

Israel's Economy and Its Race Against the Clock

An Example of an application of a Thinking Framework of Macro by a Micro Investor

I wrote this book to express my answer to a question that intrigued me intellectually:
what is the state of the State of Israel?

I reached that answer without any prior research (some of which is included here), because I already knew most of it. I believe that the background presented here has concrete value for understanding the present and looking ahead.

The book was written over two months. I began in late May – before Operation “Rising Lion” – and finished in the last week of July.

What drove me was the sharp dissonance, as I saw it, between clear economic signals and the Israeli market's refusal to reprice assets based on the data.

But – maybe they're right and I am wrong.

In this book, I look at the State of Israel as if it were **a single business**.

From the outside, Israel looks great: the Tel Aviv Stock Exchange outperformed the NASDAQ over the past five years; real estate prices have skyrocketed (even if they're dipping slightly now – it's nothing compared to the rise); the Iranian threat has been severely damaged, and it seems a new dawn is rising over Israel and the Middle East.

From the inside, though – the story is far more complex, and probably much uglier.

In this book, we'll talk about **why it's risky for Israelis to invest in the S&P 500**, whether **there's a real estate bubble in Israel**, and why, even as the Israeli market prices in a bright future – I believe the hardest economic times are still ahead.

The Israeli economy is in a race against the clock. That race has already fired – even if no one heard it.

But the climax is still ahead.

This book was written by **Elesh – a man with no name.**

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I'm not certified in anything. No licenses, no degrees.

Everything here is my personal opinion, written for entertainment – mostly my own.

Nothing here is advice. Any mention of a stock or investment tool is for discussion and example only.

Do not act based on anything written here without consulting a qualified professional.

The author is not responsible for anything.

Don't Try This At Home

Don't believe a word I say – go check for yourself.

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Disclaimer

Investing involves the risk of loss.

This book is for informational purposes only – it should not be considered personal investment advice or relied upon for making investment decisions.

Its purpose is to show how risky and complicated investing really is – and to emphasize that you should always consult a licensed and experienced professional.

I don't have a license, and I'm too young to call myself experienced.

In other words – I'm an unlicensed and inexperienced person.

Everything written here should be taken with a grain of salt – and you should go do your own research.

I include sources and encourage readers to abandon this book as quickly as possible and turn instead to the original materials – written or said by people far wiser, more educated, and more experienced than I am.

There are several companies, their CEOs, or sectors mentioned here – in which I currently hold a position.

My personal portfolio will definitely change over the years – and it might have already changed by the time you're reading these lines.

You won't know about it, which is why no one should ever rely on another person's portfolio.

Investing is a personal responsibility – and it's always best to consult a licensed professional.

All of these positions were built at different prices than those you see today – most of them much lower.

The percentage allocations of my holdings change, will continue to change, and they also play a key role in understanding how portfolios are managed and how investors form opinions – something you can't see from this static list.

So generally speaking – ignore opinions about any business and focus on facts.

Those facts should be researched by you, and ideally discussed with a licensed expert.

I'm not promoting anything, and I'm not recommending anything.

As for criticism – there's a saying in English: *"Hate the sin, love the sinner."*

I avoid naming names. Unfortunately, we live in a time when freedom of expression is under attack – lawsuits for defamation are filed over the smallest things.

Investing in securities involves the risk of loss.

Any mention of a specific security or its performance data does not constitute a recommendation to buy or sell that security.

The information in this book – including any information accessible through the website – is not directed at any specific investor or group of investors.

It is provided for general informational purposes only.

Nothing here should be considered personal financial advice, or an invitation to buy or sell any securities.

You can learn more about me – and why I chose to use a pen name (not to hide my identity, but for its own meaning) – at:

Elesh.co.il

Preface

This book is dedicated to the woman who is the light of my life, to the four-legged ones who make me smile with their endless love, and to my heroes who have walked beside me hand in hand so far and continue to walk with me every day.

“Even though I walk through the valley of the shadow of death, I will fear no evil, for You are with me.”

Before you lies the thought process of an investor who claims to specialize in investing in individual company stocks - and this time, I'm looking at the business called the State of Israel.

- **History, philosophy, and theory about the past**, in an attempt to understand the present and the future of the world.

“A nation that does not know its past – its present is poor and its future is shrouded in fog.” – Yigal Allon.

- **Understanding a business that seems interesting** (and for me, Israel is definitely interesting).

At first glance, it seems to have a promising upside – a startup nation with a positive birth rate, something rare in the Western world.

Its citizens are inventive, they've achieved the impossible (returned to their homeland, revived a dead language), always manage to prevail against the odds, a democracy (which at least appears to have a rule of law), and many other factors working in its favor.

- In a business that looks interesting and seems to have good upside, you have to look at the books.

You need to understand what assets the business holds, what capital it's built on, and how it manages its debts.

That's the *underbelly* of the business. As Peter Lynch said:

"You can't go bankrupt if you have no debt."

But if there is debt, you have to understand how the business plans to maintain its current cash flow to meet obligations and invest for growth.

- The main asset of Israeli society is residential real estate, which serves as the foundation of the entire system.

It also represents the primary source of debt in Israeli society – the mortgage.

- The main source of cash flow is the tech industry.

At first glance, two things seemed like absolute truths over the past decade – and it felt as though they would stay that way forever.

Taking a loan and stretching it endlessly at near-zero interest rates was considered smart, especially when it came to real assets.

At the same time, it appeared that growth in the tech world would never end – making it seem like the safest and smartest field to enter.

On top of these two towers – the housing market and the tech market – many of Israel's economic structures were built.

The key question, from a risk perspective, is whether these towers are still stable.

In the previous decade, two things were seen as 100% certain for young Israelis: learn to code, and buy an apartment.

Masses followed this formula – and it paid off handsomely.

They made a lot of money from their salaries and grew wealthy through residential properties, whether for personal living or for investment.

Many others benefited from these same trends – construction companies, technical colleges, contractors, bankers, and programming instructors among them.

Together, they fueled more businesses and more people – bars and bartenders, restaurants and chefs – and the ripples kept spreading.

From my perspective, I think these celebrations are coming to an end.

Even if it seems that some have not yet stopped, and others only started to fade, I believe this phase is temporary.

My role as an investor is usually to recognize, as early as possible, when a business isn't for me – or when it's too difficult to decide whether to invest – and therefore to stop being interested.

Historically, I've invested in businesses during very difficult times and was right in assuming that those difficult moments were temporary.

My track record so far is excellent, but that too may be temporary (Nassim Nicholas Taleb reminds me of this constantly in his book *Fooled by Randomness*).

So even a time of war, or any seemingly critical event, is not in itself a reason for pessimism.

The work of an investor – and of businesspeople in general when analyzing a specific company – starts with understanding where the world stands today, and where that specific business stands in relation to it.

After that come the natural questions: will the world continue on the same path, at least in the foreseeable future?

What changes are likely to happen at some point (interest rate increases for example) and what might remain constant?

"I very frequently get the question: 'What's going to change in the next 10 years?'

And that is a very interesting question; it's a very common one.

I almost never get the question: 'What's not going to change in the next 10 years?'

And I submit to you that that second question is actually the more important of the two - because you can build a business strategy around the things that are stable in time. ...

[I]n our retail business, we know that customers want low prices, and I know that's going to be true 10 years from now.

They want fast delivery; they want vast selection. It's impossible to imagine a future 10 years from now where a customer comes up and says, 'Jeff I love Amazon; I just wish the prices were a little higher,' [or] 'I love Amazon; I just wish you'd deliver a little more slowly.'

Impossible.

And so the effort we put into those things, spinning those things up, we know the energy we put into it today will still be paying off dividends for our customers 10 years from now.

When you have something that you know is true, even over the long term, you can afford to put a lot of energy into it."

- Jeff Bezos

The reason for my feelings is that I do believe some things in Israel will change – precisely because other things which in my view have never changed throughout

history, will remain the same.

Some of those are - human progress into technology, the drive of great businesses to become more efficient, the fact that interest rates act like gravity on asset prices, that most people only make difficult changes after deep suffering, and that public officials only act when “the pitchforks are out” – none of these will ever change.

The questions that guide me, in many cases, through the process of understanding the business before me are these:

Is my business healthy enough to withstand at least the first wave of a tsunami that might appear out of nowhere?

Are the business’s leaders skilled enough (meaning they are a good set of officers) to be able to navigate through the storm that follows?

