

July 27, 2023

ISRAEL EQUITY REVIEW AND OUTLOOK - Q3 2023

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About the BlueStar Indexes®

The BlueStar Indexes® were launched in 2011 by BlueStar Global Investors, a research-driven provider of indexes and financial data. BlueStar®'s Indexes were acquired by MarketVector Indexes™ ("MarketVector") in August 2020 and are now continued as a sub-brand of MarketVector.

BlueStar Indexes® produced monthly updates on the Israeli market since 2012. In this Israel Equity Review and Outlook we provide data and insight on 2022's performance of Israeli equity benchmarks, stocks and sectors driving performance, key economic data for the Israeli market, as well as data on our flagship Israeli equity indexes, BIGI® and BIGITech®. We also provide an outlook on key economic, geo-political and domestic political developments which could impact the markets in 2023.

The BlueStar Israel Global Index® (BIGI® or BLS & BLSTR INDEX on Bloomberg) is the broadest and deepest benchmark for Israeli equities trading. BIGI® is tracked by a NYSE-listed ETF, as well as an Israel-domiciled index fund.

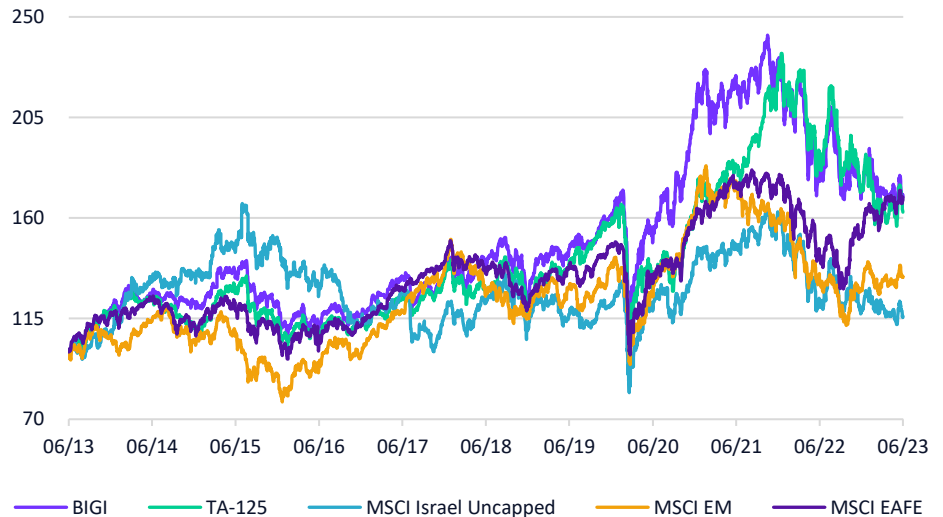
The BlueStar® Israel Global Technology Index (BIGITech® or BGTH & BGTHTR INDEX on Bloomberg) is the broadest and deepest benchmark tracking the performance of Israeli companies operating in innovative sectors such as information technology, defense technology, clean technology and bio-technology. BIGITech® is tracked by a NYSE-listed ETF. In addition, there are two Israel-domiciled investment vehicles tracking BIGITech®.

ISRAELI EQUITIES UNDERPERFORM AS JUDICIAL REFORM PROPOSES TO HANG OVER MARKETS AND ECONOMIC OUTLOOK.

Highlights:

- Israeli stocks, as defined by the BlueStar® Israel Global Index (BIGI®), fell 1.66% in the second quarter of 2023, significantly underperforming US and internationally developed market equities for the second straight quarter.
- Israeli technology stocks, as defined by the BlueStar® Israel Global Technology Index (BIGITech®), gained just 0.24% in Q2, outpacing the broader Israeli equity market but underperforming US and Global tech peers by more than 15%.
- The Bank of Israel left their policy interest rate in July unchanged at 4.75% which is still 1.50 percentage points higher than at the start of 2023.
- The Israeli economy, which entered 2023 with lower inflation, and higher growth compared to other developed nations, has weakened slightly as the year has progressed.
- The passage of the initial element of Judicial Reform on July 24 has added significant political risk into the Israeli economy and capital markets.

Ten Year Performance Ending June 30, 2023



Source: MarketVector, Bloomberg. Data as of June 30, 2023. All data in USD.

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Israel Equity Market Performance

Israeli equities, as defined by the BlueStar Israel Global Index® (BIGI®), lost 1.66% in Q2 following Q1's modest rebound from 2022's loss of 25.19%. BIGI® continued to underperform international developed markets, represented by the iShares EAFE ETF, by 4.88% while also underperforming the KSM TA-125 ETF (in USD) by 1.82%. The Israel Domestic Exposure Index corrected against the Israel Global Exposure Index in Q2 by 3.23%, following two-quarters of significant underperformance.

