

Rhetoric vs. Reality: Israel’s Remarkable Resilience

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In the early weeks of the war against Hamas 360,000 mobilized reservists left their jobs, people along the Gaza and Lebanese borders shuttered their businesses, many foreign laborers went home, and Palestinian workers were prohibited from entering Israel. According to Startup Nation Central, about 15% of the high-tech workforce was drafted into the army. In total approximately 13% of the Israeli labor force dissolved overnight.

The Israeli Central Bureau of Statistics estimates the economy contracted 20.7% in the fourth quarter of 2023, rehashing Israel’s experience during Covid lockdowns. In the two weeks following the October 7th attacks the shekel weakened 5.8% and the Israeli stock market dropped 18.1%. Astonishingly the markets turned higher on October 27th, the day Israel launched the ground offensive in Gaza. From the bottom the Tel-Aviv 125 Index rallied 40.5% and is now up 24.2% since October 7th.



Signs across Israel promoting unity and resilience:
(1) "Together we will win", (2) "Together Israel is one", (3) "Everyone Together"

The Israeli Ground Invasion Restored Investor Confidence

Despite hysterical rhetoric from Israel’s enemies and detractors around the world, offensive military operations in Gaza reinforced investor confidence. On March 5th the Israeli government sold \$8 billion of dollar denominated bonds. The bond offering was oversubscribed fourfold, involving institutional bidders from 36 countries. The bonds were sold in maturities of 5, 10, and 30 years. Apparently global investors believe Israel will be around 30 years from now to pay them back.

To get the bond deal done, however, Israel paid an interest rate premium ranging between 1.45% and 1.75% over comparable U.S. treasuries. Prior to the war Israel’s interest rates were lower than in the United States. Although Israel’s credit rating remains solid, Moody’s downgraded Israel from A1 to A2 due to increased defense spending and heightened security and economic uncertainties. Nonetheless, foreign investors would not buy these bonds at any price if they lacked confidence in Israel’s survival or even its continued prosperity.

Israeli Stock Market Valuations Reflect Near-Term Risks

We are not Pollyannaish about the Israeli economy in the near-term. Despite rebounding economic activity this quarter, Israel’s economic dislocations are substantial and an even more destructive war with Hezbollah in Lebanon still looms. We believe these risks are reflected in Israel’s very low stock market valuations. The Price-to-Earnings Ratio (P/E) for the Tel-Aviv 125 Index is 12.6 and 14 for the technology-heavy BlueStar Israel Global Index compared to 23.5 for the S & P 500 Index and 35.3 for the technology laden Nasdaq Composite Index. We believe these low valuations reflect the current risks, while recent bond auctions and the stock market rebound reflect investor expectations that the Israeli economic growth engine remains fundamentally intact over the long run.





We are long-term investors. When we look back in time five or ten years from now, we believe most of our portfolio companies will generate revenue and earnings growth even if the next couple of years are rocky. Based on the substantial recovery since October 7th it seems that most Israeli stock market investors agree. On a more granular level, we believe the performance by sector hinges on whether longer-term opportunities outweigh near-term uncertainties. Table 1 highlights the Bluestar Israel Global Index average performance by subsector since October 7, 2023. Out of 47 sectors 13 are down and 34 are up.

Table 1

Subsector	USD Return Since 10/7	# of Companies	Subsector	USD Return Since 10/7	# of Companies
Electronic Equipment/Instruments	60.31%	1	Medical Specialties	6.31%	3
Pharmaceuticals: Generic	59.37%	1	Hospital/Nursing Management	5.41%	1
Advertising/Marketing Services	54.36%	1	Chemicals: Agricultural	5.04%	3
Property/Casualty Insurance	40.86%	1	Real Estate Investment Trusts	4.47%	1
Investment Banks/Brokers	40.65%	2	Marine Shipping	3.58%	1
Hotels/Resorts/Cruise lines	33.77%	1	Major Banks	3.10%	6
Electronic Components	32.28%	1	Aerospace & Defense	2.50%	1
Chemicals: Specialty	31.41%	1	Finance/Rental/Leasing	1.38%	1
Food Retail	30.18%	2	Internet Software/Services	1.22%	3
Information Technology Services	29.51%	5	Industrial Machinery	0.22%	2
Semiconductors	29.45%	2	Movies/Entertainment	-0.14%	1
Alternative Power Generation	28.95%	2	Electronics/Appliances	-1.51%	1
Apparel/Footwear	27.85%	2	Integrated Oil	-2.49%	1
Wireless Telecommunications	26.08%	2	Major Telecommunications	-4.10%	1
Packaged Software	22.50%	8	Computer Peripherals	-5.91%	1
Pharmaceuticals: Major	17.19%	1	Internet Retail	-9.24%	1
Multi-Line Insurance	15.19%	5	Food: Specialty/Candy	-10.84%	1
Real Estate Development	15.04%	6	Construction Materials	-12.63%	1
Engineering & Construction	14.87%	4	Data Processing Services	-14.31%	1
Oil & Gas Production	14.40%	1	Telecommunications Equipment	-14.76%	1
Computer Communications	11.10%	1	Medical/Nursing Services	-21.05%	1
Oil Refining/Marketing	10.35%	2	Miscellaneous Commercial Services	-22.12%	1
Electric Utilities	8.42%	3	Electrical Products	-42.74%	1
Wholesale Distributors	7.78%	1			





The Construction Industry Needs a Solution for Palestinian Labor

The downside issue most impactful on our portfolio is our exposure to construction materials and related industries such as consumer durables (for example refrigerators, washing machines, and air conditioners). The restrictions on Palestinian workers disproportionately impacted the construction industry. Demand for buildings and infrastructure remains robust, but new solutions for construction labor must be found.

Despite the turmoil in the construction industry, stock prices for real estate development companies rose substantially, likely reflective of their valuable land holdings. Perhaps most surprisingly, the share price of Israel's largest private sector defense contractor – Elbit Systems, Ltd. – declined slightly. While we are surprised to see the stock trading down since the start of the war, we believe rising geopolitical tensions around the world and Israel's growing defense budget should provide a tailwind in the coming years.

Israel's Detractors are Loud, but those with Real Financial Power are Quietly Betting on Israel

On the upside for our portfolio was the substantial rebound in insurance, retail, and technology stocks. The rebound in retail is particularly surprising and encouraging. Retail spending took a big hit in the early weeks of the war but is bouncing back as Israelis resume a semblance of normal life.

We expect the upcoming Rafah offensive - to wipe out Hamas' remaining battalions and seize control of Gaza's porous border with Egypt - will once again engender frantic condemnation from Israel's enemies and detractors, but also further strengthen global investor confidence. Even though the detractors are distressingly loud, the people with real financial power are quietly betting on Israel.

For a more in-depth analysis of Israel's economy and war-time financial strength please read our research report "[Israel's Financial Firepower.](#)"

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Investor Trip to ISRAEL 2024:

Israel Investment Advisors is proud to offer our current and potential investors the opportunity to travel to Israel during the last quarter of 2024 to experience Israel's economic resilience first hand.

To inquire about trip details please email Amy Kaufman at akaufman@israelinvestmentadvisors.com.

If you know of someone who might appreciate this opportunity, please send us their contact information, and we'll be happy to reach out.

We extend our deepest condolences to the families who have lost loved ones; may their memory be for a blessing. We wish Refuah Shlema (complete recovery) for those who have been injured, and we pray for the safe return of every hostage and every soldier defending the State of Israel.

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