Is there a certain quality to the business in terms of execution – meaning, an excellent team with a strong culture that stands behind it and it will make the difference between the organization and everyone else?

We never really know what will happen tomorrow in the world or with the business. The question is always one of probability – what is likely to happen going forward?

The healthier a business is from a balance sheet perspective, the more oxygen and blood it has to maintain itself and invest in growth (stable and positive cash flow, with growth investments that expand it over time), combined with a strong culture.

There aren’t many businesses like that and some have no choice but to become that way.

The State of Israel has no choice because it faces an existential risk. For that reason, it must operate as an excellent organization.

I’ll share that just before the beginning of the current decade, back in 2018, I used to tell anyone who would listen that I was certain Israel was *the* place to be – that the 2020s would be Israel’s decade.

What developed afterward changed that picture.

Both shifts in the business world and the end of the zero-interest-rate era reshaped the landscape.

What further altered Israel’s situation were the political struggles within the country, and the inability to rise above them unless we’re truly at the brink – as during the 12 days of war with Iran.

These are some of the reasons that make me feel somewhat differently today.

You’re welcome to join me as I look at the ocean (the world), the ship (the state), its leadership, and the crew – in an effort to understand the true condition of the vessel.

The bottom line: Israel is in a **race against the clock**, and its greatest enemy is itself.

You’ll notice that my thinking is influenced by certain figures. I’m not trying to imitate them; I take ideas that resonate with me and adapt them to my own style. I cannot do what Warren Buffett did with Coca-Cola – that’s a fact – and he couldn’t do what I have done in other stocks. When I attended Berkshire Hathaway’s shareholder meeting in

Omaha I was taken aback. Many had replaced the message with the messenger. They had turned it into a personality cult. For many of them what Buffett did is the *only* way, and they try to mimic him in every possible aspect – in complete contradiction to prior messages of his.

There are endless paths to success. Some will make billions as activists, short sellers, or traders. Statistically, there are fewer of them than long-term asset holders, because making money by buying and holding great assets over time is simply easier. That suits me – I do not think I am smart enough to do otherwise. I do not dismiss any style or person. I do however, stay skeptical about the depth of thought behind every action and I try to understand a person’s reasoning – maybe even encourage them to think in broader directions even when they act just as I do.

One thing I always come back to is this: being able to appreciate others when they make money in ways different from ours. That is the best protection against getting caught in a bubble. A bubble, by nature, is the greatest danger to any investor – and that is exactly why it fascinates us so much. Managing a portfolio properly inside a bubble is the fine line between getting rich and going broke fast.

Part 1 – A Brief Summary of The Beginning of What’s Important

Chapter 1- How Does My Brain Work

Why do I write?

“But if I say, ‘I will not mention Him or speak any more in His name,’ His word is in my heart like a fire, a fire shut up in my bones. I am weary of holding it in; indeed, I cannot.”
(Jeremiah 20:9)

As a joke I chose a very unusual profession when I originally opened a Facebook account back in eighth grade. The platform asked me to choose a profession.

Unlike a popular ‘job’ that people would put as a joke - “I Don’t work – people work for me,” I picked something completely nonsensical – something that probably never appeared on the platform before.

The reason is simple: I’m a weirdo. You might as well get used to it.

As a private joke, I decided to have my job description listed as a *“Prophet in God’s Army.”*

God as his own personal joke cursed me. Not by speaking to me of course, but by not speaking at all – and instead letting me think on my own, letting thoughts simmer inside me and I can’t rest until I release them into the world.

I can’t focus on anything else until I let go of the weight of what I have to say and I write it down on the computer. Explaining things to my close friends who are less educated on these matters, my words have a single purpose, keeping them from harming themselves.

As a general rule, the majority of the time I keep quiet or don’t fully express myself, because people don’t want to hear, they don’t want to listen.

And yet, I’m cursed with the same classic curse the Bible describes every prophet having – no one listens to me because I don’t interest anyone (or they simply don’t want to hear what I have to say no matter who would have said it).

Not being a real prophet is in its own way a blessing. As the Bible teaches being a prophet comes with enormous responsibility – and a miserable life.

I don’t want that responsibility nor the price the prophets paid. Therefore, I’m grateful that no one listens and that almost no one reads what I write.

I mention this because I have nothing to sell – and that is worth noting.

Everyone who usually talks about these things is trying to sell something.

Financial journalists want to sell articles. Editors want to sell ads.

People on TV panels want fame and contracts.

Developers want to sell apartments. Brokers want to sell their service.

Politicians sell themselves for votes.

Investment managers want to sell their management and make their commission by just having assets under management (investment returns are the cherry on top)¹.

There are countless “educators” who want to sell their “knowledge” instead of actually applying it – a signal that it probably doesn’t work².

When people ask me what I do for a living I don’t have a short or clear answer other than saying that I’m simply me.

So I start explaining slowly and they get lost quickly. Then they interrupt, trying to tell me they understand, and begin describing something that’s absolutely not it.

The less ego-driven a person is, the higher the chance they’ll actually listen and in order to clarify things for them will ask me further questions. I find that the smarter the person is, the more of an open ended question he will ask, because it allows the person who is

¹ I had once a Meryll Lynch broker brag that he managed to have a return close to the same of the market in a given year. This would maybe be an achievement if he did it with a portfolio with really reduced risk and timely buying (which would demonstrate he is an excellent capital allocator who buys with a significant margin of safety), however those were not the main points of the positive review he gave himself.

² The greats constantly repeat that they can tell you what they do because you have a 0 chance of being successful doing it yourself.

being asked to speak about what he believes is important.

Ego is the primary reason why most don't listen at all unless it confirms their prior beliefs or makes them feel good about themselves. Many of those who do begin listening to me when I speak just a little realize quickly, even subconsciously, that the person in front of them carries an ocean of knowledge that feels unclear or intimidating. Although an ocean can't fit inside a box, they try to put me into boxes they already know and by doing that, they miss what's right in front of them.

The reason this happens is because most people think in **Aristotelian logic**—a way of thinking that does not serve anyone well. **The same rigid thinking appears in science too.**

It's a logic that insists on defining everything and fitting it neatly into categories. However, the world doesn't operate according to fixed definitions and we see this all the time in physics and science (I recommend reading *Science and Sanity* by Alfred Korzybski, which explains how our language and categorical thinking distort our perception of reality.)

Even though Newtonian physics were good enough to land humans on the moon, we now know the universe does not actually work the way Newton described.

But on the other hand, we still don't fully understand how it *does* work.

The same goes for light and the speed of light—we have no real idea what photons actually are.

Many of our studies only show a certain probability that something behaves as we think it does but not with certainty.

It's like medicine: a drug might work in 90% of cases, but not in all.

If you ask your doctor about the **NNT**³ (Number Needed to Treat—the percentage of patients a drug truly works for), you might be surprised.

For example, acetaminophen has a very high success rate, while stronger drugs for serious conditions often drop sharply in effectiveness—and their side effects increase. A proper examination of the medication you take or might take might lead you to obtaining surprising insight about your medication and your doctor's recommendation⁴. What I am trying to demonstrate in this example, that the fact that there is a massive difference between a drug that is used to treat a disease (aka medicine) and cure for the disease. You hope that this drug will cure it, and all we know is that there a statistical relationship between them.

³ A statistic used in clinical research to quantify the effectiveness of a medical intervention. The proper way to make a decision on medication is taking a risk management approach of weighing the NNT and the severity of the condition of not getting treatment while including the likelihood of side effects and their likelihood of happening.

⁴ Remember that just like any profession there is a scale of how good and smart your doctor is relatively to others, and they too are vulnerable to sales and marketing of health companies selling drugs or medical equipment. I am not a vaccine denier at all. I believe that all the ones that I have taken outweigh any possible side effect (this belief may be a justification of my actions. You may think of me what you will about my decisions).

Likewise, our assumptions are often built on things that aren't absolute. In reality they rest on a "broken reed" (Isaiah 36:6) - a fragile base that eventually turns into a house of cards waiting to collapse.

The world of investing much like the world of business, is a sport for people who can think beyond rigid structures.

As Nassim Nicholas Taleb puts it – if you want a profession where you perform a specific action that's likely to lead to a predictable result, become a dentist.

And before anyone tells me that investing also has instruments with predictable outcomes such as a savings account where the return on deposits is known, what truly matters isn't known at all: the preservation of one's purchasing power, which is the original reason you wanted interest in the first place.

