

May 2, 2023

## ISRAEL EQUITY REVIEW AND OUTLOOK - Q2 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.

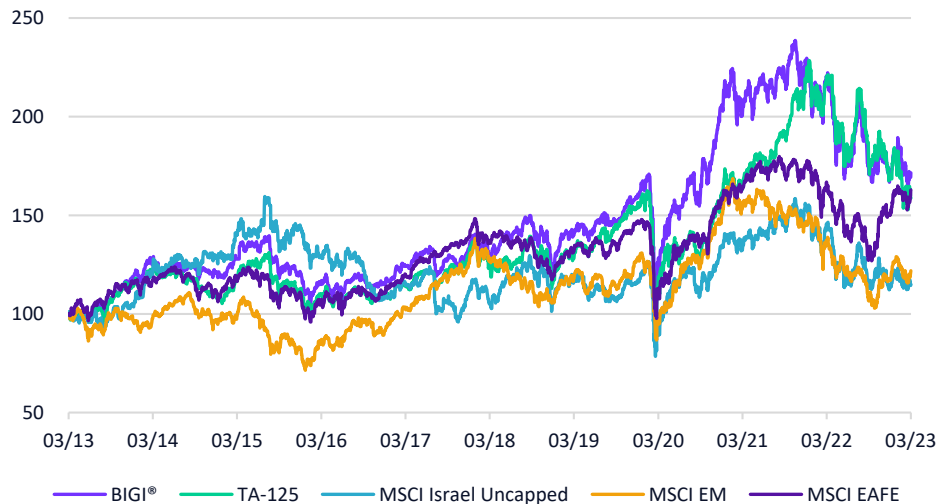
The BlueStar® Israel Global Technology Index (BIGITech® or BGTH & BGTHTR INDEX on Bloomberg) is the broadest and deepest benchmark tracking the performance of Israeli companies operating in innovative sectors such as information technology, defense technology, clean technology and bio-technology. BIGITech®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

## 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®), gained just 0.68% in the first quarter of 2023, significantly underperforming US and international developed market equities.
- Israeli technology stocks, as defined by the BlueStar® Israel Global Technology Index (BIGITech®), gained 5.14% in Q1, outpacing the broader Israeli equity market but underperforming US and Global tech peers by more than 15%.
- The Bank of Israel raised its policy interest rate in February by another 0.50% to 4.25%. The Bank of Israel has now raised rates by a full percentage point in 2023 to date.
- The Israeli economy, which entered 2023 on a strong note, boasting lower inflation, higher growth, and a notable fiscal surplus, outpacing other developed nations.
- Proposed reforms to the power of Israel's judiciary have made their mark on Israel's equity markets as domestically-oriented stocks dramatically underperformed their globally-oriented peers in Q1, by a wide margin of 17.69%.

Ten Year Performance Ending March 31, 2023



Source: MarketVector, Bloomberg. Data as of March 31, 2023. All data in USD.

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## Israel Equity Market Performance

Israeli equities, as defined by the BlueStar® Israel Global Index (BIGI®), gained 0.68% in Q1 2023, a modest rebound after 2022's loss of 25.19%. BIGI® continued to underperform international developed markets, represented by the iShares EAFE ETF, by 7.94% but outperformed the KSM TA-125 ETF (in USD) by 7.64%. The Israel Domestic Exposure Index underperformed the Israel Global Exposure Index in Q1 2023 by 17.69%, the second straight quarter of significant underperformance.

BIGITech® gained 5.14% in Q1 2023. While any absolute gains are welcomed following a dismal 2022, Israeli tech stocks underperformed the iShares U.S. Technology and the iShares Global Tech ETFs by a wide margin of 19.61% and 16.02%, respectively.

While much of Israel's 2022 underperformance against international peers could be attributed to a disproportionate effect of systemic global macro developments on the valuations of Israeli companies, the relative performance in 2023 appears to be more particular to local events in Israel. The spillover from political uncertainty over proposed reforms to Israel's judicial system into Israel's economy and the financial system became heightened in Q1.

