

Policy Brief

Why Now? Re-Invest in Israel

The Case for Institutional Capital Allocation to Israel's Capital Markets



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Case for Capital Allocation to Israeli Capital Markets

From Innovation Economy to Innovation Capital Market

Glenn Yago

Senior Director, Milken Innovation Center | Van Leer Jerusalem Institute

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Israel's innovation economy has been building for decades. The question institutional and retail investors ask is not whether it will continue to produce value — it will — but whether *now* is the moment to increase allocation rather than wait. The answer is yes, and for reasons that go beyond the familiar “Startup Nation” narrative.

Five forces are converging:

- a post-conflict valuation reset that creates an asymmetric entry point;
- structural economic resilience that is measurable and predictable;
- a geopolitical risk premium that is overcompensated relative to actual outcomes;
- a wave of supply-side and buy-side market reforms that could materially change the accessibility and liquidity of Israeli assets;
- a deliberate agenda — already underway — to transform Israel's capital markets from a domestic exchange into a global technology capital market.

1. The Valuation Reset: A Window That Doesn't Stay Open

The geopolitical events of 2023–2024 created a classic dislocation. Credit agencies downgraded, foreign capital pulled back, and Israeli asset valuations compressed relative to comparable markets. But the fundamentals never broke. Israeli startups raised \$15.6 billion in 2025 — a decisive rebound from \$6.9 billion in 2023.¹ Exits hit \$17.7 billion across 180 deals, with another \$63 billion in announced transactions pending, including Google's \$32 billion acquisition of Wiz.² Both S&P and Moody's have now revised Israel's outlook from negative to stable.³ GDP growth projections for 2026 range from 3.5% to 5.2%, and the Bank of Israel has begun cutting rates.⁴

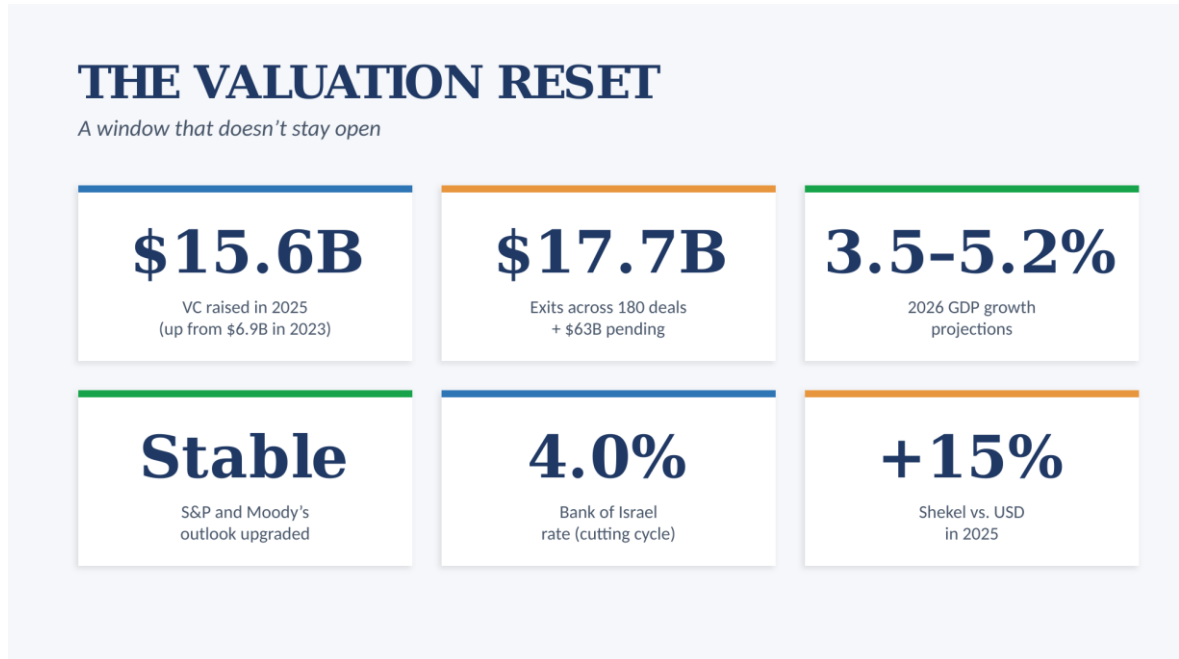


Figure 1. The Valuation Reset: Key Indicators, February 2026

Institutional investors who waited out the turbulence are now looking at an economy re-rated by credit agencies but still priced at a geopolitical discount. That is the definition of an entry point. But the valuation reset alone is not the argument. The argument is that Israel is simultaneously building the market infrastructure to make that entry point structurally more attractive than at any prior moment.

