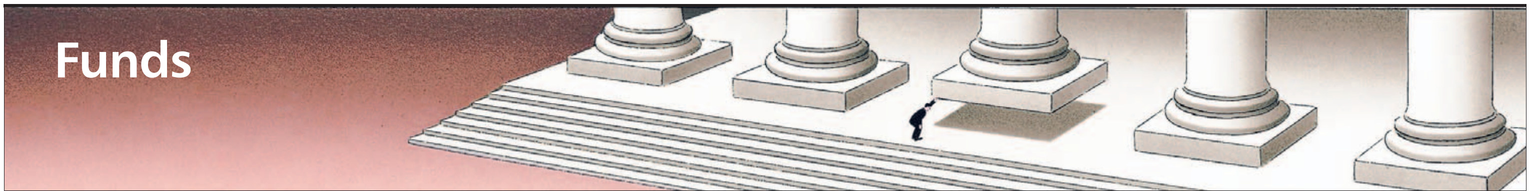


# The Allure of Israel's Fledgling Hedge Funds

**By Eric Uhlfelder**

YOU'VE PROBABLY NEVER HEARD OF ANY OF ITS ASSET MANAGers, and the country is about the size of New Jersey. To boot, its broad market indexes have been floundering. But Israel's dynamic economy offers opportunities for the nimble.

Active management is the key to profitably navigating the market. Several leading hedge funds have delivered top-notch returns, bolstering an industry that's open to U.S. investors. In 2011, there were roughly a dozen funds running $2 billion. That's grown to 140 overseeing more than $6 billion, according to Tzur Management, a fund administrator started by U.S.-reared Yitz Raab, who returned to Tel Aviv seven years ago to provide services to the funds.

Aside from the country's obvious security issues, Israel's market suffers from a lack of liquidity and a dearth of research, something the funds are trying to remedy. The market's value of $204 billion amounts to a fraction of 1% of the MSCI Developed Market Index. That hasn't been helped by mediocre performance. Net annualized returns in U.S. dollars over the five years through early July have been just 3.6% (4.41% in local currency terms). The weak index showings make exchange-traded funds less attractive.

Hurting performance has been the collapse of three large-cap stocks. Generic drugmaker **Teva Pharmaceutical Industries** (ticker: TEVA) has suffered from declining prices, debt, and management issues; its stock is off more than 60% over the past three years. **Perrigo** (PRGO) another drug manufacturer, has fallen by a similar amount, owing to pricing issues, plus acquisition and antitrust worries. They are the Tel Aviv 125's two largest companies. Another large-cap pharma, **Mylan** (MYL), recently delisted voluntarily from the Tel Aviv Stock Exchange, after having suffered a comparable fall. (It had gone onto the exchange in 2015, in connection with an attempted takeover of Perrigo that eventually failed.)

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In contrast, Israel's growth-oriented small-cap Yeter Index is up a third over the same period.

Even hard-hit Teva has a major booster: Warren Buffett, who told Forbes magazine in February that he's accumulated a stake in Teva and is a "big believer in Israel's economy."

Indeed, the macro outlook is encouraging. Israeli gross domestic product growth, at 4.5% on an annual basis through the first quarter of 2018, has historically outpaced U.S. growth. The Organization for Economic Cooperation and Development reports Israel spends more on research and development as a proportion of the economy than any other country (4.25% in 2016, the latest period for which figures are available). Israel has 4,000 start-ups, second only to Silicon Valley. It's also second to China in having the largest number of foreign stocks (96) listed on the Nasdaq.

Israel's most successful companies sell well beyond its borders. Roughly 85% of the revenue of hedge fund ION Israel Equity Long/Short's top 10 holdings comes from abroad. More than 40% of its book is made up of energy, networking, and chemical shares. While the Tel Aviv index has struggled, Ion climbed nearly 20% in the 12 months through June. Since its inception in July 2006, the $400 million fund has had annualized returns of 10.7%, versus the S&P 500's 8.8%, and with 9% annualized volatility, versus 14.3% for the U.S. index.

"We manage a concentrated, high-conviction book," explains portfolio co-manager Stephen Levey, "that has more than doubled local-market returns, with approximately half the risk, while at the same time exceeding the S&P 500's total returns." The fund plans to close to investors in August, though Israeli funds often close for short periods until they can deploy all of their assets satisfactorily. They generally charge a 1.5%-2% management fee and 20% performance fee.

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**Sphera is Israel's largest** hedge fund manager, with $1.6 billion spread across five funds. Since it was launched in October 2011, Sphera's $75 million small-cap fund had generated annualized returns in dollars exceeding 16% through June. Its volatility has been just half that.

"Despite the importance of Israeli tech to the local economy," says Sphera CEO Ori Goldfarb, "we have found diverse value opportunities, with the fund's largest sector exposure in industrials, financial services, and consumer discretionary." He declines to specify company names.

Sphera's diversified flagship fund, with $750 million in assets, was founded at the beginning of 2004. Since then, it's up more than 11% annualized, with 7.6% volatility.

New investors can gain access to either fund when existing ones cash out.

Another fund, Senvest Israel Partners, launched in April 2003, had generated annualized returns above 20% through June, but with volatility averaging 26%. However, the $150 million fund's manager, Robert Katz, has tamed the ride over the past five years. Annualized standard deviation has slid to 13.5%, while yearly returns remain healthy at 16.6%.

Another portal into Israel's vibrant economy is IBEX Israel Strategy, which is long equities and has about a third of its book in private, unlisted firms. Its annualized gains have exceeded 18% since its inception in April 2012.

Like all hedge fund investments, much due diligence is required. But given the gap between the country's strong macros and struggling market performance, good managers should continue profiting from differences in valuation. ■