*"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."
- Mark Twain*

The main problem that costs people a great deal of money is deeply connected to whether the **feedback loop** is short or long.

Investing in stocks *seems* simple—after all, you can buy or sell shares with the click of a button (See *Simple But Not Easy* by Richard Oldfield).

The real challenge is that almost no one measures returns correctly, and it's nearly impossible to know whether a decision was truly good.

What is even more dangerous is that a feedback loop can quickly make you *think* you are a genius.

*"The stock investor is neither right nor wrong because others agreed or disagreed with him; he is right because his facts and analysis are right."
- Benjamin Graham, The Intelligent Investor*

Anyone who thinks *The Intelligent Investor* is a complex book has clearly never read Graham's book for professionals. The first and most meaningful test for an investor to see if they are truly serious about investing (and this isn't a test of skill, just of sincerity) is whether they've read *Security Analysis*⁵ by Benjamin Graham and David Dodd.

So next time some professional brags about reading *The Intelligent Investor*, ask them about *Security Analysis*.

A small note about that book - it sparks an essential way of thinking about **opportunity cost**.

The real complexity in investing lies in the countless variables we don't see. That in itself is a serious problem. That's why you'll often hear very successful people say they were lucky. They'll tell you that something happened they never planned for, something that completely changed the picture. So far this has been accurate for me as well.

⁵ Aswath Damodaran in an interview once said that although his books are incredibly boring, they are like Harry Potter compared to *Security Analysis*.

If we choose to be investors who aim to outperform the market, the goal is to position ourselves in situations where:

“Heads I win big, tails I do not lose much.”

- Mohnish Pabrai

That means, we position ourselves in a way where if luck plays into it, the odds are by far in favor of having good luck over bad luck.

Most people never actually make that decision. The vast majority decide - consciously or not – they want to be like everyone else on their socio-economic rung of the ladder. On one hand it is common to claim that “you can’t beat the market.” On the other they chase the returns their neighbors are making, or buying and selling their homes when everyone else does in a similar fashion. They do not seek to reduce risk and to position simultaneously for higher returns by managing their allocation of their portfolio and managing their own personal cashflow effectively (I believe that you can reduce risk while simultaneously position for higher returns. This is contrary to the broad thought that higher risk means higher returns- something I believe to be false).

People tend to buy the same stocks others have bought and profited from hoping to repeat their success. (We’ll talk later about why investing *with* the market can often be great - but the big money is made at the edges in rare moments when you take the opposite side. You can also enhance returns by affectively managing portfolio allocation).

At the same time, the public refuses to let go of its fantasies about being richer than everyone else. Sometimes they act on a subconscious belief that they can identify a great investor or a great investment though we see, time after time, people investing in things that later make the headlines for all the wrong reasons.

Most of them don’t even know how to do a **DCF** (Discounted Cash Flow analysis) and the “professionals” don’t run a proper one by running it mentally like a Monte Carlo Simulation⁶. If you don’t know what a DCF is or a Monte Carlo Simulation - you’re definitely in that category.

We also see it everywhere: anyone who takes an investing course feels the need to prove they understand investing, instead of staying quiet and asking, “*What should I learn in the stage of education I’m in?*” Everyone is chasing *the next stock pick* and asking for a ‘hot stock pick’ when they should be learning *how to think*.

The biggest problem for all of us is that we can never know who’s right about the future and who isn’t.

⁶ A Monte Carlo simulation is a way to model the probability of different outcomes in a process that cannot easily be predicted due to the intervention of random variables. It is a technique used to understand the impact of risk and uncertainty. (Investopedia - <https://www.investopedia.com/terms/m/montecarlosimulation.asp>)

“No amount of sophistication is going to allay the fact that all of your knowledge is about the past and all of your decisions are about the future.”

— Ian Wilson, former GE executive

Just because someone has an impressive track record doesn't mean they'll keep performing brilliantly, look at Seth Klarman over the last decade.

(And if I'm using names you don't recognize, I'll give you two tools: Google and YouTube. Full disclosure: I'm a shareholder in Alphabet – so in order not to be blamed me for the comment you can also look them up on ChatGPT, Yahoo or any other tool you may choose).

Howard Marks likes to ask investors a simple question: do you prefer higher returns or lower risk?

They always answer the same way - they want both.

He always replies: *“You can't have both.”*

At first glance, people understand that where potential returns are highest, the risk is also greater.

However I disagree with that notion to a degree because I believe that the greatest risk in investing is not being wrong with everyone else, it is to be wrong when everyone else is right. For example sitting in cash because you think there is a bubble in tech sense 2016. There are people who still believe that. Jeremy Garntham is one who has preached Armageddon already for years. He is not alone in that camp. This is why trend following and riding a bull market are powerful things as long as you know when to get off the bull. Because building wealth is relative to other people, falling behind is riskier than keeping up. This is why indexing too is so powerful, because many people get things wrong at times when the majority (therefore the market) is right.

I will argue, that higher returns than the market average tend to be where the risk appears to the average investor to be greater than it actually is. This is why great investors talk constantly about looking for a margin of safety.

If it were obvious that an investment offered both high returns and safety, the market would rush in, drive up the price, and push the yield down quickly—making the investment far less attractive and far less certain.

The only real way to create situations where risk seems low and the upside high is when the investor either knows more than the public or understands the data better than everyone else. In other words, an investor must have either superior knowledge or superior insight.

That's why such investors often think differently from their peers - or even from the entire market.

That's what it means to be a **contrarian investor**.

Thinking differently isn't comfortable - it's lonely, but that's where opportunity lies.

Ironically, the same people who fear risk the most end up taking the biggest ones - trusting someone who promises there is none. Personally I believe that cash, cash equivalents and bonds (especially at current yields) many times offer exposure to the greatest risk of all, hyper inflation.

Most investors who select investment managers also behave in comical fashion. They drive their investment managers crazy with constant questions, pressure, and threats to withdraw money when they act in a way that is contrarian at the time when contrarian thinking is needed most, either near the top or near the bottom.

In the worst case investors give all their capital to a manager who guarantees the impossible: **massive returns with zero risk.**

The investing game is a probabilistic one

We try to estimate the likelihood that risks will materialize and the potential damage if they do. At the same time, we assess the chance that things will go well - and what the potential gain might be. We are constantly dealing with the **unknown**.

“Warren Buffett once told me about his two criteria for a desirable piece of information: it has to be important, and it has to be knowable.”

- Howard Marks

Since we're dealing with the future no one knows anything for certain.

Neither we nor the best investors of the next 30 years know they'll be the best.

Only after those 30 years - say, from 2025 to 2055 - will we look back and see who truly generated exceptional returns.

That still doesn't mean that after 30 great years they'll continue to outperform for even two more.

Statistically a long-term outperformance becomes less likely especially after 20–30 years of outperformance⁷.

But by then, most top investors are already multimillionaires or billionaires - so their job is simply not to be stupid and to preserve their wealth.

That's why we must learn to evaluate the information available to us and *sense* the information that isn't.

We must learn to sense the variables we don't even know exist - and still decide anyway. I recommend studying the concept of decision making under deep uncertainty.

In other words, we need to accept that there are things we don't know and still act in spite of that uncertainty. We must try to estimate how things might develop.

“There are unknown unknowns.”

- Donald Rumsfeld, Former U.S. Secretary of Defense

⁷ This is why reversion to the mean is such a powerful concept.

Even if Barry Bonds *did* take steroids⁸, the truly astonishing part of his game was his **intelligence**.

In a sport where statistics and the history of matchups dominate (watch *Moneyball* or read the book to get a feel for it), what made him so dangerous was his ability **to anticipate** the pitch that was coming.

I'm paraphrasing Felipe Alou here from his interview in *Baseball: The Tenth Inning*, an episode in Ken Burns' documentary series, when he described Bonds' gift for anticipation.

"Anticipate" doesn't mean *predict*; it means being able to *evaluate* what's about to happen.

Bonds was so good at reading the pitcher and understanding the situation, that his anticipation seemed sometimes as if he was able to predict the future. He simply refused to swing at bad pitches and when a good one came, he almost never missed. The steroids (if he took them) only amplified the damage he could inflict once he made contact.

And that, essentially, is what's required of every investor: the ability to evaluate the future and ask two brutally honest questions:

1. What are the failures I can afford?
2. What are the failures I can't afford?

For example, a common "unacceptable failure" for most people is the risk of being evicted if they can't pay rent so they buy a house, thinking it's safer (say, as a hedge against inflation if their mortgage payment is fixed).

