

## Chapter 1

# ***Welcome to the World of Investing***

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### **Israel's Economic Outlook**

A bird's-eye view of Israel's economic picture shows a land of growth and opportunity – a modern nation with advanced ideas, a world leader in innovation. Israel's high-tech heroics have made the country a magnet for foreign investment and earned it the nickname, "silicon wadi." Its economy, historically based on agriculture and light industry, has been updated to include the transition to a knowledge-based financial system. Recognized worldwide for its excellence in telecommunications, information technology (IT), and life sciences, Israel attracts billions of dollars of "hot money," which is a major impetus to the further building of the economy.

With thousands of high-tech start-up companies, Israel ranks among the top countries in the world as a recipient of venture capital (VC). Over 150 Israeli companies trade on international markets, with around 80 trading on various U.S. exchanges. In

fact, Teva Pharmaceuticals and Check Point Software\* are both listed on the exclusive NASDAQ-100 list. But that's not all ...

### **Israel is Forging Ahead**

As a strong democracy with a capitalist economy, Israel often appears at the top of the list of global stock markets in terms of returns. This is due to Israeli talent working both at home and abroad. Israel's national resource of "brainpower" has enticed some of the world's most powerful companies to focus development resources in Israel: Motorola developed the cell phone in Israel; Microsoft built most of the Windows NT operating system in Israel; Intel designed its Pentium MMX and Centrino chips in its Israeli labs; the technology for instant messaging was created in Israel and eventually sold to AOL, etc.

Israeli companies have made an impact both locally and abroad: Pharmaceutical giant Teva paid \$3.4 billion for U.S. generic drug maker, Sicor, in 2004, and \$7.4 billion to acquire Ivax, a company in the same business, in 2005; an Israeli company now owns the prestigious half-billion dollar New York Plaza Hotel; and the internet infrastructure company BackWeb Technologies, whose clients include Hewlett-Packard, Siemens, and Kodak, finds its roots in one of Israel's first venture capital firms, the BRM Group. Sparing patients the discomfort associated with endoscopies, Given Imaging created a pill-sized video camera that can be swallowed. As it works its way through the small intestine, doctors can get a good view of what's going on inside. After 9/11, Moseroth Technologies created the Spider Rescue System, which

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\* The listing of a particular corporation in this book is *not* a recommendation to buy or sell its stock. Consult with an investment professional to determine if and when it may be appropriate for you to trade in a specific security. The author, Profile Investment Services, Ltd., and its associates and/or affiliates may take long or short positions in the companies mentioned in this book. All securities cited throughout the text are examples for educational purposes only.

uses elevator-quality steel cables to quickly lower people to safety when immediate evacuation from a tall building is required.

Israel's business success extends to many sectors, including financial services and security. Other success stories include firms such as Nice Systems, which supplies technology to record almost 90% of the brokerage transactions around the world. Not only that, but the Los Angeles and New York City police departments record their incoming calls with Nice's equipment. Nice also sells sophisticated audio interception and video surveillance systems to various government agencies to monitor terror threats. Then there's ISDS, founded by Mossad veterans, which offers security training and systems to international organizations, including Mexico's national oil company, the Olympic Games Committee, World Cup soccer, and the airport, energy, and power plant security units in Brazil, Chile, India, Italy, and elsewhere. Magal Security Systems, the firm that's building the anti-terrorist security fence in Israel, is the same company that built the security system for Buckingham Palace. The kibbutz-based company called Mofet Etzion has pioneered the concept of a lightweight ceramic material called LIBA, "Light Improved Ballistic Armor." After examining the product, the U.S. Marines bought the armor for over 1000 of their "Expeditionary Fighting Vehicles," which are used in the battle zones of Iraq and Afghanistan.

Though there's always risk associated with trying to surge ahead, consider some of these points about the Israeli economy:

- Vigorous privatization plans are lowering the administrative and financial burden on the government by letting the free market take over. (Major moves by the government included selling off its stakes in the telephone company Bezeq, the Israel Discount Bank, and the national airline, El Al.)
- Tax rates are dropping.
- Per capita gross domestic product (GDP) matches other industrialized countries.
- As a percentage of its GDP, Israel's expenditure on education

tops the United States, the United Kingdom, Spain, Japan, and many other nations. And the vast majority of adults have 12 or more years of education.

- Twenty-four percent of the Israeli workforce has a university degree.
- Key economic points include low inflation, decreasing interest rates, and a solid currency.
- Israel has an investment grade rating from Standard & Poor's of A-, which is excellent by international standards.

Israeli companies deal in a broad range of commerce. In fact, each of the industries listed below exports over \$100 million to the U.S. alone (in addition to sales made to Europe and the Far East):

- medicinal, dental, and pharmaceutical preparations,
- telecommunications equipment,
- scientific, medical, and hospital equipment,
- electric apparatus and parts,
- photo and service industry machinery and trade tools,
- civilian aircraft and parts,
- industrial organic chemicals,
- synthetic cloth and fabrics, thread and cordage,
- pulp and paper machinery,
- semiconductors and related devices,
- apparel and household goods,
- gems – diamonds,
- jewelry, and more.

Despite all of these positive features, the bursting of the high-tech bubble and the tenuous political situation provide many *olim* with a sense of nervousness about their new economic reality, and they feel a degree of concern regarding the volatility of the Israeli economy. They see the great potential, but nevertheless feel more comfortable diversifying their holdings so that only part is “Blue and White,” and the rest is placed elsewhere. Often they choose

to keep some of their assets in the U.S. markets. Although many are well aware of some of the political and corporate disasters Americans have experienced during the last several decades, these investors also recall more positive aspects. They remember that the U.S. economy, with its strong will to succeed, continues to forge ahead even in the wake of financial setbacks.