BIGITech® gained just 0.24% in Q2. Israeli tech stocks continue to significantly underperform the iShares U.S. Technology and the iShares Global Tech ETFs by a wide margin, reaching year-to-date underperformance of 41.68% and 34.4%, respectively.

Israel's economy and markets are fighting battles on three fronts: continued political uncertainty over proposed reforms to Israel's judicial system into Israel's economy heightened geopolitical risks and monetary tightening. It is proving difficult for Israeli companies to thrive in such an environment, compared to some of their international peers.

The two largest sectors in BIGI® are Information Technology and Financials. Unfortunately, many of Israel's largest technology stocks have not participated in 2023's global tech rally which has been centered around mega-caps, semiconductors, or other companies with direct exposure to the AI trend. Israeli tech stocks, by and large, fall into the small and mid-cap growth category across a wide range of sub-industries and, except for a few companies, are not necessarily tied to the trends driving today's markets.

For example, the largest Israeli tech company is SolarEdge, which targets the solar energy industry with specialized power converters, while clean energy stocks have generally also underperformed in the broader markets this year. The second-largest Israeli tech company, Check Point Software, which is focused on the cyber security market, is negative on the year.

Israeli financials are suffering the direct consequences of an inverted yield curve and the fallout from political uncertainty including a weakening currency and slowing international investor interest.

The Israeli economy has a long history of resilience and still boasts favorable demographics and a world-class technology sector. But some of the pain points mentioned above must abate, and the global tech rally must broaden beyond the mega-cap names, to let its equity market recover from this nearly 12-month-long bear market.

ISRAEL AND GLOBAL EQUITY BENCHMARK COMPARISON		
Benchmark	Q2 2023 Return(%)	2023 YTD (%)
BIGI®	(1.66)	(0.99)
BIGITech®	0.24	5.39
iShares Israel ETF	(3.78)	(2.84)
KSM TA-125 ETF	0.16	(6.80)
SPDR S&P 500 ETF Trust	8.74	16.89
iShares Emerging Markets ETF	0.90	4.89
iShares EAFE ETF	3.22	12.13
Israel Domestic Exposure	1.68	(10.22)
Israel Global Exposure	(1.55)	4.34
Israel Infrastructure	0.45	(20.16)

ISRAEL AND GLOBAL TECH EQUITY BENCHMARK COMPARISON		
Benchmark	Q2 2023 Return(%)	2023 YTD (%)
BIGITech®	0.24	5.39
iShares U.S. Technology ETF	17.90	47.07
iShares Global Tech ETF	15.37	39.79

SECTOR PERFORMANCE (%): Q2 2023	
Consumer Discretionary	10.55
Industrials	8.05
Consumer Staples	3.26
Real Estate	1.80
Financials	1.70
Utilities	(1.64)
Information Technology	(3.47)
Energy	(3.89)
Health Care	(6.15)
Communication Services	(7.35)
Materials	(18.02)

TOP AND BOTTOM BIGI® PERFORMERS: Q2 2023			
Positive Contributors (%)		Negative Contributors(%)	
NANO-X IMAGING LTD	168.46	AUDIOCODES LTD	(35.81)
888 HOLDINGS PLC	95.22	NOVOCURE LTD	(30.99)
TARO PHARMACEUTICAL INDUS	55.96	ZIM INTEGRATED SHIPPING SERV	(30.25)
KORNIT DIGITAL LTD	51.70	FIVERR INTERNATIONAL LTD	(25.52)
OPKO HEALTH INC	48.63	PAYONEER GLOBAL INC	(23.41)
JFROG LTD	40.61	PERION NETWORK LTD	(22.51)
ISRAEL CANADA T.R LTD	37.66	WIX.COM LTD	(21.60)
TREMOR INTERNATIONAL LTD-ADR	37.27	ISRAEL CORP LIMITED/THE	(19.98)
ONE SOFTWARE TECHNOLOGIES LT	33.87	ICL GROUP LTD	(17.47)
LEONARDO DRS INC	30.61	ENERGEAN PLC	(17.30)

Israel Macroeconomic and Political Update

Economic Highlights

The Bank of Israel's Monetary Committee left their policy rate unchanged in early July at 4.75%, representing a real yield of 0.15%, rendering it effectively neutral. Inflation pressures are moderating (and are lower than many of Israel's peers) and are expected to fall within the upper bound of the BOI's target inflation range over the coming year. If inflation does not continue to moderate, interest rates will likely need to become restrictive though the BOI must balance the negative impact of political instability around the proposed judicial reforms with reining in inflation; of particular concern is that Israel's country risk premium is rising and the Shekel continues to depreciate against both the US dollar and Euro.

Despite the headwinds, Israel's economy is expected to grow by 3% in both 2023 and 2024.