But beyond the assumptions they make about risk, they also expect to *make money* on the purchase, while ignoring the fact that most people around them are buying homes in the very same market.

They focus only on avoiding the fear of falling behind so they end up choosing an investment vehicle that yields *average returns* while somehow expecting *above-average* results.

Since the vast majority are not **savvy investors** and real estate isn't a professional pursuit for them the probability that they will fall below average is actually quite high. Since the only way to enhance their returns are through buying in buyers' markets and selling in sellers' markets. However, most people buy in sellers' markets and sell in buyers' markets (that is what creates the shift of powers between buyers and sellers). This also requires being able to sell in a sellers' market and riding it out by renting and sitting on cash until a buyers' market comes by.

Even though that's an *active* decision they make, they refuse to accept that their wealth will probably align with the average and ultimately depend on their ability to save each month.

⁸ it hasn't been *legally proven beyond doubt* that Barry Bonds took steroids.

The lower they are on the income spectrum, and the higher their expenses are relative to income, the greater the odds that others investing in more productive assets will outperform them.

After everything I've just described, the likelihood is that they'll fall into the lower half of Israel's wealth distribution for their age group.

That doesn't stop them, of course, from using the same smartphone as the top decile (the iPhone Pro Max club), buying brand new cars, flying abroad, and dining out regularly.

Then, in total cognitive dissonance with their behavior, they stand there in shock wondering why they're poorer (in net worth) than they thought they'd be compared to everyone else.

The main reason we're here, at this exact moment—and the reason I've written this long preface so far—is that the Israeli economy and its people have benefited from **massive tailwinds** that I seriously doubt still exist.

When the entire economy is moving in your favor, reality is far more forgiving of mistakes. A rising tide makes even bad decisions feel smart.

But that era is over.

When asset prices are rising, everyone feels richer. When an entire public's purchasing power rises, everyone's quality of life improves. And more than anything, people start believing they, too, can land in the top of the wealth distribution, that they will get rich by making "good" financial decisions. The thing is, broad asset-price increases make everyone think decisions that aren't necessarily good are, in fact, good. In the dot-com bubble, anyone could launch a website start up in Silicon Valley and get rich. That didn't make them a good entrepreneur. I think that anecdote fits today's Israeli public, which has enjoyed a steady upgrade in living standards over the past two decades (versus roughly five years in Silicon Valley in the late '90s).

"Sometimes people don't want to hear the truth because they don't want their illusions destroyed."

— *Friedrich Nietzsche*

I'm not here to sell you some "truth" I am here to share how I think. Which is exactly what no one wants. People want a simple answer and there isn't one. I think I know the crossroads where Israel's economy and its public now stand, and I have a sense of which path we'll take. I also have views on which path we *should* take (hint: it's not the one the public will likely choose). If the public makes hard choices, I think the payoff will be significant. And even at the individual level, if people start thinking differently, they'll benefit personally. The price for what I have to say is great because it's free.

Maybe that's exactly why people are less inclined to listen: I'm not charging money, so it feels odd, like there must be a catch (we'll get to this when we discuss Rory Sutherland), or ego and cognitive dissonance get in the way (and we'll touch on that now, too). In any case, here I am, laying out what's on my mind and in my heart, trying

to answer a seemingly simple question: **Where are we now?** Where does Israel's economy stand? Everything here is an opinion not recommendations. There will be a lot of information, and I'll ask of you what a teacher of mine, Yaron Ben-Ami, once asked our class:

"Don't believe a word I say, go see for yourselves."

My only goal is to push you toward multi-dimensional, critical thinking, cutting across time, and across disciplines like philosophy, biology, history, psychology, economics, technology, sociology, physics, and more. That's why I love capital markets. It's a place where I can take what I've learned from others' theories, others' experiments (war, for example, is where strategic and tactical theories are tested in the harshest reality), along with my own theories and my own real-world experiments. In other words, there's a venue to test everything I've learned and everything I think I know.

We're going to start at the beginning. We're going to jump back **100,000 years** and then sprint forward. You can't talk about the stock market today or tomorrow, or real estate, or the economy, without talking about human beings. Without broad knowledge of human history, and, on the other hand, human psychology, you can't talk seriously about Israel's housing crisis, real-estate prices, government bonds, or the Israeli economy.

For anyone who thinks you don't need all that background to understand where Israel's economy stands, let me share an anecdote about another man - one who didn't jokingly call himself a *prophet*, though a similar nickname was given to him: **the Oracle of Omaha**, Warren Buffett.

Back in the 1970s, he wrote the only article he ever published in a major magazine. It was his 1977 essay in *Fortune* magazine titled:

"HOW INFLATION SWINDLES THE EQUITY INVESTOR"

by Warren E. Buffett

<http://csinvesting.org/wp-content/uploads/2017/04/Inflation-Swindles-the-Equity-Investor.pdf>

And this is a good place to pause and make a suggestion - stop reading this book.

Go listen to every Berkshire Hathaway shareholder meeting instead.

It'll be a much better use of your time.

https://www.youtube.com/watch?v=kgKEiP6L9EQ&list=PLq-w-W7JoGRI_hc1PKJaNA1kyxB69iq8

Warren Buffett's article was originally meant to be published in a newspaper, however it ended up stretching across eighteen pages. In it, he tried to answer a question that seemed on the surface much simpler than figuring out where an entire economy is headed.

When he sent the article to the editors they replied that it was too long. They said he didn't need to write *everything* he knew about investing, all they wanted was just for him

to answer the question, and make sure his answer was shorter.

His reply was that this was the **shortest possible answer** he could give.

For Mr. Buffett, even a seemingly simple question, one as straightforward as “*How does inflation swindle the equity investor?*” contained layers upon layers of complexity.

Obviously, the things that Buffett knew that are relevant to the topic easily fill hundreds of more pages on that single topic, not just eighteen.

But as the editors pointed out, eighteen pages is too long for an article. The reason is simple- most readers want something they can finish in five or ten minutes before moving on with their day. The average reader doesn't really want to *fully understand* anything all they want serves as a quick fix to their question and then to move on (all they usually are looking for is to hear something that makes them feel good about themselves, or reenforces an opinion they already have).

In the digital age - people suffer from this even more, but this is far from being a modern phenomenon. From the dawn of time, like every other creature in nature we've been wired to conserve energy and survive. We prefer to get the most calories with the least effort, which is exactly why ordering food on Uber Eats or Door Dash is so addictive.

That same primitive instinct drives our desire to own a home a safe, stable place that frees us from the need to wander. These things run so deep in human nature that **the best businesses in the world are built on many of these primitive needs and instincts.**

That's why you can't talk about Meta (Instagram, Facebook, WhatsApp) without talking about sociology — and, above all, gossip.

You can't talk about Apple, Louis Vuitton, American Express, or Ferrari without talking about status, social psychology, dominance, and, most fundamentally, the drive to reproduce.

You can't talk about Amazon without recognizing humanity's instinct to maximize utility — once expressed as the pursuit of as many calories as possible with minimal effort, and now reflected in the consumption of products and services, from its cloud infrastructure to its marketplace management tools, all designed to make life easier.

And you can't talk about Google without acknowledging curiosity — our innate drive to understand, to question, to solve problems, and to seek advice. That's precisely the need Google was built to satisfy: knowledge.

For a deeper exploration of these layers, I recommend Scott Galloway's book *The Four*.

<https://www.youtube.com/watch?v=GWBjUsmO-Lw&t=2233s>

(A lecture of Galloway's on the topic. All links here are non-affiliate — I don't make any money from traffic. Go search for them yourself, in whichever search engine you prefer.

Another word on Galloway, in my opinion, he is the definition of a person who in most cases is status and virtue signaling. He only breaks from his signaling when he truly believes in something, which is a good way to evaluate the strength of his ideas in his own mind)

This book that lays before you, contains a great deal of background information because behind every decision we make, there's always a lot of background. The background information in the book is only a drop in the bucket.

Every point we see is, in the end, the result of an ocean of different processes.

The Americans have a saying about anyone who became famous overnight:

"I was an overnight success ten years in the making."

So why does it even matter to understand human origins?

Because the decisions we make are, first and foremost, **irrational**.

Even when they seem smart, they often rely on evolutionary patterns that have developed over thousands of years.

These patterns sit with us in the room - no matter how much we deny or ignore them - and they show up in moments as simple as buying groceries or purchasing a home.