2. Structural Resilience: Not Mythology, but Measurable Architecture

Investors often attribute Israel's economic resilience to soft factors: military culture, national solidarity, the "startup mentality." These are real, but they are not investable. What is investable is the structural architecture that produces a consistent, measurable pattern: sharp contraction during conflict, followed by rapid V-shaped recovery driven by an export engine that operates largely independent of domestic conditions.

R&D intensity: the structural shock absorber

Israel invests 6.35% of GDP in civilian R&D — more than double the OECD average of 2.7% and the highest ratio of any country in the world. South Korea, in second place, is at roughly 5%; the United States at 3.45%.⁵ R&D intensity at this level functions as a structural shock absorber: the economy continuously generates new productive capacity, new intellectual property that can be monetized through measurable revenue streams, and new strategic export potential regardless of the geopolitical cycle. When the shock passes, accumulated R&D converts into growth faster than in economies dependent on physical capital formation or commodity exports.

The tech export engine: decoupled from domestic conditions

High-tech accounts for roughly 20% of Israel's GDP, 53–57% of total exports (the highest share ever recorded in Q1 2025), and 12% of the workforce.⁶ Critically, these exports are overwhelmingly services — software, cybersecurity, AI, cloud infrastructure — not physical goods. They are not disrupted by port closures, supply chain interruptions, or the mobilization of manufacturing workers. During the 2023–24 conflict, technology exports continued to grow even as the domestic economy contracted by nearly 20% in Q4 2023. Cybersecurity investment alone doubled to \$4 billion in 2024, representing 40% of the total U.S. cybersecurity funding market.⁷

STRUCTURAL RESILIENCE

Not mythology — measurable architecture

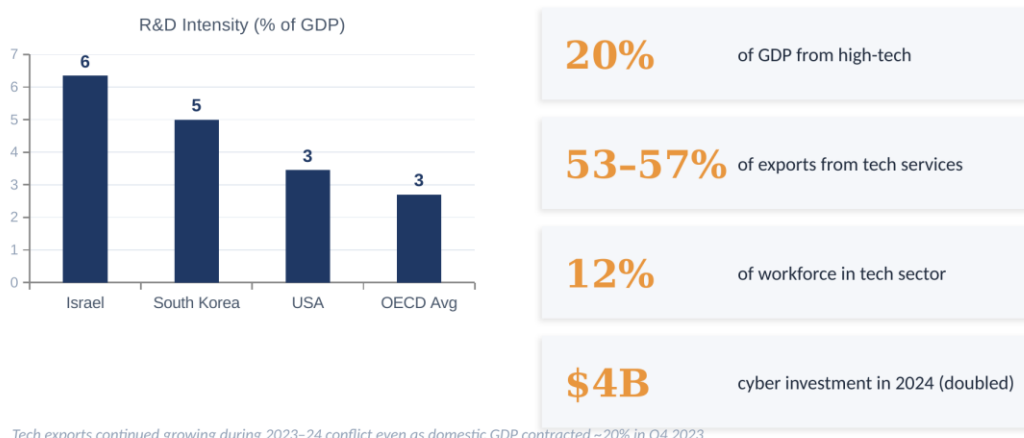


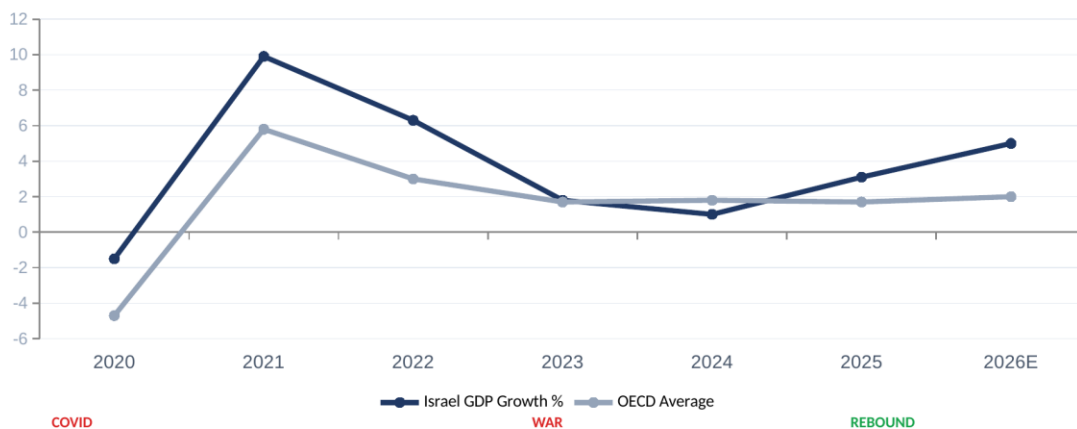
Figure 2. Structural Resilience: R&D Intensity and Tech Sector Metrics

