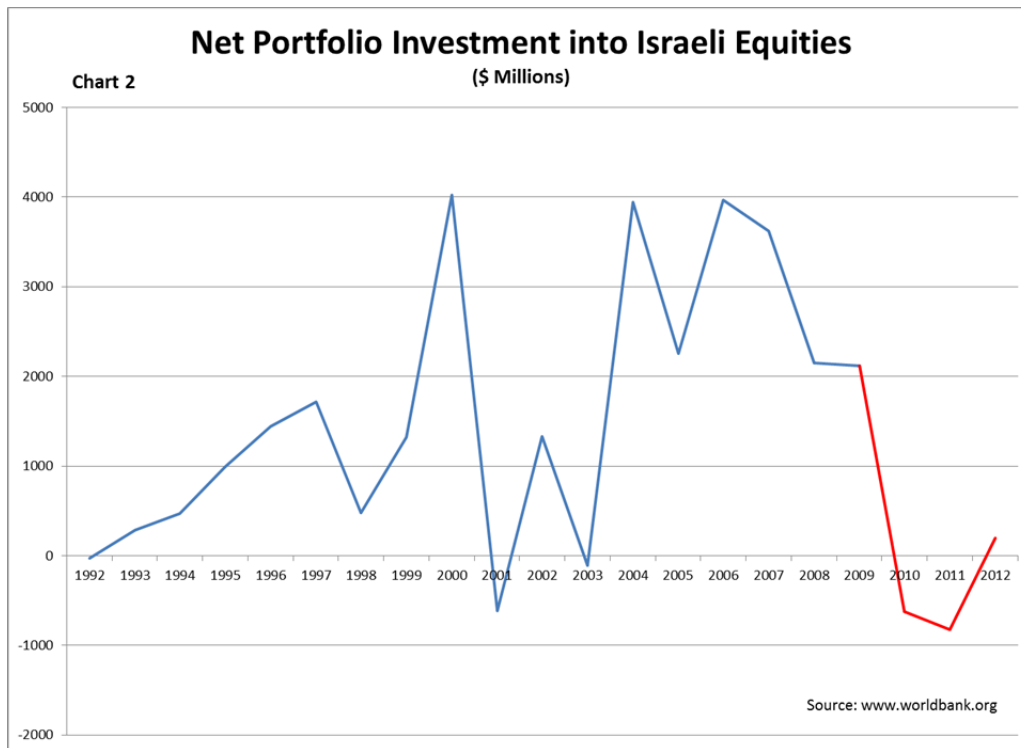
Israel competes for capital in a \$50 trillion pool alongside much bigger developed countries such as the United Kingdom, Japan, Germany and Australia. In fact, Israel's weighting in the developed country indexes is so negligible that index fund managers are not required to own any Israeli stocks.



Forced liquidation by emerging market index funds created many outstanding opportunities to acquire Israeli stocks at low valuations. Despite a strong economy and robust corporate profits, stock market valuations will likely remain low for many Israeli companies until foreign investment returns. As you can see in Charts 1 and 2, foreign participation in the Israeli stock market is highly cyclical. Interest surged during the technology bubble of the late 1990's only to dissipate in the tech crash. Inflows resumed once again during the emerging markets boom of the 2000's. We believe the next wave of portfolio inflows will come from investors such as ourselves, i.e. long-term strategic investors familiar with the varied aspects of the Israeli economy.

BDS Failed, but Divestment Succeeded

Israel's detractors launched the global boycott, divestiture and sanctions (BDS) movement several years ago. This movement largely failed since venture capital continued to pour into Israeli start-ups, Israeli academics still teach at universities around the world, and Israel joined the ranks of wealthy democracies in the OECD. Despite the failure of BDS, divestment from the Israeli stock market happened anyway as index funds sold out. Pro-Israel American capital has an opportunity to profit while rectifying this situation. Israeli stocks have been a good investment over the long run, but more proactive research and analysis are required now that Israel is absent from major indexes.



We started Israel Investment Advisors, LLC knowing index funds were going to sell out of the Israeli stock market. Israel remains a very solid investment story despite diminished global attention. In the coming decade the Israeli economy could support a stock market in excess of \$500 billion, similar to Singapore today. To do so, Israel will need foreign capital. Who other than pro-Israel Americans are better positioned to take the necessary risks, and also reap the potential rewards? Our goal at Israel Investment Advisors, LLC is to connect Israel's supporters in America with opportunities in the Jewish state. Thank you for supporting this goal. We believe you will continue to profit in the coming years while supporting the State of Israel.