



The Resurgence of Israeli Capital Markets

Brian J. Friedman, CFA
September 30, 2019

While the media focused on Israel's election redo, another important event occurred in the Israeli economy. After a lengthy process of restructuring its membership, demutualizing, and converting to a for-profit corporation, the Tel-Aviv Stock Exchange (TASE) listed its own shares for trading in an initial public offering (IPO) on August 1st.

The total market capitalization of listed securities on the TASE exceeds \$500 billion and includes \$214 billion in stocks, \$265 billion in bonds and \$26 billion in exchange-traded funds (ETFs). At present, there are 447 companies listed on the TASE plus 650 corporate bond issues. There are 103 additional Israeli companies with market capitalization of \$60 billion trading on foreign exchanges, such as the Nasdaq or New York Stock Exchange (NYSE), but not listed on the TASE.

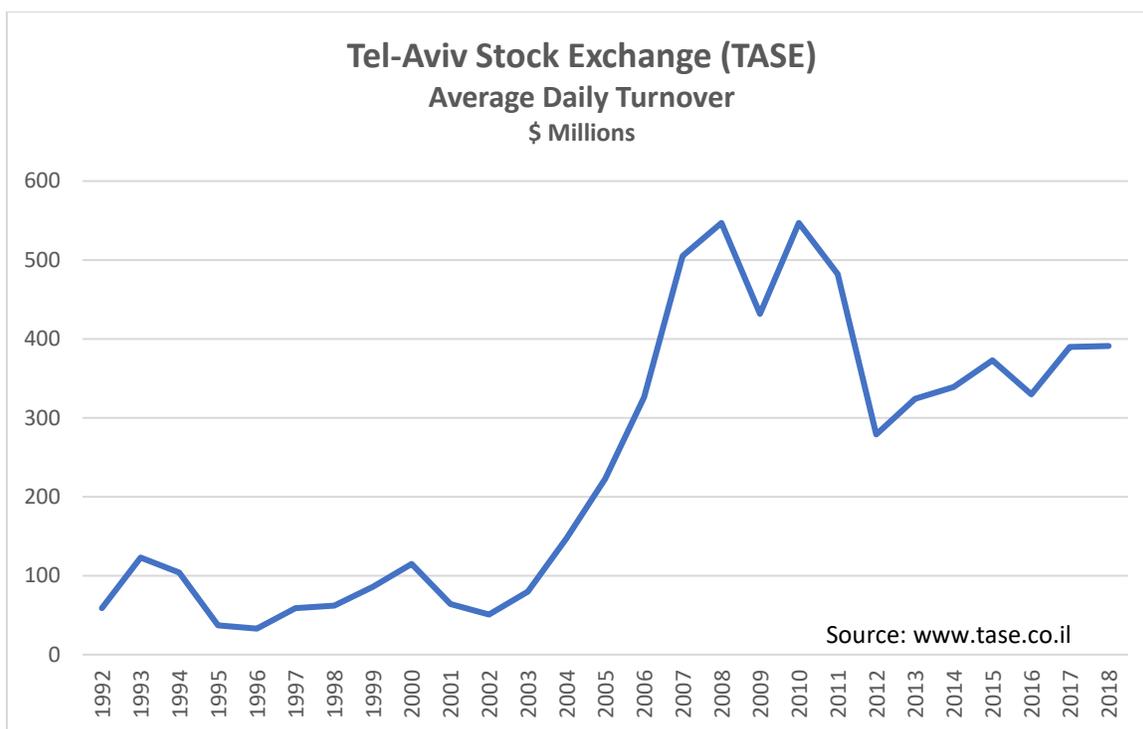
The TASE is following in the footsteps of most major exchanges around the world. The New York Stock Exchange converted into a for-profit company in the 1990s and is now a subsidiary of the Intercontinental Exchange corporation. The London Stock Exchange Group (LSE) owns the Borsa Italia. Euronext owns the primary stock exchanges in France, Holland, Belgium, Ireland, Portugal, and Norway. Within the past several weeks, Hong Kong Exchanges and Clearing, Ltd. tried to acquire the LSE. With its IPO, the TASE becomes a potential player in this global consolidation game.