The recovery pattern: V-shaped and tech-led

The historical data is remarkably consistent. After COVID-19, GDP contracted 1.5% in 2020 and then surged 9.9% in 2021 — among the fastest recoveries in the OECD. After the 2023–24 conflict, GDP grew just 1.0% in 2024, then rebounded to 3.1% in 2025 (outpacing the OECD average of 1.7%), with projections of 4.9–5.2% for 2026.⁸ During the worst of the conflict, 81% of funding rounds for Israeli tech companies involved global investors, and Israeli startups raised over \$12 billion in 2024 — a 27% year-over-year increase.⁹

THE V-SHAPED RECOVERY PATTERN

Consistent across every major shock



Sources: IMF, OECD, Bank of Israel, CBS

Figure 3. V-Shaped Recovery Pattern

Defense-tech startups nearly doubled from 160 to over 300 since October 2023, and defense exports hit a record \$14.8 billion in 2024.¹⁰ Israel now ranks consistently among the world's top five capital-raising hubs alongside San Francisco, New York, London, and Boston — an extraordinary position for an economy that was at war. The TA-125 index surged 51% in 2025, far exceeding the S&P 500's 16.9%, the Dow Jones's 13.3%, and the Nasdaq's 21% return. TASE ranked as the top-performing equity market in local-currency terms globally, propelling Israel to third place in ranking of the world's best-performing economies (The Economist).

What this means for portfolio construction

- **Model the recovery, not just the shock.** If your risk framework only captures the downside of geopolitical events without modeling the V-shaped recovery that has followed every Israeli conflict, you are systematically overestimating net risk.
- **Weight the tech export engine as a distinct factor.** The structural decoupling between Israel's technology export economy and its domestic consumer economy means that GDP during conflict understates the performance of the asset class most institutional investors actually access.
- **Treat R&D intensity as a leading indicator of recovery speed.** The 6.35% ratio is not just a measure of current activity — it is a predictor of post-shock growth velocity.

3. Geopolitical Risk: Episodic, Not Structural — and Overcompensated

Geopolitical risk occupies a peculiar place in institutional portfolio construction. It is simultaneously the risk category investors talk about most and analyze least rigorously. When allocators say they are “concerned about geopolitical risk” in Israel, they are typically expressing a sentiment — a narrative discomfort — rather than applying the same disciplined framework they would use to evaluate credit risk, liquidity risk, or interest rate exposure. That asymmetry between narrative and analysis is precisely where return is generated.

Episodic vs. structural risk

The analytical distinction that matters is between episodic risk and structural risk. Episodic geopolitical risk — a military conflict, a political crisis, a credit downgrade — produces sharp, temporary dislocations in asset prices. Structural geopolitical risk — regime change, institutional collapse, permanent impairment of the productive base — destroys long-term value. The two require fundamentally different responses. Episodic risk is a buying opportunity. Structural risk is an exit signal.