That is why human beings are very often predictable.

The number of people who say "buying a home gives me the feeling of security," yet can't explain *why* it feels that way, is staggering.

And historically, we can see that in extreme situations, what seems safest can actually be the most dangerous.

True danger rarely lies in routine - it reveals itself in moments of extremity.

We'll touch on a few such historical turning points to shed light on the present.

We have a natural tendency to look for identical cases in the past to understand the present.

The problem is - no case is ever truly identical.

But doing so does help us recognize recurring patterns that can illuminate the situation we face today.

Notice how news channels always seem to oscillate between two extremes:

Either they tell us we're living in "*unprecedented times*", moments that have never happened before, or they insist it's "*just like back then*," referencing some famous event from history.

What they rarely say is the truth, that there are *always* similarities, and *always* differences.

To understand the present, we'll draw from two main sources:

1. **Human psychology and evolution** — who we are as human beings.
2. **Human economic history** — how people have thought, acted, and reacted in different situations.

We'll use these to understand the **distribution of possible outcomes** - not to calculate them precisely (because we can't), but to *feel* the probabilities, to sense what might happen, and to consider the consequences of each scenario.

The world we live in is one defined by a **distribution of outcomes**, and we must remember that we never think of *all* possibilities - and that even the probabilities we do consider, we almost certainly estimate incorrectly.

I recommend reading books on **Decision Making Under Deep Uncertainty**, because that's the exact world we live and operate in.

We can't study the future - but we *can* study the past, or at least its various versions.

“History Doesn't Repeat Itself, but It Often Rhymes”

- Mark Twain

And what have I been trying to say so far? Let's sum it up in a few words:

Investing is a probabilistic game.

At any given moment, we stand at a crossroads with infinite possibilities, wrapped in a thick fog of uncertainty.

A great investor is one who considers not only the variables they know exist but don't know the value of, but also has the ability to *sense* the unknown.

They are aware of their own limits, reminding themselves to stay humble, because investing is a sport where everything can go wrong,

and an investment that seems perfect on paper can erase all gains faster than anyone can comprehend.

The world of investing holds within it all of human knowledge, and all of human emotion. It demands deep understanding of people, and, above all, **ourselves**.

Chapter 2 – Prehistoric Economics: On the Connection Between Creation, Germs, Guns, and Steel.

The distilled essence of the world's economic prehistory - from the dawn of creation up to the Dutch Tulip Bubble of the 17th century.

Before anything else - everything you're about to read is **a lot of imprecise information**, and I urge you to **doubt me**.

Don't take anything for granted - go, research, and leave no stone unturned.

While reading (or listening, if it's a lecture or an interview), turn the gears in your mind and have an **internal dialogue** with yourself about what you're learning.

Question, challenge, doubt, and verify.

Make use of Investopedia - it may not be a perfect source, but it's a great doorway into a world of knowledge.

The two sources I'll mention here will help you get into the right frame of mind.

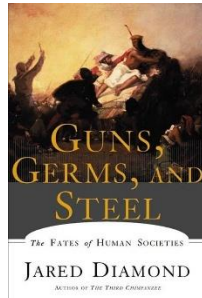
And perhaps, as happened to me, they'll send you on a journey -

to dozens of other sources, new ideas, and questions you haven't yet thought to ask.

The Psychological Significance of the Biblical Stories- The Book of Genesis (Jordan Peterson)

https://www.youtube.com/playlist?list=PL22J3VaeABQD_Izs7y60I3IUrrFTzkpat

Jared Diamond - Guns, Germs, and Steel - Book



The guiding thread of this entire line of thought begins with one big question - **what crossroads is the State of Israel truly standing at?**

Alongside it, a second question - smaller, more personal, and in many ways far more important to you - **what does that mean for each and every one of us?**

The original is written in Hebrew, and is geared towards Israelis. This version will include a chapter and a few other parts that will make this book more relevant for Non Israelis, and especially the Jewish community in what the **Israelis** call the diaspora. If you are not Jewish and not Israeli, I believe that those parts will be especially meaningful for you in order to understand your relationship and your ancestors relationship with this extremely odd people, the jews.

In this process, we'll talk about the pricing of war and terror risks, the housing and real estate market, the high-tech sector, and more.

But before we dive into the present and its timelines, we'll take a short journey from the past to the present.

And we'll begin with the most fundamental question of all - **the question of place.**

Why did we settle down in the first place?

Not just us, the Israelis - but humanity as a whole.

Why did human beings, at some point, decide to stop wandering and stay in one place?

Why Buying a Home *Feels* Psychologically Safer – A Result of Human Evolution

The origin of humankind is from apes, and more broadly, human beings are first and foremost **animals**. If you look at nature, you'll notice that every animal is focused on a single mission – **reproduction**. Animals are willing to risk themselves repeatedly in order to ensure the continuation of their species. If you study reproduction in the animal world, you'll see a consistent pattern: animals are willing to expose themselves to danger in order to reproduce. In other words, the reproductive drive is one of the strongest “irrational” forces shaping behavior in nature.

Penguins, for example, march for hundreds of kilometers through violent Antarctic snowstorms, sometimes in temperatures of minus 40 degrees, just to reach the place where they can lay their egg and protect it. They stand pressed together for weeks, almost without food, shielding that tiny egg from the wind and the ice.

Salmon undertake a similarly extreme journey. They swim against the current of rivers for hundreds or even thousands of kilometers, through rapids and waterfalls, dodging predators (bears, eagles, and other fish), just to return to the place where they were born and produce the next generation. All of this is done for one purpose – to ensure their genes are passed on. But in order to reproduce, there is one basic requirement – **survive long enough to help the next generation survive on its own**.

And for that, two things are necessary: **food and water**, and enough of them to support raising offspring. This fundamental need is what pushed humans to migrate out of Africa and settle across the world. When I say “settled,” I mean that they continued to move, but within limited territories (like Native American tribes in North America who migrated with the seasons). Over time, humans began to **stay in one place** and anchor themselves to the land. They realized that it was more efficient, both in terms of energy and safety, to gather in larger groups. More people meant more strength, and it was smarter to **grow** food rather than gather or hunt it.

Notice that many people begin thinking about buying a home and “settling down” precisely when they begin thinking about starting a family. Settling down **feels** safer and more appropriate when the goal is to raise children. However, this has not always been true.

Extreme climate events, such as long droughts (a Biblical reference to seven-year

drought cycles), forced tribes to abandon their land and migrate (like the descent of Jacob's family to Egypt at the end of Genesis). We will elaborate on this point later, but to anyone who is more invested in a specific part of land is less likely to leave it, unless a real cataclysmic event occurs. Sometimes it was too late. Tribes and families that were more adaptable and mobile tended to survive better. Human history is full of nomadic tribes that conquered and displaced sedentary populations, as Mordechai Kedar often notes when he references Ibn Khaldun and his writings. The conclusion is significant: **owning land or property does not guarantee future security.**

In fact, there are situations where anchoring yourself to the ground becomes a trap. Take Tel Aviv, widely seen as "safer" than Kiryat Shmona which was under Hezbollah rocket threat – until a few missiles from Iran changed that perception. Yes, Hezbollah rockets are dangerous, but they are typically survivable when shelter is available. As we learned during the 12-day war with Iran, even being inside a reinforced "safe room" does not guarantee protection from a direct strike by an Iranian missile.

Additionally, the **property damage** from strikes, even without a direct hit, is enormous and much larger than that of a Hizballah rocket to Kiryat Shmona (Hizballah also has the capabilities of bombing Tel Aviv as well). The public learned something else – the state does not fully compensate losses. Economically, most Israelis believe that buying a home is safer than renting. But there are situations where the opposite is true.

A renter who wants or needs to leave can do so as soon as their lease allows.

A homeowner depends on the willingness of others to buy or rent their property.

The public belief that "it's financially safer to buy a home in Kiryat Shmona than to rent there" collapsed during the recent war in the north.

Anyone who bought property there faced a new reality: some residents want to leave, others who planned to move there changed their minds, and some returned to live there but now prefer to rent, because they want the **ability to leave at any moment.**

An individual who is truly paranoid would think of all these before buying a place. I believe that the best investors, generals, managers are of this kind and yet are also optimistic in their ability to deal with bad situations. They see first what can go wrong, understand how to deal with it, and they are mentally aware that their fears are worse than reality, and therefore are comfortable with dealing with these odds. Most people are not driven by these things, and typically behave irrationally or just follow the herd.