From the immediate impact of large-scale protests and labor union strikes on economic productivity to the longer-term impact on Israel's growth prospects, credit outlook, and ability to attract foreign direct investment (especially in the technology sector), the judicial reforms proposed are being discounted into Israel's equity markets. Investors are currently requiring significantly higher expected returns for the risk of investing in Israel's capital markets. This topic is discussed further on the following page.

Despite a broad-based rally in internationally developed markets in Q1, only three sectors of BIGI® gained. Consumer discretionary stocks, which were the worst performers in Q4 2022, gained 16.67%, while technology stocks gained 8.99% (a significant underperformance against international technology peers), and industrials gained 1.70%. All other sectors were in the red, with those that are most sensitive to the local Israeli economy, such as real estate and consumer staples, faring the worst.

Several Israeli companies, however, did participate in the global stock market rally including technology companies Perion, Global-E, Stratasys, Wix.com, and Nano Dimension. Isracard, Israel's only pure-play credit card company managed to rally 45%, despite the broader Israeli financials sector loss of 5.52%, following Harel's takeover bid. And Zim Integrated Shipping, Israel's leading global logistics company jumped by 37.17%, only to fall 27% in the first 10 days of the second quarter.

ISRAEL AND GLOBAL EQUITY BENCHMARK COMPARISON		
Benchmark	Q1 2023 Return(%)	2023 YTD (%)
BIGI®	0.68	0.68
BIGITech®	5.14	5.14
iShares Israel ETF	0.97	0.97
KSM TA-125 ETF	(6.96)	(6.96)
SPDR S&P 500 ETF Trust	7.50	7.50
iShares Emerging Markets ETF	3.96	3.96
iShares EAFE ETF	8.62	8.62
Israel Domestic Exposure	(11.71)	(11.71)
Israel Global Exposure	5.98	5.98
Israel Infrastructure	(20.51)	(20.51)

ISRAEL AND GLOBAL TECH EQUITY BENCHMARK COMPARISON		
Benchmark	Q1 2023 Return(%)	2023 YTD (%)
BIGITech®	5.14	5.14
iShares U.S. Technology ETF	24.75	24.75
iShares Global Tech ETF	21.17	21.17

SECTOR PERFORMANCE (%): Q1 2023	
Consumer Discretionary	16.67
Information Technology	8.99
Industrials	1.70
Energy	(0.29)
Communication Services	(5.43)
Financials	(5.52)
Materials	(5.69)
Health Care	(7.43)
Utilities	(9.77)
Real Estate	(14.50)
Consumer Staples	(15.29)

TOP AND BOTTOM BIGI® PERFORMERS: Q1 2023			
Positive Contributors (%)		Negative Contributors (%)	
PERION NETWORK LTD	56.44	LIVEPERSON INC	(56.51)
GLOBAL-E ONLINE LTD	56.15	888 HOLDINGS PLC	(38.97)
ISRACARD LTD	45.11	PARTNER COMMUNICATIONS CO	(35.96)
STRATASYS LTD	39.38	SHIKUN & BINUI LTD	(33.25)
ZIM INTEGRATED SHIPPING SERV	37.17	OPC ENERGY LTD	(33.16)
PLAYTIKA HOLDING CORP	32.31	CELLCOM ISRAEL LTD	(31.52)
WIX.COM LTD	29.90	ELCO LTD	(29.23)
CAMTEK LTD	29.10	TEL AVIV STOCK EXCHANGE LTD	(26.74)
NOVA LTD	27.90	ONE SOFTWARE TECHNOLOGIES LT	(26.08)
NANO DIMENSION LTD - ADR	25.65	MEGA OR HOLDINGS LTD	(22.52)

# Israel Macroeconomic and Political Update

## Economic Highlights

The Bank of Israel's Monetary Committee raised their policy interest rate in February by another 0.50% to 4.25%. The Bank of Israel has now raised rates by a full percentage point in 2023 to-date. Inflation over the 12 months leading to February's interest rate decision was 5.4%, well above the upper band of the Bank of Israel's target, though 12 month forward expectations are all within the target range. Overall economic activity in Israel remains strong as GDP grew by 6.5% in 2022 and is now trending at a faster growth rate than pre-covid crisis levels.