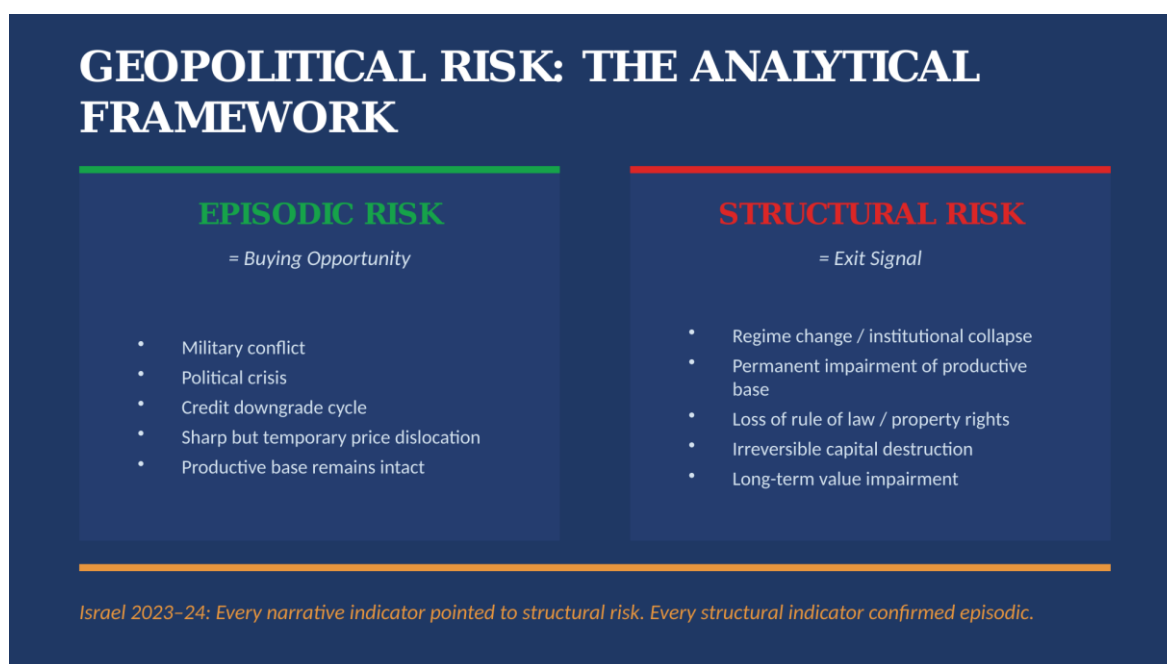


Figure 4. Demystifying Geopolitical Risk: The Analytical Framework

Israel’s October 7 War experience is a near-perfect case study. Every narrative indicator pointed to structural risk. But the structural indicators told a different story: technology exports never stopped, cybersecurity companies raised record capital throughout the conflict, the defense technology sector became a growth vertical, and by early 2026, both credit agencies had reversed their outlook,³ the shekel had strengthened 15% against the dollar,¹² and GDP growth projections were among the highest in the OECD. An investor who exited on narrative would have sold at the bottom.

The overcompensation premium

Geopolitical risk in Israel is not uncompensated — it is overcompensated. Israeli assets trade at a persistent geopolitical discount relative to comparable innovation economies. Israeli technology companies at equivalent revenue and growth metrics consistently trade below their U.S., European, and even Asian peers. For a long-term institutional allocator, that discount functions as embedded compensation for geopolitical volatility. The question is not whether the risk exists but whether the compensation exceeds the expected cost. On a decade-long horizon, the answer has been unambiguously yes. Security and geopolitical risk (recurrent conflicts) raise required returns for both equity and debt, so investors demand lower entry prices even when earnings are strong. They have also generated political and institutional uncertainty through controversies over judicial reforms, coalition instability, rule-of-law demands raising concerns about long-term policy predictability reflected in risk premia. As a small, relatively illiquid market, asset managers fear they cannot deploy large capital without moving the market. The reclassification into developed-market indices reduced Israel’s weight in global bench marks, which limited passive inflows and kept valuations under pressure relative to fundamentals.

Correcting the perception gap

The perception gap in Israeli capital markets is not primarily informational — it is structural. Investors don’t misperceive Israeli risk because they lack data. They misperceive it because the market infrastructure through which they evaluate risk was never designed to make Israel legible to their systems. The correction requires intervention on three levels.