As a small exchange, the TASE is more likely to become prey than predator in the global financial ecosystem. The NYSE lists 2,300 companies worth \$29 trillion, and the Nasdaq lists 3,500 companies worth \$12 trillion. The total market capitalization of companies listed on the LSE is \$3.9 trillion. Although the market capitalization of listed companies on the Euronext exchanges is collectively \$4.4 trillion, the TASE is similar in size to several of its subsidiary exchanges. Nasdaq, Inc. owns several Scandinavian exchanges quite a bit smaller than the TASE. Acquisition by one of the larger exchange companies could enhance the international profile of the TASE, allowing it to garner more larger inflows of foreign investment.

Why Now?

As we discussed in several previous quarterly letters¹, the TASE suffered an ironic blow in 2010 when the leading international index company upgraded Israel from the MSCI Emerging Markets Index to the developed country MSCI Europe, Australasia, Far East (EAFE) Index. 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 became a very small fish. In the process, emerging market mutual funds and ETFs sold their Israeli equities, but developed country index funds did not replace the lost investment.

For the TASE, the upgrade to developed country status proved tumultuous. Prior to 2010, much of Israel’s foreign stock market investment was linked to emerging market index funds. As illustrated in the chart below, trading volumes plunged 50% between 2010 and 2012.



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 \$60 trillion pool alongside much bigger developed countries, such as the United Kingdom, Japan, Germany, Australia, and even the United States. Israel’s weighting in the developed country index is so negligible that index fund managers are not required to own any Israeli stocks.

Despite the absence of significant foreign portfolio investment, trading volumes on the TASE started to recover in 2012. From a low of \$279 million at that time, stock trading volume grew to an average of \$345 million per day in the first three quarters of 2019. Fortunately for the TASE, government and corporate bond trading has held steady around \$1 billion per day since 2010. IPO activity is also improving due to legal and regulatory changes intended to break up monopolistic business groups (see our Q2:2019 letter, “Israel Charges Toward a More Competitive, Less Monopolistic Economy,”¹). Israeli companies raised \$28 billion from stock offerings on the TASE over the past 5 years compared to \$10

billion for the five-year period from 2009 to 2013. Given the favorable interest rate environment, Israeli companies also raised \$112 billion over the past decade by issuing bonds traded on the TASE.

The Israeli Investment Industry is Growing

As we discussed in our March 2016 newsletter, “Wealth and Capital in Israeli Society”¹, financial assets in Israel are growing steadily. Contrary to outdated stereotypes, Israel’s savings rate is robust, and the government debt burden is shrinking. As a result, more capital is finding a home in Israel’s financial sector. The financial advisory industry in Israel is burgeoning, and the capital markets are maturing. The TASE IPO is an important step toward more globally competitive capital markets in Israel.

Most Americans are not aware of the dynamic changes taking place in Israel’s securities markets. As in Israel’s technology start-ups, jobs in the financial sector are also mushrooming. In our view, the investment industry in Israel resembles the United States in the 1950s or 1960s. Of course, there will be risks and potential problems along the way.

For more than 10 years, Israel Investment Advisors, LLC has been one of very few American firms focused on the Israeli capital markets and economy. Our goal is to mirror the dynamic development of Israel’s financial industry with an equally dynamic, Israel-focused investment industry in America.

¹Newsletters are available on our website: www.israelinvestmentadvisors.com

The Israel Investment Advisors Quarterly Newsletter is published as a service to our clients and other interested parties. This material is not intended to be relied upon as a forecast, research, investment, accounting, legal or tax advice and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The views and strategies described may not be suitable for all investors. References to specific securities, asset classes and financial markets are for illustrative purposes only. Past Performance is no guarantee of future results.