

Cheapest Israel Stocks Lure Aberdeen as Economy Trumps Syria (3)
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(Updates prices beginning in third paragraph.)

By Shoshanna Solomon and Belinda Cao

Sept. 17 (Bloomberg) -- Israeli stocks are rebounding from their lowest valuations on record relative to developed equities as economic growth twice the pace of the U.S. outweighs concern over the conflict in Syria.

"There are certainly some attractive companies in Israel which trade at an undeserved discount to peers globally," William Scholes, assistant investment manager at Aberdeen Asset Management Plc in London that oversees \$318 billion including Israeli assets, said by e-mail Sept. 11. Scholes favors technology and services stocks as well as "companies with domestic consumption exposure," such as Azrieli Group, a real estate investment company, and Ituran, which makes systems to locate cars.

The benchmark TA-25 Index advanced 6.4 percent from an 11-month low reached Aug. 27, as speculation of a U.S.-led strike on Syria eased with America and Russia agreeing on a plan to take control of chemical weapons in Israel's neighbor and remove or destroy them by mid-2014. Shares in the index rose after trading at an average 10.5 times estimated earnings on Sept. 8, 28 percent below the valuation of the MSCI World Index of developed markets and the biggest discount in data compiled by Bloomberg going back to 2008.

The Israeli measure traded at 11.2 times earnings at the close in Tel Aviv, a 26 percent discount to the developed market gauge's multiple. The TA-25 Index added for an eighth day, the longest winning streak since Oct. 3.

'Main Beneficiaries'

Israel's economy will expand 3.6 percent this year compared with 1.6 percent in the U.S., according to the average forecasts of economists surveyed by Bloomberg.

The country's financial companies, which include Azrieli Group and Bank Hapoalim Ltd., the nation's biggest lender by assets, make up the cheapest industry group in the index, with a valuation of 9.4 times estimated earnings. This compares with an average 13.2 for companies in the MSCI World Finance Index.

"We like banks because they have underperformed most developed banks and will be the main beneficiaries from a pick-up in the economy," Micha Goldberg, the head of equity research at Excellence Nessuah in Ramat Gan, said by phone on Sept. 11.

Israel's five largest bank stocks are trading at a price to book ratio of 0.75, which compares to a 1.15 ratio for the MSCI World Bank Index of developed lenders.

Israeli stocks will recover from declines sparked by military conflict, if history is any guide. While the TA-25 benchmark index sank to an eight-month low during the Second Lebanon war, which started on July 12, 2006, it ended the year close to a record. The measure climbed to a 17-month high on Dec. 11, 2012, a month after Israel began an eight-day military operation in the Gaza Strip.

Developed Status

The TA-25 has gained 4.6 percent this year, lagging behind the MSCI World Index, which is up 16 percent. Israel's reclassification by MSCI as a developed rather than emerging market in May 2010 contributed to a 44 percent tumble in trading volumes through the end of 2012 compared with an average 18 percent global decline, the Bank of Israel said in a March 12 report.

As part of the MSCI Emerging Markets Index, Israel had a weighting of 2.7 percent. Now it makes up 0.2 percent of the MSCI World Index of 33 developed nations.

Government rules to spur competition in telecommunications as well as a review of tax and royalty policies on natural resources have weighed on investor sentiment.

As trading falls, initial public offerings have dried up and companies are leaving the exchange, from Mellanox Technologies Ltd., the maker of equipment that speeds up electronic data transfers, to Hot Telecommunication System Ltd., a telecommunications company and ELAD Canada Inc., a real estate company owned by billionaire Isaac Tshuva.

More Regulation

In June, Kadimastem Ltd., a developer of stem cell therapies, became the first company to list on the Tel Aviv bourse since the end of 2011, compared with a record 56 IPOs in 2007, exchange data show.

The average valuation for companies on the TA-25 gauge fell below the multiple of the MSCI Emerging Market Index on Sept. 3, the first discount in three months.

"Regulation is weighing on the companies and adding a risk premium to the shares, in addition to the traditional geopolitical risk and the MSCI shift," Yaniv Pagot, chief strategist at Ramat Gan, Israel-based Ayalon Group Ltd. with 14 billion shekels in assets, said by phone on Sept. 10. "The pricing of the market indicates that investors perceive Israel

as an emerging market, with the same risk premium.” Pagot said the most attractive sectors are banking and energy.

‘Buy Opportunity’

The start of natural gas production in March from the Tamar field, the reservoir off Israel’s Mediterranean Coast that contains 10 trillion cubic feet of natural gas, is also helping improve Israel’s economic outlook.

The central bank projects gas production will add as much as \$3 billion this year to the current account balance. For every \$1 billion improvement in the current account, the shekel strengthens about 1 percent, according to the Bank of Israel.

The shekel is posting the biggest advance among 31 major currencies tracked by Bloomberg this year, with a gain of 5.6 percent against the dollar, even as the central bank cuts interest rates and buys greenback to try to weaken the exchange rate.

“It’s very clearly a buy opportunity,” Brian Friedman, who manages the Israeli equity fund unit of GHP Investment Advisors Inc., which oversees about \$775 million, said by phone from Denver on Sept. 11. Selloffs sparked by security concerns “tend to be very short-lived and almost always tend to be good buying opportunities,” he said.

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