

Israeli Stocks Follow The Shekel

Water flows downhill and printed money creates inflation. Both statements should fall into the “duh!” category, but we live in a world where only the first one is accepted amongst central bankers. This last group has managed to convince themselves the observed surges in various commodity prices have nothing to do with currency debasement and, if those prices fall into the categories of [food](#) and [energy](#), well, they just do not count because they are non-core.

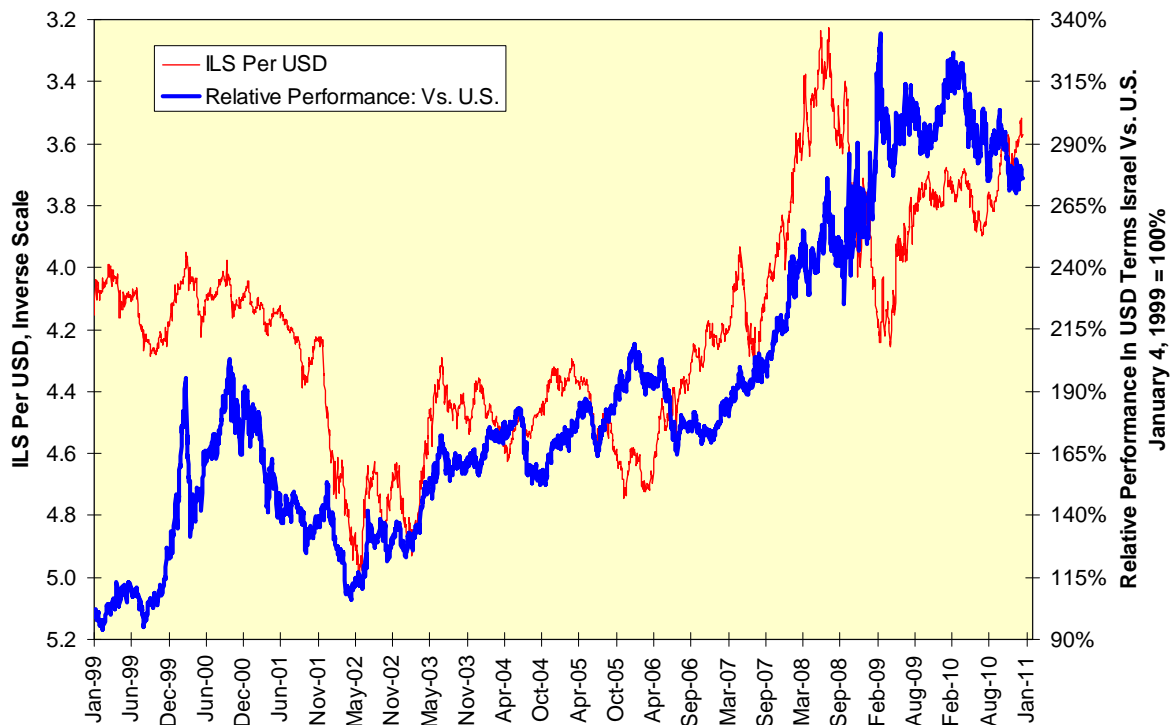
The monetary excesses of the U.S. and the Eurozone have had the effect, which I have discussed in the context of numerous countries, of creating carry trades. Let’s add one more country, Israel, to that list and demonstrate how money flows propel the Israeli shekel higher and create a direct link to the relative performance of Israeli stocks. We should note Israel has raised its base lending rate six times since July 2009, and while its current level of 2% is hardly Draconian, it is in comparison to the U.S., now the land of milk and money.

As an aside, it is going to turn into the land of offshore natural gas, too. The recent finds in the Tamar and Leviathan fields are sufficient to make Israel a natural gas exporter provided they do not scare away investors with high taxes and royalties. As I have told many over the years, 150 years of drilling for oil has demonstrated one truth and that is if you find it, they will take it from you. Sometimes they let you out with a profit; sometimes they confiscate properties directly and sometimes they just tax you to oblivion. But no one, anywhere, ever emerges unscathed.