Physical survival ranks higher than "economic stability" on the human hierarchy of needs.

This is why in my view, any population whose wealth is largely **illiquid** and **immobile**, and whose assets are located in areas of war or climate risk must consider holding assets that are **highly liquid** and **highly portable**. During World War II, that meant **gold and diamonds**. Today, that means **digital currencies**. A modern example is Ukraine.

Another alternative is holding assets **outside** high-risk zones. Sam Zell recounts in his autobiography how his father managed to move the family's small wealth out of Poland and into the United States under enormous danger.

The lesson that survivors of the Holocaust and those who escaped before it internalized is simple: **"Only the paranoid survive"** (a nod to the book by Andrew Grove bearing that title).

Only the paranoid survive is what Israel was founded with and forgot temporarily, which led to October 7th. Throughout history, the Jews have learned and always forget repeatedly, that when you get too comfortable, violence, death and rape are on their way.

As I just told my uncle in a recent trip to the states when we spoke about the rise of antisemitism in the U.S

"Germany too was a wonderful place for the Jews from 1880 to 1930" -self quote.

Economics and evolution are the same - that those who survive are those who adapt best.

In order to succeed over time you have to adapt the fastest and embrace real change.

A person whose wealth is tied to fixed assets is essentially *stuck* in one place.

If that place becomes less desirable (due to war, climate change, or a local economic crisis) - they cannot move. In contrast, someone whose capital is **mobile** can relocate to wherever the opportunities are greater.

This is why, throughout history, merchants and bankers - whose wealth was **liquid and portable** - were able to accumulate far more wealth than feudal lords, whose entire fortune was tied to one piece of land in one specific location.

The Question of Place - Why *Here* Matters to Jews

Thousands of years ago, human beings put a stake in the ground.

They didn't understand why the world behaved the way it did, so they tried to explain it through religion. Everywhere, a local religion emerged - one that explained the nature of the surrounding environment, the conditions of life, and the cultural code required of those who belonged to that community.

This realization hit me during conversations with Aboriginal people when I lived in the Australian Outback (I will speak more about this real soon). At the time, I was rereading *Guns, Germs, and Steel*, and spending long hours thinking about the world, about humanity, about agriculture, and about nature.

Their relationship with the land gave me a deeper understanding of religion (which intellectually I already knew well, through my familiarity with history, geography, and studies of different religions) and also clarified what truly distinguishes Judaism and the Jewish people - and it is definitely not because Jews were "chosen by God."

All religions try to answer the same big questions: Why are we here? How did we come into the world? How was everything created? And what does any of it mean?

God is nature, and nature is God (yes, I know I sound like Spinoza here).

What is nature? What is God? I don't know.

And anyone who claims they do know is either arrogant, delusional, or a liar.

And anyone who claims they know what God wants is usually all three.

So you might ask - if that is what I believe, why do I still pray sometimes and put on tefillin once a week?

The answer is simple: I am a descendant of an indigenous - the Judean Tribe, people whose indigenous land, resided in Judea, a part of the land of Israel.

This is how our people expressed for thousands of years gratitude toward nature and towards God. This is how we make requests of the world - and more importantly, of ourselves. The way I engage with God and nature is the result of my own life experience, and the tradition passed down to me generation after generation - a tradition that changed, eroded, adapted, distorted, and survived all at once.

And that tradition is tied to the physical place where it was born.

Therefore, Judaism without the Land of Israel is hollow.

The purpose of Judaism is to teach how a specific group of people (the tribe) are meant to live in a specific land. It is not just a religion - it is a way of life tied to the soil.

This is the unique essence of Judaism.

From that flows a simple economic point:

As long as the State of Israel exists, there will always be Jews who want to live here - and who are willing to pay and to sacrifice in order to do so.

This forms one of the fundamental floors beneath housing prices in Israel.

This does not mean that any rabbi owns the "correct" way to live here.

The "how" is a question each of us must answer individually.

But before we assume we are masters of the land, or rightful owners of the Promised Land -

we need to look around, detach from ourselves, and let reality place us in perspective. We are small. We are not particularly important. But this place - is.

On the Separation of Religions from the Element of Location

The first religion to significantly detach itself from the element of location was Christianity. Prior to that in almost every culture, the gods were local: gods of the river, gods of the mountain, gods of the forest, the sun god, the ocean (as examples) alongside ancestor worship. Those ancestors served as the basis for claims of land rights and inheritance. (This is also the deep reason why the Cave of Machpelah and the stories of the “Fathers” -Abraham, Isaac and Jacob are foundational in Jewish consciousness – they establish the connection between a people and a specific land).

The Book of Genesis is primarily meant to explain why specifically the Land of Israel is the “Promised Land” to the Hebrews. The rest of the Torah deals with how the Israelites arrived in that land, and along the way lays out a system of laws describing how one is meant to live in that place. The rest of the Tanakh is essentially a historical record of a people and their relationship to that land. The religious texts form a structure: Why here? How did we get here? And how are we supposed to live here? All ancient religions dealt with these same questions.

Christianity broke this global ancient convention. It became a religion not tied to a specific place, but one intended for the entire world (I’m not discussing Hinduism, Confucianism or other Eastern religions here – not because I didn’t study them, but because they’re less relevant to the questions we’re dealing with, and because the Western world was built on certain elements inherited from Judaism which are relevant specifically to Israel, its history and its conflicts).

Judaism, by contrast, was from the beginning a local religion. It came to explain how a specific people should live in a specific land in a specific way.

So why, then, didn’t the Jews assimilate once they were exiled from that land?

The answer is simple: **the Jews are the People of the Book.**

This is truly what makes us unique.

And with all due respect to the religious pride in the Friday night Kiddush line “*You chose us and sanctified us*” - it’s a very arrogant sentence. We are not the chosen people because God selected us. We are the chosen people because **we chose ourselves.**

The ritual that cements this choice is the Bar Mitzvah.

In other cultures, the Rite of Passage was physical (As an example, for those who have watched *Vikings*, think of the arm ring ceremony, which later found its echo in the Catholic communion ritual).

In Judaism, the Bar Mitzvah requires every member of the tribe to learn how to read.

Our cultural obsession with literacy allowed Jews to preserve:

- memory
- stories
- accumulated knowledge
- and the experience of previous generations

This realization became clear to me only after my conversations with Aboriginal people in the Australian outback. Their agricultural and ecological knowledge was based on working with nature (controlled burns, forest management, sustainable hunting and planting). They told me that enormous knowledge about the land was lost because it lived only in the minds of elders who died while a generation of children were taken to orphanages and grew up disconnected from their ancestral teachers.

They, as many other cultures transmitted knowledge orally.

The Jews **wrote it down**. The only other ancient culture with a comparable written continuity is the Chinese who brought this knowledge to other Asian nations at an early time period. You will notice how stereotypically Asians too are considered to be smart and they have also “taken over” industries that require a high degree of education. These comments are typically very racist as they are used similarly towards Jews, but the reason is that there is the same origin reason, generations of educated people. The Jews did not only write it down, they carried these books everywhere, and read them weekly, generation after generation.

That is why Jewish cultural memory is tied to:

- agricultural practice,
 - social organization,
 - and religious ritual,
- all rooted in one specific region: the Land of Israel.

So when Jews returned to the Land of Israel, they recognized places, and even had a sense of which crops might grow well — it was already written in the Tanakh.

The economic advantage of this literacy was enormous.

While other cultures lost knowledge whenever elders died, the Jews accumulated knowledge over centuries. So every place they arrived, they didn't start from zero. They brought with them:

- commercial and financial practices,
- legal reasoning,

- and methods of community organization.

A Jew arriving in a new city carried with him an entire **portable library** of practical knowledge.

This explains why Jews adapted quickly to complex economic roles like banking, international trade and the professions. They were the only group capable of preserving and transmitting accumulated practical knowledge across generations and across continents.

This is in stark contrast to medieval Catholic Christian societies, where literacy was restricted to wealthy men and clergy. The conflict between Protestants and Catholics, in many ways, began over the translation and accessibility of sacred texts.

While Jews worked (through the Bar Mitzvah) to give literacy to the entire community, Catholic Christianity worked to **restrict** that power to a narrow elite.

Another reason, is that Jews for nearly two millennia were not allowed to own land work in agriculture. The only land that they could ever really call their own, was Israel. Also they were constantly reminded wherever they were, that they “don’t belong here”.