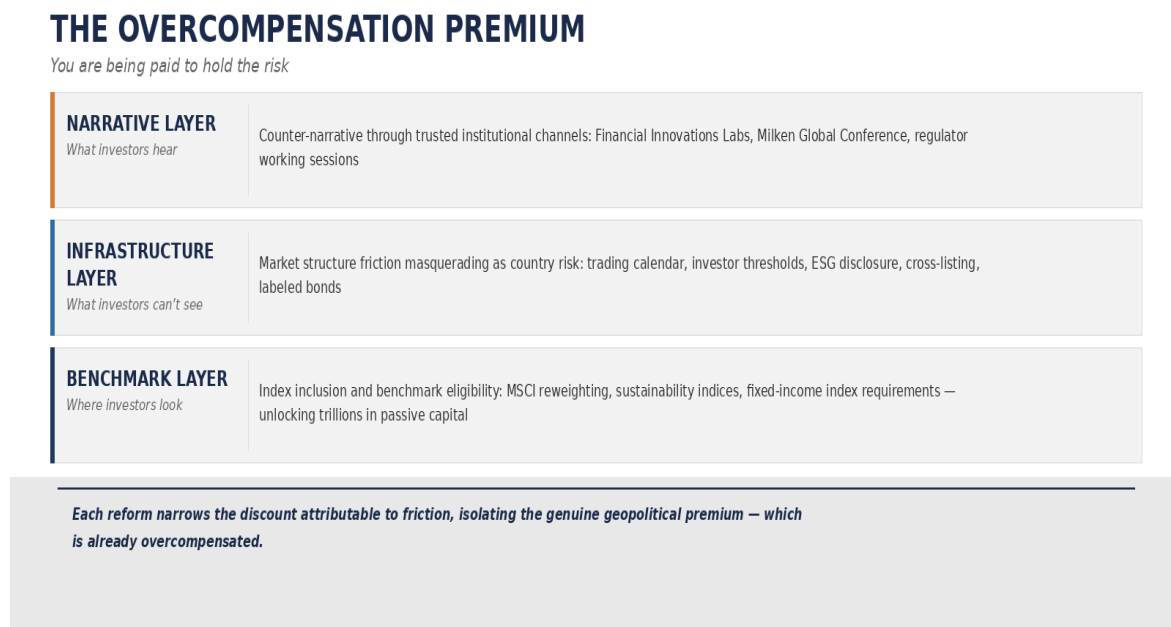


Figure 5. Three Layers of Risk Perception Correction

The narrative layer requires counter-narrative delivered through channels institutional decision-makers trust: internationally-recognized business and investment conferences (e.g. Financial Innovations Labs, the Milken Institute Global Conference, and curated working sessions with regulators and overseas investors to re-invent Israeli capital markets anew. **The infrastructure layer** addresses market

structure friction masquerading as country risk — a misaligned trading week (now resolved), exclusionary investor thresholds, non-standardized and confusing ESG disclosure (shifting to impact metrics) limited cross-listing infrastructure, and the absence of labeled bond issuance. **The benchmark layer** targets index inclusion and benchmark eligibility, which unlocks trillions in passive capital that simply cannot flow to Israel until technical criteria are met.

4. Supply-Side Reforms: Building the IPO Runway and New Issuance Architecture

We are currently planning a next wave of work at the Milken Innovation Center to support further structural reforms for capital market solutions to accelerate technology, AI, and related applications to new Tech sectors in Israel.

Israel has long suffered from a paradox: one of the world’s deepest innovation pipelines feeding one of the developed world’s thinnest public equity markets. The Tel Aviv Stock Exchange has historically been too small, too illiquid, and too disconnected from global trading calendars to serve as a natural listing venue for the companies the innovation economy produces. That is changing — through a specific, sequenced reform agenda that the Milken Innovation Center has been instrumental in designing and advancing since our 2013–14 Financial Innovations Lab with the Israel Securities Authority, Bank of Israel, Ministry of Finance, and the TASE.¹⁷

SUPPLY-SIDE REFORMS

Building the IPO runway and new issuance architecture



Figure 6. Next-Generation Supply-Side Reforms

Rebuilding the IPO runway

The goal is a full life-cycle capital market — from seed-stage companies through public equities, business combinations, and cross-border co-listings. This means lighter disclosure for growth-stage technology firms, SPAC and SPV structures limited by tight regulation, market depth, tax and securitization gaps, and investor

appetite, and cross-listing frameworks enabling dual Tel Aviv–NASDAQ or Tel Aviv–London listings with minimal incremental cost avoiding delisting of Israeli market capitalization. Currently, a very large fraction of Israel’s equity universe is either listed only overseas or never listed locally, so the TASE captures well under the full national market capitalization. According to the Israel Innovation Authority, if Israel traded companies abroad listed on the the local exchange, the total value would rise by more than 70%.