U.S. Case

Let’s map the value of the shekel against the dollar against the relative total return of Israel to the U.S. as measured by MSCI-Barra. With the expected and prominent exception of the 2008 financial crisis where the dollar rallied against most currencies, the linkage is rather clear: Money flowing into the ILS finds its way into Israeli stocks in a hurry.

Relative Stock Performance Vs. U.S. Reconverging To Spot Rate

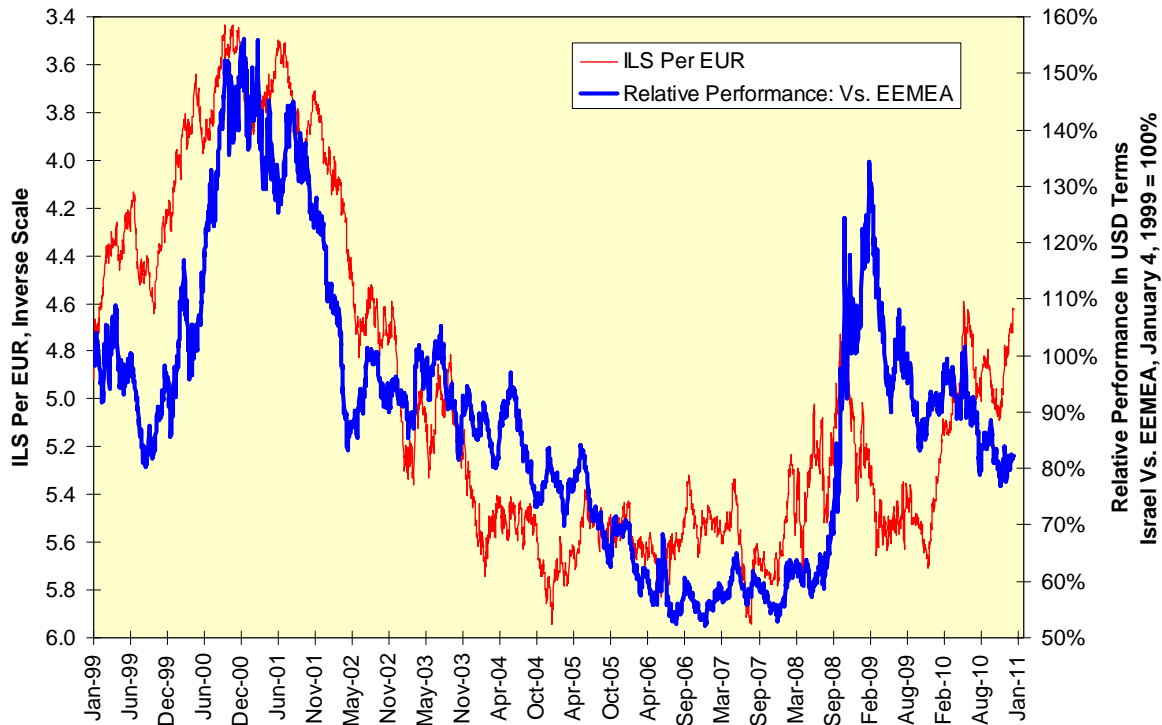


Eurozone Case

The comparison is a little less direct for the euro case. Israel is part of MSCI’s Eastern Europe, Middle East and Africa index, and while most of those countries do not use the euro directly, they are in the euro bloc far more than in the dollar bloc. If we map the cross-rate of the ILS against the EUR, we see the same general linkage between

currency and relative stock market performance and with the same late-2008 disruption. Once again: Free money elsewhere leads to a strong shekel and strong relative performance.

Relative Stock Performance Vs. MSCI-EEMEA



You can access the Israeli market through closed-end funds such as the Aberdeen Israel Fund, through ETFs such as the iShares MSCI Israel Capped Index Fund or through open-end mutual funds such as the American Israeli Shared Values Capital Appreciation Fund.