## Judicial Reforms

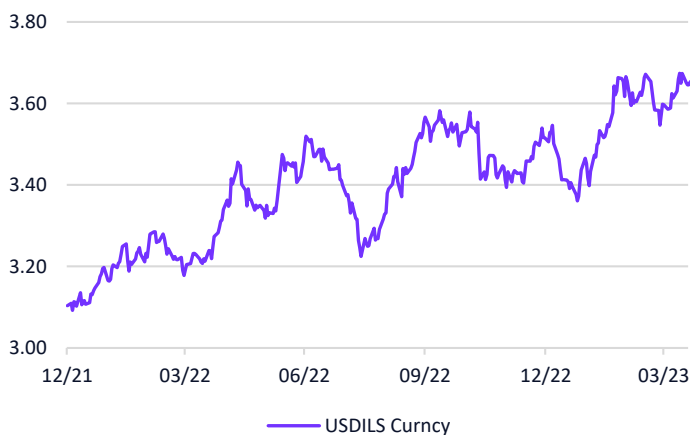
In January 2023, Deputy Prime Minister Yariv Levin, along with Simcha Rothman, Chair of the Knesset's Constitution, Law and Justice Committee, proposed legislature outlining a set of modifications to Israel's judicial system and power structure. The proposed changes aim to reduce the judiciary's sway over general regulation and public policy by restricting the Supreme Court's ability to carry out judicial review, giving the government more control over judicial appointments, and limiting the power of legal advisors. The consequence of the proposal translates to the ability of the Knesset to override Supreme Court rulings, which is, in essence, a massive transfer of power.

The potential overhaul was, for the most part, received negatively from the public, and provoked significant protests. The scale of the public protests was in the tens of thousands, and the uproar reverberated globally. In an effort to restore balance, Prime Minister Netanyahu called for a pause on the judicial overhaul.

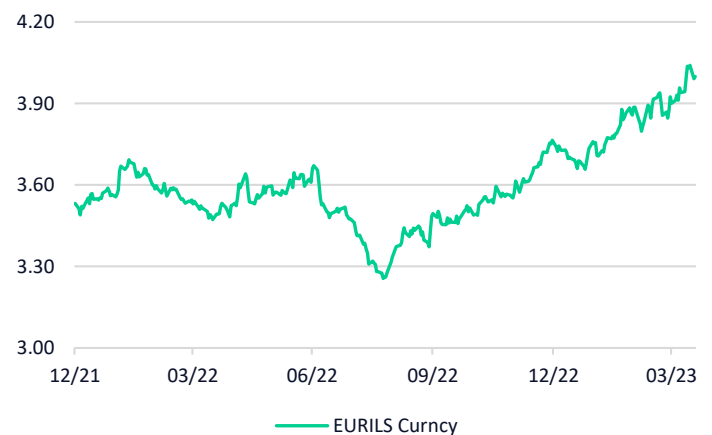
Pointing to the “deterioration of Israel’s Governance”, rating agency Moody’s downgraded Israel’s credit outlook from positive to stable. While the country’s actually credit rating remained at A1, if current political and social tensions persist, capital inflows could materially diminish. Earlier in 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 in relation to a basket of currencies in anticipation of the ratings report, reflecting added risk premium corresponding to political events.

If the judicial reforms are eventually passed we would expect a one time shock to the financial markets and economy followed by a long period of “wait and see” how they actually impact Israel’s economy and companies over the medium and long term. If, however, the final version of the reforms are significantly moderated before their eventual passage, it could provide an upside surprise to Israel’s markets and economy. In the meantime this issue hangs over Israel’s economy and markets as evidenced by the massive underperformance of Israeli stocks compared to global peers in 2023 to-date as well as the significant weakening of the Shekel.