Green, social, and sustainability bond issuance-Impact Measurement Conditioning Risk and Returns

Israel’s technological expertise in water, agriculture, energy, and climate adaptation is globally recognized — yet Israel has barely entered the labeled bond market. The reform agenda includes creating ICMA-aligned frameworks for green and sustainability-linked bond issuance. Globally, cumulative labeled bond issuance exceeds \$6.2 trillion, and Israel’s absence from this market represents a significant missed opportunity.¹³

Regional capital market collaboration

The Abraham Accords opened a corridor that remains underexploited in capital markets. Cross-listing arrangements with Gulf exchanges and other partner Exchanges, co-investment vehicles for regional infrastructure, and joint issuance platforms for Middle Eastern and Eastern Mediterranean projects are under active discussion.

FinTech and digital securities infrastructure

Israel’s capital markets are preparing for blockchain-based settlement (including potential application for municipal/regional project finance), tokenized securities, and distributed ledger deployment in corporate and project finance. The opportunity for early institutional participants is to be positioned before these efficiencies are priced in.

5. Buy-Side Reforms: Unlocking Domestic Capital and Broadening the Investor Base

The supply-side story matters only if there is corresponding depth on the buy side. A parallel reform agenda is underway that will materially improve market liquidity and co-investment opportunities.

BUY-SIDE REFORMS

Unlocking domestic capital and broadening the investor base



Figure 7. Buy-Side Reform Agenda

Lowering investor qualification thresholds

A proposed 2026 reform would align Israel’s accredited investor definitions with OECD standards, significantly broadening the eligible investor base for alternative investments, venture capital, and private placements.

Household participation and Yozma 2.0

Israeli households remain significantly underweight in domestic equities relative to OECD peers. The Yozma 2.0 program — \$450 million in government co-investment in venture capital funds with asymmetric upside for institutional partners — is already attracting Blackstone, KKR, Apollo, and StepStone.¹⁴

ESG disclosure and data infrastructure

The agenda includes adopting international best practices in ESG disclosure (SASB, GRI, ISSB frameworks), deploying data technologies for improved investment reporting, and establishing disclosure requirements for contingent liabilities related to impact-adjusted accounts.

The Monday–Friday trading week

Starting January 2026, Israel shifted its trading week to align with global markets for the first time.¹⁵ This eliminates a friction that has kept passive international capital on the sidelines, and is expected to facilitate Israel’s inclusion in additional global indices, triggering automatic allocations from the trillions in passive capital that tracks them.

6. The Convergence: Innovation Economy Meets Innovation Capital Market

The standard case for Israel rests on the innovation economy: the R&D intensity, the startup density, the cybersecurity and AI leadership. That case is real — \$1.1 billion raised in January 2026 alone, overseas funds now entering at seed stage, locally managed private evergreen funds holding over \$10 billion in AUM.¹⁶

But the case we are making is different and more compelling: Israel is not merely producing innovative companies. It is building the capital market infrastructure to finance, list, trade, and govern them at global standards. The reforms described above are not aspirational. They are the product of a decade-long institutional collaboration between the Israel Securities Authority, the Bank of Israel, the Ministry of Finance, the TASE, and research institutions including the Milken Innovation Center, which has placed over 300 trained fellows in Israeli regulatory agencies and conducted more than 60 Financial Innovations Labs on exactly these challenges.¹⁷

The first generation delivered demutualization, BDC legislation, ETF expansion, and reduced IPO barriers. Related measures that emerged included the pathway to securitization (first private mortgage securitization completed in July 2025 and final legislation approval anticipated for Summer 2026). The next generation — launching through a new series of Financial Innovations Labs beginning in 2026 — targets further securitization frameworks for expanding structured credit, municipal and project finance markets, digital securities infrastructure, and the cross-border issuance platforms that could position the TASE as a regional and global innovation market hub.

The Bottom Line

Institutional investors don't allocate to the absence of risk. They allocate to asymmetric return profiles where risk is understood, compensated, and — in this case — being structurally reduced by the very reforms that make the market more attractive for other reasons.

Israel today offers a rare convergence: a post-dislocation repricing in an economy whose innovation engine never stopped running; structural resilience that is measurable in the data and predictable in its pattern; an overcompensated geopolitical risk premium that is narrowing as market structure aligns with global standards; and a deliberate capital market modernization agenda that is creating the liquidity, instruments, and institutional accessibility that sophisticated allocators require.

The question is not whether Israel's innovation economy will continue to produce value. It will. The question is whether you want to allocate at the compressed valuations the 2023–24 dislocation created — with the benefit of reforms deepening the market in real time — or at the normalized valuations the recovery and reforms together will establish.

