Our Worst Quarter

Brian J. Friedman, CFA
March 31, 2020

The Israeli stock market experienced its sharpest decline and worst quarter since we started the Israel Investment Fund, L.P. in August of 2010. The Tel-Aviv 125 Index fell 34.3% from peak to trough during the quarter before rebounding a bit prior to quarter end. As such, the TA-125 Index was down 24.1% for the first quarter. The shekel also declined 10.8% relative to the U.S. dollar before rebounding modestly at quarter's end. It is cold comfort that the Israeli stock market roughly tracked all global markets, including the S&P 500 Index.

Of course, coronavirus and the reaction to the virus are to blame for this dramatic turn of events. The Israeli government acted swiftly and decisively when the first cases appeared in Israel. Israel was one of the first governments in the world to impose travel restrictions and then to drastically up the ante as more people fell ill. Israel closed restaurants and other face-to-face businesses weeks prior to such actions in the United States. On March 25th, Prime Minister Netanyahu announced a near total closure of the country, limiting movement to within 100 meters of home.

The Economic Impact of Social Distancing is Huge

In 2019, Israeli Gross Domestic Product was $375 billion, so daily GDP averaged a little more than $1 billion prior to the crisis. By early March, we estimate at Israel Investment Advisors, LLC that daily GDP in Israel was already down by 5% due to the imposition of severe travel restrictions. Within days, hotel occupancy plummeted, and the tourism sector went from record arrivals to almost nothing overnight.

Even as Israel's social distancing restrictions tightened in mid-March, daily GDP fell by only about 10%. Israel's export markets, particularly for technology products, buoyed the economy. Toward the end of March, however, the skies darkened considerably as the United States and other major economies followed Israel's trajectory toward more severe social distancing policies. With export markets shutting down, we estimate Israel's daily GDP is currently running about 25% to 30% below pre-virus levels.

Israeli Unemployment: A Harbinger of Our Near Future

The unemployment rate in Israel skyrocketed to 21.7% in the first report released since social distancing policies went into effect. There are more than 1 million Israelis now out of work, with the numbers likely to escalate from here. The Israeli unemployment data is a sobering harbinger of the news we will soon receive in the United States and around the world.

A Silver Lining: The New Coronavirus Coalition Government

Although his opponents initially accused Prime Minister Netanyahu of an authoritarian power grab for his draconian actions, some political pressure was relieved as other world governments adopted similar policies. As of the writing of this letter, the virus appears to have broken the political logjam in Israel with the potential formation of a national unity government (of sorts). Benny Gantz and his Israel Resilience faction broke away from the anti-Netanyahu Blue and White Coalition to join a Netanyahu-led government.

As in the United States, the Israeli Knesset is debating a massive 80 billion shekel ($22 billion) economic support package for unemployed workers and idled businesses. Fortunately, Israel begins this crisis with a debt-to-GDP ratio of 60%. In comparison, the debt-to-GDP ratio of the U.S. government is 79%. By our calculations at Israel Investment Advisors, LLC, this fiscal legislation will support Israel's severe social distancing policies for 90 to 120 days without further fiscal action.

Israeli Stocks are Attractively Valued, but the Crisis Must be Endured

Israeli stocks were attractively valued prior to the recent market rout, but now they are very inexpensive. At the end of the quarter, the average company in the Tel-Aviv 125 Index sold for 7 times last year's cash flow. Of course, cash flows will decline dramatically in the coming months, but we believe Israeli companies and stocks will ultimately bounce back.

At least the Israeli economy was on strong footing, by global standards, going into this crisis. Besides Israel's low debt-to-GDP ratio, the country's annual GDP growth rate of 3.4% was significantly higher than much of the developed world. Last fall, Israel was enjoying record low unemployment of 3.5%. Its sovereign debt credit ratings (AA-, according to S&P, and A+, according to Fitch) also reached record positive levels. These indicators bode well for Israel's ability to recover from this crisis relatively quickly.

Indeed, Israel is one of the most resilient countries in the world. The Israeli economy prospered through war and terrorism (see last quarter's IIA newsletter). The speed of Israel's rebound depends on the trajectory of the world economy. Nonetheless, Israel remains well positioned to succeed in the future as it has in the past. The Israeli government took bold and decisive action early in the coronavirus crisis. If all goes well, Israel will be one of the first countries to exit quarantine as a result.

Past and current newsletters are available on our website: www.israelinvestmentadvisors.com

1801 California Street, Suite 2200 Denver, CO 80202 303-861-3798
www.israelinvestmentadvisors.com