USD:ILS



EUR:ILS

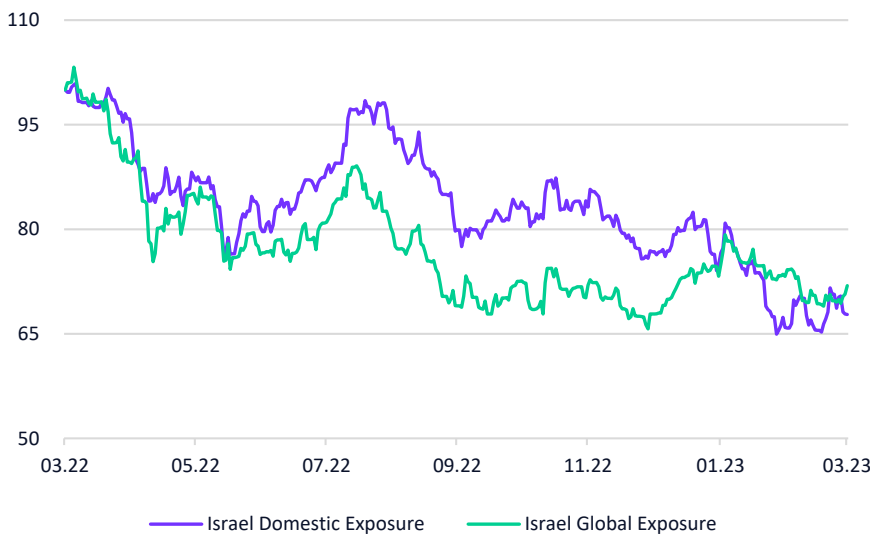


## Israel Economic Exposure Indexes

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 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.

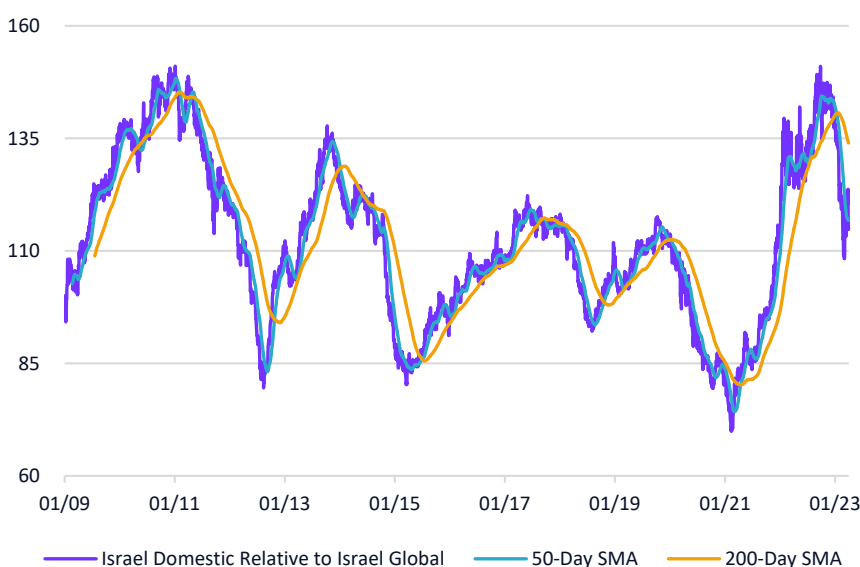
**Trailing Twelve Month Comparative Total Returns**



Last quarter our reasoning for expecting continued underperformance by domestically-oriented stocks was mostly technical, and possibly transitory, in nature:

1. From a technical perspective domestically-oriented stocks continued to look overbought, and the relative performance of the Israel Domestic Index over the Israel Global index had dropped below both the 50 and 200-day moving averages indicating a reversal in trend.
2. Globally-oriented stocks were hit harder in the direct aftermath of rising global inflation and the onset of a global monetary tightening cycle, making room for a stronger rally in those stocks once interest rates and inflation began to stabilize.

**IEEI Relative Performance Since 2009**



The reason that globally-oriented stocks could continue outperforming is now 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. Many pieces of the foundation of Israel’s relative economic strength over the last two decades were predicated on Israel’s superior fiscal position and the strength of its financial institutions, including a relatively strong currency, strong real estate market, the ability to attract foreign direct investment, and favorable demographic trends.

Should any of those attributes be diminished as a result of the judicial reform bill’s eventual passage, the long-term impacts would need to be further priced into Israel’s domestically-oriented stocks. Currently, the downside risk seems to be far greater than the upside.

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