The honest caveat: fiscal strain from elevated defense spending is real (debt-to-GDP projected at 70.4% in 2026), and the geopolitical environment remains complex.¹⁸ Trading remains highly concentrated in a small group of large caps (banks, a few conglomerates, handful of liquid/tech names), with long tail of small-mid-caps with promise but trade thinly. Illiquidity is pronounced in small/mid-caps, corporate bonds, and more complex instruments. Regulatory improvements and increased reforms for overall system depth will contribute to sustained growth. But the reforms described here are not contingent on perfect geopolitical conditions — they are being implemented now, precisely because Israel’s policymakers are coming to understand that the window for building a globally competitive capital market does not wait for geopolitical certainty. Neither should institutional capital investors.

Endnotes

1. IVC Research Center and Startup Nation Central, “State of Israeli Tech 2025,” January 2026.
2. IVC-LeumiTech Annual Report 2025: 180 exits totaling \$17.7 billion, with \$63 billion in announced transactions including Google’s acquisition of Wiz (\$32 billion).
3. S&P Global Ratings revised Israel’s outlook from negative to stable, January 2026; Moody’s upgraded Israel’s credit outlook from negative to stable, January 2026.
4. IMF World Economic Outlook, January 2026; Bank of Israel forecast (5.2%); Ministry of Finance forecast (5.1%); OECD Economic Outlook (4.6%).
5. OECD Main Science and Technology Indicators, 2025. Israel: 6.35% of GDP; South Korea: ~5.0%; United States: 3.45%; OECD average: 2.7%.
6. Israel Central Bureau of Statistics, National Accounts Q1 2025. Tech services accounted for 53–57% of total exports.
7. YL Ventures, “Israeli Cybersecurity Funding Report 2024,” January 2025. Israeli cyber companies raised \$4 billion across 89 funding rounds in 2024.
8. Israel Central Bureau of Statistics, GDP estimates: Q4 2023 contracted 19.4% (annualized); full-year 2025 grew 3.1%.
9. IVC Research Center, “Israeli Tech Funding Report Q4 2024.” 81% of funding rounds involved global investors; 15 mega-rounds totaling \$4 billion.
10. Israel Ministry of Defense, Defense Export Report 2024: \$14.8 billion in defense exports, a record. Startup Nation Central: defense-tech startups grew from ~160 to 300+.
11. Bank of Israel, Monetary Policy Decision, January 2026: rate cut to 4.0%, the second consecutive cut.
12. Bank of Israel, Foreign Exchange Data 2025. New Israeli Shekel appreciated approximately 15% against the U.S. dollar during 2025.
13. Climate Bonds Initiative, “Global State of the Market 2025.” Cumulative green, social, sustainability, and sustainability-linked bond issuance exceeded \$6.2 trillion.
14. Israel Innovation Authority, Yozma 2.0 Program Guidelines, 2025. \$450 million in government co-investment across venture capital funds.
15. Tel Aviv Stock Exchange, “Trading Week Transition to Monday–Friday,” effective January 2026
16. IVC Research Center, January 2026. Israeli startups raised \$1.1 billion in January 2026. Locally managed private evergreen funds hold over \$10 billion in AUM.
17. Milken Innovation Center, “(Re)inventing Israeli Capital Markets,” Financial Innovations Lab Report, 2014. Reforms included demutualization of the TASE, BDC legislation, reduced IPO regulatory burdens, and ETF expansion. See also regarding the impact of MSCI Classification criteria which have cost over \$1 billion in portfolio flows into the Israeli capital markets, Glenn Yago, Geography is Not destiny: Israel and Financial Securities Index, Milken Institute Review, March 2022. As of February 2026, Israel remains the only developed market classified within the Middle East region by MSCI. Its weight in the MSCI World Index is approximately 0.4%, down from roughly 3% of the MSCI Emerging Markets Index before the 2010 “upgrade”. If reclassification were to occur, at least \$2 billion in immediate passive flows into Israeli equities.
18. Bank of Israel, Fiscal Report 2025. Public debt projected at 70.4% of GDP in 2026; defense spending remains elevated above pre-war norms.



Milken Innovation Center

Van Leer Jerusalem Institute

43 Jabotinsky St, Jerusalem 9214116, Israel

Phone: +972.2.5605288

www.milkeninnovationcenter.org