A Christian and Muslim Perspective

The Christians were almost the complete opposite of the Jews, not only in the matter of teaching reading and writing, but also in their concept of place. While Judaism is tied to one specific land, Christianity detached itself from that idea and became a universal religion. It allowed people from different cultures and regions to belong to the same system of beliefs and values.

You can see this even in the names of the days of the week in English:

- *Thursday* is named after the Norse/Germanic god Thor.
- *Sunday* is named after sun worship.

But there’s no reason to be condescending and view Christians as “More Pagan” Judaism also contains layers of very ancient pagan ritual. For example, the act of laying tefillin contains echoes of older ritual practices that predate Judaism.

Islam found a kind of middle ground between the universality of Christianity and the location-based identity of Judaism. On one hand, Islam aspires for the entire world to eventually become Muslim. On the other hand, any territory where a Muslim foot has ever stood is considered sacred and must remain under Islamic identity and control. Place matters, but differently.

Christianity and Islam both saw value in spreading their belief systems to people who were not from the land where the religion originated. Judaism, by contrast, did not

operate as a missionary faith. It functioned as a way of life tied to a specific people and a specific land.

From this emerged deep historical differences:

- **Islam** grew out of a desert nomadic culture, a culture that did not farm land but moved from place to place.
- **The Jews** wanted to settle, but in practice were not allowed to work the land in most of the places they arrived. Their longing to settle remained tied specifically to the land of Israel. Everywhere else, they were forbidden to be farmers, forbidden to develop a deep relationship with the land – the kind only agriculture creates.
- **Christianity**, on the other hand, took over an agricultural, Europe the land of Serfdom, where most people were serfs bound to the land of a local lord.

And from here emerges an important point:

In many Islamic regions, where trade and movement were built into the culture, Jews often integrated more easily. A merchant culture recognizes the value of movement, adaptation, and opportunity.

But in Christian Europe, the peasants were tied to fixed land and borders. They saw Jews traveling across the kingdom (because Jews were considered property of the king, not of local lords), and therefore saw them as outsiders and threats. Often Jews were the “guests of the king” - until a new king came, had them slaughtered, exiled, and seized their property.

Medieval Europe fell into a repeated cycle:

1. Invite Jews to settle.
2. Benefit from their commercial activity and the economic growth it brings.
3. Resent wealthier Jews and any debts owed to them (everyone hates the bank).
4. Turn on them violently, exile or kill them. These “Pogroms” always included rape. This is why no European Jew looks middle eastern. All of them have genetic ancestors who raped some of their ancestral mothers. This is why being Jewish is tied to who your mother is. It is an ethnic selection, and it is based on the concept that you always know who the mother is. This is why being Jewish is first and foremost an ethnic identity and not a religious identity.
5. After a few generations, invite them back again and the cycle repeats.

Jews enjoyed freedom of movement - but suffered from the inability to farm or own land. This forced them to become resourceful in finding ways to make a living. Over generations, this pushed them from being farmers who were not allowed to farm, into merchants and businesspeople.

From here comes the historical economic advantage.

The reason is simple:

- A farmer's income is limited by the size of his land and by nature. Even the best farmer cannot grow more than his land allows.
- A businessperson can scale. He can work with dozens of farmers, buy in bulk, sell in distant markets at higher prices, and repeat the process. He can also create new value - take wheat and turn it into bread, take wool and turn it into clothing.

The farmer remains with wheat.

The businessperson builds a world from it.

And so, out of necessity and not choice, the Jews developed expertise in the fields with the greatest potential for wealth creation.

The Jews and the Cross

This chapter did not exist in the original version I wrote. But after my recent trip to the United States, I realized how necessary it is - especially for American Jews. And since this chapter will appear in the English edition of the book, I included it in the Israeli one as well.

The writing style here will be a bit different, because this section needs to move quickly through a set of historical points that summarize key aspects of Jewish history in the Western world.

There is a massive disconnect between how Israelis understand Jewish history and how the rest of the world understands it. Israelis generally have no idea how historically ignorant the world is regarding Jewish history, especially the history of Jews in their own countries. At the same time, Israelis often assume this history must be familiar to others simply because Israel receives disproportionate global attention. In Israel, Jewish history is a large part in the education of world history in the school system.

There is a basic psychological bias: when something feels self-evident to us, we assume others know it too. Israelis suffer from this significantly. So do non-Israeli Jews who are deeply embedded in Jewish community life, they assume shared knowledge that in fact is not shared.

The global focus on the Holocaust allows the Western world to *avoid* dealing with its own Jewish history, a history of nearly **2,000 years of Rape, Violence, Segregation and Bloodshed**.

By placing all guilt on Germany, the world absolves itself.

Notice something: the three most hostile countries to Israel in the EU today are **Ireland, Spain, and Slovenia**. Poland is also far from friendly. This is not random. All are countries with deep Catholic heritage, where Jews were an enemy for over a millennium.

The Roman Context – and the First Split

During the period in which Judea existed under Roman rule, the Jews held a **unique legal-religious status**. Rome permitted every conquered people to continue worshipping their own gods, but only if they *also* recognized the Roman gods. **Except one people.**

The Judeans, aka, the Jews. What happened to the rest of the Israeli tribes is a whole other topic. Those tribes were scattered around the world (including India and Ethiopia) and are seen also as Jews and many have Migrated back to Israel, their ancestral and indigenous home.

The Judeans were the only nation **exempt from worshipping the Roman pantheon**. They were permitted to worship their *one* God, exclusively.

This exemption is recorded in Roman sources of the time, Suetonius' *The Twelve Caesars*, Josephus, and others. Ironically, this unique status is what sparked the earliest rupture between Jews and the first Christians.

The earliest Christians were themselves Jews who argued that Jesus marked a new covenant (and their numbers were much less significant than depicted in Christian mainstream materials like Ben Hur). But Judaism saw Jesus as **another one of many false messiahs**, and historically, there were *dozens* of such figures during Jesus' time (and there were others who had a much larger following). Monty Python's *Life of Brian* captures this truth more accurately than most theological retellings.

Once Christianity began attracting **non-Jews**, the situation changed drastically.

Non-Jewish Christians had **no exemption** from Roman civic religion.

If they refused to add Roman gods, they became **political rebels**.

This is why Rome persecuted Christians, not because of theology, but because of **civil disobedience**.

And the Christians looked at the Jews and saw:

- The Jews do not worship Roman gods.
- And the Jews are **not** persecuted for it.

While Christians were being tortured and executed.

From here emerged the first deep resentment:

“The Jews are allowed what we are denied.”

The first seed of Christian bitterness was therefore **political**, not theological.

When the Roman Empire Converted

Once Christianity became the state religion, two political needs emerged:

1. The empire could not be blamed for the crucifixion. **A political inconvenience.**
2. There had to be an explanation for why the Jews rejected Jesus. **A religious inconvenience.**

Therefore:

- Jesus was framed as the savior *rejected* by the Jews.
- The Jews were framed as those who **killed** Jesus.
- And the ancient Roman exemption became proof of Jewish “stubbornness and evil.”

The political resentment became **religious doctrine**.

The last historical memory of Judea was the Jewish revolts that led to the destruction of the Second Temple. This rebellion was one of many the Roman Empire dealt with.

This became another piece of the story:

“Look how ungrateful and disloyal they are.”

The “Secret Jew” as Enemy

For centuries, Jews refused conversion.

To Christians, this refusal became evidence of arrogance and willful blindness.

Later, when some Jews *did* convert, they were **not accepted**.

Suspicion arose that these converts were still Jews “in secret”, and they were accused of conversion for unethical reasons. Not because they accepted Christ, but because they wanted to preserve wealth, avoid prosecution and gain power.

This fear led directly to the establishment of the **Inquisition**, which focused not on Jews who remained Jewish, but on Jews who had *converted*.

Thus was born the enduring image of the Jew as:

- Someone who hides who he is,
- Someone who is loyal to a different power,
- Someone who manipulates religion for advantage,
- Someone whose wealth must be explained by deceit.

This was not a temporary stereotype.

It became the **identity** of the Jew in Christian civilization for **1,800 years**.

This narrative justified:

- The Crusades

- Blood libels
- Forced conversions
- Expulsions (England 1290, France 1306 & 1394, Spain 1492, and many more)
- Pogroms across Europe
- Mass rape, looting, and extermination of entire Jewish communities

Now we arrive at a cultural split:

In Christianity, the phrase “**She is on a crusade**” means:

She is fighting for something noble and righteous.