Israeli Political and Geopolitical Update

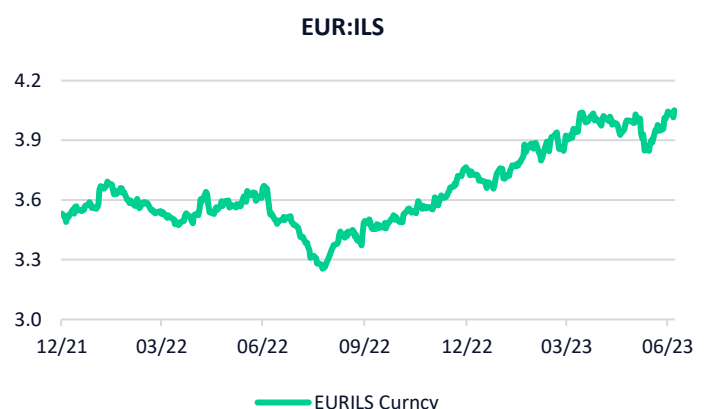
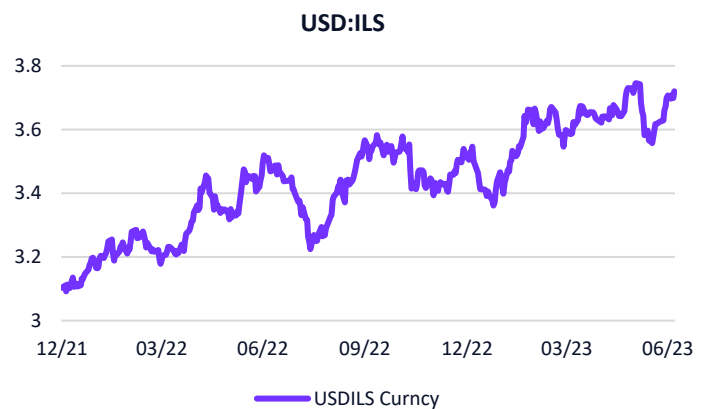
Israel's domestic political environment continued to be turbulent during the 2nd Quarter, and uncertainty remains very high as the 3rd Quarter began. Despite a pause of the judicial overhaul by Prime Minister Netanyahu in March, Justice Minister Yariv Levin, along with Simcha Rothman, Chair of the Knesset's Constitution Law and Justice Committee have now re-introduced their legislative effort to modify Israel's judicial system albeit in a 'piece-by-piece' manner. The initial proposal was a sweeping move to reduce the judiciary's sway over public policy by restricting the Supreme Court's ability to carry out judicial review, giving the government more control over judicial appointments, and government policy.

The overhaul has provoked significant public protests, in their 28th week as of this writing, and along with the reintroduction of the legislation, the protests have re-intensified in early July. In addition, criticism of the planned overhaul was directly articulated by President Biden and the American administration.

In early Spring, global rating agency Moody's downgraded Israel's credit outlook from positive to stable. While the country's actual credit rating remained at A1, if current political and social tensions persist, capital inflows could materially diminish. Similarly, in April, the OECD warned that the "risks are skewed to the downside" and expected GDP to slow to 3% in 2023 from the 6.4% growth rate last year. Additionally, the Shekel fell about a basket of currencies in anticipation of the rating report, reflecting added risk premium corresponding to political events. S&P Global and Fitch have held their sovereign ratings stable but have also hinted that they would downgrade the outlook if the judicial reforms are enacted without consensus.

On July 24th, despite massive popular protests and calls for a pause for negotiation by leaders from all areas of society, an inflection point was reached on the political front, when the Netanyahu government decided to push through the initial parts of the legislation. We believe that this will intensify public protests and potentially see reserve officers of the IDF boycott their training, putting Israeli security and deterrence at risk. The question now is if the Supreme Court challenges this legislation toward the end of the summer, and if, however, the future elements of the reforms are significantly moderated before their eventual passage.

In the meantime, this major issue looms over Israel's economy and markets as evidenced by the underperformance of Israeli stocks compared to global peers in 2023 to date as well as the significant weakening of the Israeli Shekel. In response to the political turmoil, the Shekel steadily weakened through the quarter, ending near NIS 3.7 – USD 1, with only a slight rebound in July to date. (see charts on right)



Israel Macroeconomic and Political Update (continued)

The geopolitical and strategic situation for Israel generally worsened during Q2, both in Gaza and the West Bank, as well as on the northern border with Lebanon. Israel fought a short but decisive campaign against the Palestinian Islamic Jihad (PIJ) terrorist group in Gaza in May. In addition, early July saw a short but intense Israeli operation against terrorist cells in the West Bank city of Jenin in early July. Furthermore – and perhaps most threatening – Hezbollah in Lebanon continues its efforts to erode Israel’s ‘red-lines’ against the Iranian-backed organization. After a brazen attack in Israel earlier this year, Hezbollah has challenged Israel’s UN-recognized border with Lebanon in numerous ways this Spring and early summer, and Israel is attempting to deter the group without triggering an all-out escalation.