### **Past Performance Does Not Indicate Future Results**

Keep in mind when considering the statistics in this book (and in any other investment guide that you read) that the numbers are not necessarily indicative of how a particular investment or market segment will perform in the future. Although studying historical performance is an accepted method used to analyze and make predictions, the reviewer of such facts must always be aware that an educated estimate is not the same as an assurance or guarantee. In fact, the U.S. Securities and Exchange Commission (SEC) insists that investment companies make a clear disclaimer to warn investors that what happened in the past is not a prediction of what will occur in the future.

### **Opportunities for the Market to Fall**

One of the most common reasons for not creating an investment portfolio is the fear of losing money. People hear woeful stories about investors who lost everything, and imagine themselves in the same scenario.

While loss of principal sometimes does happen, it is important to keep the larger financial picture in mind. The stock market has seen highs and lows, but over time has moved steadily upward. For those investors sufficiently diversified and able to accept the risks associated with owning securities, investing in the market has generally been a solid, long-term financial choice. The difference between winning and losing on financial selections often turns out to be just a matter of time, with the most successful investors being the patient ones.

### **Opportunities for the Market to Rise**

Global and political catastrophes have made apparent the resiliency of the American markets as they coped with and subsequently recovered from adversities. Even following the terrorist destruction of the World Trade Center, the American markets soon found their balance and were able to concentrate on moving back up. A quick lineup of historical events during the last half-century demonstrates the continuing determination and drive of the American markets in the face of national and global upheaval.

During the Cuban missile crisis in October 1962, Americans were worried that nuclear war was imminent and everything they held dear might be destroyed. However, when the crisis was diffused, the markets picked up steam and by the following year, the Dow Jones Industrial Average (a major market indicator) had gained 29%, jumping from 572 to 738.

Just a short time later, on November 22, 1963, President John F. Kennedy was assassinated. Many wondered what direction the country would take after the heartbreaking loss of its charismatic young leader. While some politicians may have floundered, the markets did not fall apart, and by the next year they showed gains of 25%, climbing from 711 to 890.

On August 9, 1974, in the midst of a recession, President Richard Nixon resigned following his involvement in the Watergate scandal. The Dow, on that date, was at 777. Just one year later, it had gone up 5% to 817. Considering the state of the economy at the time, and the fact that the market had dropped significantly due to the oil embargo and the Vietnam War, this figure is actually quite impressive.

“Black Monday,” October 19, 1987, shook up the market considerably. In one of the biggest losses in Wall Street’s history, the market tumbled over 22% in a day, falling 508 points from 2246 to 1738. It only took one year for the market to once again regain its health. On October 19, 1988, the market was at 2137, just about

4% below its standing before the crash, and about 23% higher than it had been on the actual day of the crash. Another year later, it was up to 2683, an increase of over 19% above the pre-crash value two years earlier.

As Gulf War I began in 1990, the Dow tumbled 22% in less than three months, from a high of 3019 on July 20 to 2344 on October 11. Fear of an extended war, a spike in oil prices, and potential terrorism might have encouraged investors to sideline their money. If they had, however, they would have missed the incredible bull market of the 1990s – and they might not have participated in the millennium ending without an infection of the Y2K bug and with the Dow at 11,497.

In each of these time periods, the market survived declines that to some may have seemed insurmountable. Each downturn, however, proved to be temporary and the market recovered, lending credence to economists who say that short-term volatility doesn't necessarily hamper the long-term upward motion of the markets.

The above examples should offer encouragement to the long-term investor. International and domestic affairs may have an immediate effect on the marketplace, but their long-term impacts have often been negligible. Many shareholders, who jumped ship upon hearing bad news, ended up selling investments that, if held, would have returned huge profits. Historically, the potential for future returns outweighs the temporary risk of the catastrophe *du jour*.

### **Individual Companies Often Make Comebacks**

In addition to the major national and international happenings that cause general market turmoil, individual corporations also experience unexpected setbacks that may prove difficult to overcome. While there are instances when hard times force companies to close their doors, sometimes problems can reverse themselves. For example, in 1989, the Exxon Valdez disaster had

shareholders worried. One of Exxon's tankers had a devastating accident, polluting the waters of Alaska's Prince William Sound with oil. Damage to wildlife and to the environment was extensive, and cleanup costs loomed massively ahead. Exxon's shares dropped 7% when the news broke. However, the stock quickly rebounded, and was soon selling at multiples similar to other stocks within its industry.

In 1984, Union Carbide Corporation, America's third largest petrochemical company, was sued for over \$3 billion after a deadly gas leaked from one of its plants, tragically killing over 3,300 people in Bhopal, India. The fiasco was a public-relations nightmare, and the company's stock fell 21% within a short time. However, a year later, the stock was back at its previous level, and by 1989, it had reached a new all-time high.

There are many examples of how strong firms have regrouped, restructured, and recovered after disasters have struck. Consider how many companies survived, and even prospered, after the September 11, 2001 terror attacks on the Twin Towers (e.g., Cantor Fitzgerald lost over 650 employees and today is back as a powerful financial force). Look at how the world's largest tobacco company, Philip Morris (now called "Altria"), has constantly survived the onslaught of litigation brought against it. Watch how pharmaceutical companies see their share prices rebound after sharp drops caused by problematic drug recalls.

Stories like these illustrate that while market conditions, company news, and external situations may adversely affect the price of a stock in the short term, the shares of well-managed companies can often ride out the calamities and manage to rise in the long run.

## Summary

- Israel is an important player in the world marketplace and is a key leader in the technology field.
- Investors should be aware that past performance is not necessarily indicative of future results.

- Historical events show that markets, as well as individual stocks, are resilient and often recover after setbacks, sometimes even going on to new highs.