All of these challenges in close proximity to Israel’s population centers bear the fingerprints of Iran, which backs PIJ, various radical terrorist groups in the West Bank, and Hezbollah in Lebanon. In positive contrast, strong economic cooperation continues to grow between Israel and Egypt in the energy sector, and trade and investment between Israel and the UAE are growing steadily

Israel Economic Exposure Indexes

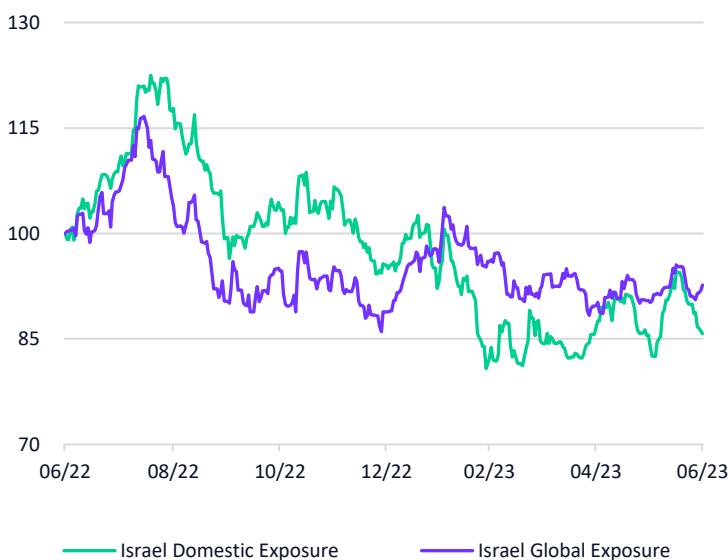
With such a dichotomy between global and local monetary policy and economic developments, there are now even more potential insights available from tracking the performance of Israeli Domestic vs Israeli Global companies. The path of inflation, interest rate differentials and currencies, and real economic activity are expected to continue to impact both earnings growth and price multiples on these two groups of Israeli stocks differently, presenting an opportunity for investors to capitalize on these trends.

In 2021 the Israel Domestic Exposure Index outperformed the Israel Global Exposure Index by an astounding 44% and continued to outperform through 2022 by an additional 17.5% bringing the total outperformance from the end of 2020 through 2022 to roughly 69%. However, in our Q4 2022 update, we noted that the “IEEI Relative Performance Since 2009” chart suggested a high probability of a relief rally for the Israel Global Exposure Index in the near future. Indeed, the Global Exposure Index has outperformed by more than 19% since the end of Q3 2022.

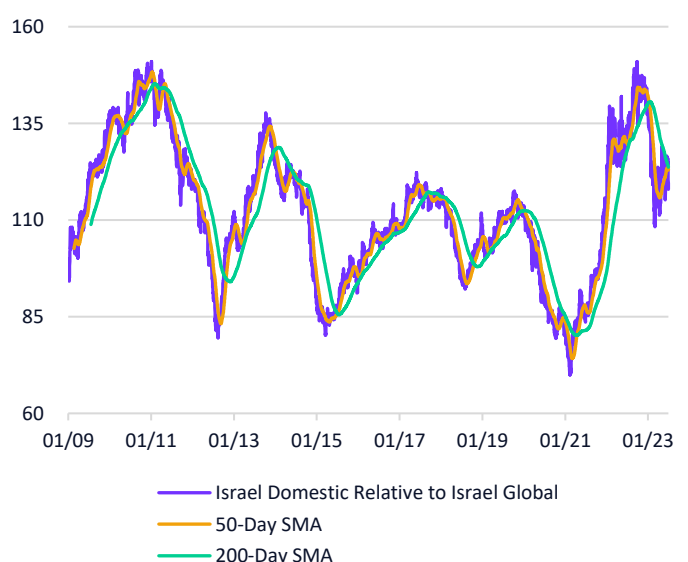
In Q1, our reasoning for expecting continued underperformance by domestically-oriented stocks was mostly technical, and possibly transitory, in nature. In Q2 we said the reason that globally-oriented stocks could continue outperforming is a bit different, and potentially more entrenched in investors’ psyche. The impact of the proposed judicial reforms, which were discussed in more detail on the previous page, stands to harm the credit rating of the Israeli government which would be a major systemic blow to the economy, Shekel, and financial system at large.

As we enter the third quarter, the relative performance outlook is muddled since domestic stocks appear poised for a more substantial relief rally. But the longer-term outlook continues to favor globally oriented stocks at least until the judicial reform debacle is behind us.

Trailing Twelve Month Comparative Total Returns



IEEI Relative Performance Since 2009



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