In Judaism, “**Crusade**” means:

Rape, torture, burning families alive, and obliteration of communities.

The Christian memory is **romantic**.

The Jewish memory is **traumatic**.

Why Teaching Only the Holocaust is Dangerous

When only the Holocaust is taught,
the world is freed from responsibility.

The Holocaust becomes:

“A uniquely German crime committed by Nazis.”

Instead of:

The culmination of 1,800 years of Christian anti-Jewish civilization.

This is the foundation most modern non-Jews do not know.

And many Jews have forgotten.

The American Piece of the Story (Race, Whiteness, and Misunderstanding)

In the U.S., progressive white Americans apologize for slavery and segregation and they look at (Ashkenazi) Jews and categorize them as **white oppressors**.

Yet the only reason Jews in Europe came to **look** European is because of **centuries of rape during massacres known as pogroms** (which is a word that people can't relate to and shouldn't be used. It should just be called a massacre).

Ashkenazi Jewish “whiteness” is not a sign of privilege. It is a genetic **scar**.

Meanwhile, most of these same progressives have no idea that Jews were barred from American universities until ~100 years ago.

The ignorance of American liberals and the ignorance of Israelis are mirror images:

- Americans do not know Jewish history.
- Israelis assume everyone knows (and they aren't that well educated about it anyway because most of them do not remember their history classes from school).

Both are wrong.

The Jews and the World

Since the beginning of humanity, people have dealt with the same challenges: how to survive, how to remember the past, and how to prepare for the future. Trade between cultures began long before the discovery of America, and the Silk Road is one example that the world was global long before airplanes or modern nations existed. Every region had different resources (grain here, metals there, spices elsewhere), and so even then it made sense to move, exchange, trade, and identify value gaps.

Most rapid cultural development happened along the Eurasian belt surrounding the Mediterranean and stretching eastward to China, because similar latitudes shared similar climates, which allowed agricultural knowledge and trade practices to travel. In the Americas, development ran north-south across sharp climate shifts, which slowed the movement of knowledge.

Within this world, the Jews were a people moving between cultural centers. And unlike most nations, they were almost never allowed full ownership of land. Sometimes because of external decree, bans, expulsions. And when you have no land to anchor yourself to, a different ability develops. The Jews learned to move, to trade, to produce, to invent, to work in crafts, to be a mediator and organizer, to understand value and not just physical material. In a world where most people were tied to their soil and the weather of that year, the Jew could get up, leave, and rebuild elsewhere.

This was the most significant historical conversion: the land became memory instead of possession. Simultaneously with technological developments and scientific discoveries, knowledge became more valuable than materials, ideas became more important than land.

Judaism itself preserved the idea of a future return to the Land of Israel, but as long as return was impossible, the goal was survival. To survive, to learn, to remember, to pass onward. Not to die and disappear like many nations who chose to convert or merge into the conquering or neighboring tribes just to stay on familiar land. When the only skill you have is working the land, and your identity is tied physically to that land, you stay because that is all you know. If you leave, you would not know what to do.

Jews, by structure, had a solution to this. And so more than the Land of Israel preserved Jewish identity, it preserved the Jewish ability to adapt to the current reality. Because for a Jew, the task was simply to survive until the coming of the Messiah and the return to the land. The Jews did not return to the Land of Israel because the Messiah came. They returned because of Zionism. In other words: they got tired of waiting. They got tired of

being dependent on the goodwill of others and the risk that those others may change their minds.

Zionism in a simple sentence, is the Jewish discovery that:

“God helps those who help themselves”- something my mom used to tell me as a kid

The Jews said to themselves: we are done waiting for the Messiah to save us from the non-Jews, so we will save ourselves, and we will go to the only land we know (even if only on the cultural and spiritual level). But we did not do this before the 19th century, not truly. Small groups may have come (for example, descendants of the expelled from Spain who settled in Safed), but not as a people.

Only when the world changed, did the Jewish cultural thinking change.

Something changed in the 17th century

In the 17th century, Europe began to transform. Maritime trade routes expanded, the economy became more energetic and dynamic, science began to challenge religious authority, agriculture improved, and European society began to break away from feudalism. This change allowed Jews a real alternative to life as Jews in exile. Some stopped waiting for the Messiah and gave up on national existence as a people in a land of their own. They began to think of Judaism only as a religion, and believed that the tools for self-redemption already existed where they lived. European societies tried to make this possible through a large historical experiment.

This was the birth of **Emancipation** – a new idea saying to Jews: be citizens. Be “like us”. No more ghettos, no more separation.

Many believed it. Many truly became part of society. They became educated, became doctors, engineers, musicians, army officers, professors. There was a time when German Jews believed they were German and the only thing that was Jewish about them was some obscure detail in their family tree. French Jews felt Parisian to their core. They believed the story was over. That they could fully belong. They left the national Jewish customs. Many converted to Christianity. Many adopted all local customs and gave up their family heritage.

Then came the pogroms. Or the Dreyfus Affair in France. And as the culmination of many other events, the Holocaust. And all masks fell as they rounded up people who the only Jewish thing about them was a grandparent and shipped them off to die.

And it happened to all types of Jews, from those living in Jewish neighborhoods to those whose only Jewish connection was one grandfather. Europeans said to them plainly: if your blood is Jewish (which is an ethnic marker), you are not one of us. Being Jewish as

far as non jews are concerned is an ethnic question. And has nothing to do with how one identifies, or what religion they follow. Although Jewish religious authorities (Orthodox Rabbis as an example) may only look at the mother being Jewish (which is also an ethnic question) or may denounce someone who converts (many of jews who became non orthodox practicing jews were considered dead to their parents when they left the ghettos). The only question that non jews have is do you have enough Jewish blood running in your veins?

A big part of this confusion is due to the fact that Ethnically Jewish and Religiously Jewish bare the same name but have completely different meanings.

The reason Israel is an ethnic and non religious answer for the Jewish problem is that the world told them clearly, with no room for interpretation:

You will be Jews in our eyes even if you change your name, your language, your clothing, and your religion. And when we are in crisis, you will be the first to pay.

This has not changed today. After October 7th, Jews in Paris were attacked in the street, Jewish students on American campuses were afraid to leave their rooms, and synagogues in Germany again needed police guards. The world reminds Jews again and again that they are not at home. They are guests.

This is why Zionism was not ideological choice but survival response - Jews understood that they needed a place of their own, not out of ideology, but out of recognition that redemption is personal and internal.

And this is why Jews came to the Land of Israel. Because new waves of antisemitism already seemed inevitable 200 years ago (even though some hoped that in America it would not happen, or at least that there they could defend themselves physically - we will discuss this later, I will also elaborate on how I balance in between a Jewish ethnic identity, being 100 % Israeli and 100% American. This, as this entire book, is my own personal and biased point of view).

The Jewish attachment to the Land of Israel and its function as the world's Jewish refuge is the primary reason for the value of housing in Israel. The land value in Israel was extremely low compared to the rest of the Middle East - neglected land, sparse population, lack of Ottoman investment - until Jews returned in the 19th century.

And thus the Jewish people, the greatest survivors in history, the most adaptive people in history (in my opinion), returned to their ancestral and indigenous land. But they did not do it until the modern world disappointed them.

And that modern world was the one forming in Western Europe, where Jews received emancipation and rights beginning in the 17th century. Those societies (French,

German, Italian etc.) succeeded relative to Eastern Europe, and their citizens were not occupied solely with survival.

These were people who went out into the world, built colonies overseas, and allowed their subjects to detach from local soil (to stop being serfs) and to hold wealth that was movable and not locked in local land. In other words: **gold** - the universal currency that enabled real mobility and was the foundation of the mercantilist economy.

Gold - the most precious thing that is also the most useless

We've moved from the prehistoric world, where the economy was mainly local agriculture with minimal global trade, into the beginning of modern economic history. In my view, the prehistoric economic era lasted until around the 17th century – until the moment Holland experienced the Tulip Bubble. From there, the story shifts entirely and ties itself to gold in a way it didn't before, continuing until 1971 – the year the world effectively detached itself from gold.

During the Middle Ages, the Black Plague wiped out about a third of Europe's population. It wasn't just a human tragedy – it was an economic earthquake. Suddenly, there was a massive shortage of labor. Farmers and serfs, who had been tied to land and forced labor, became rare and valuable. They could demand money. The nobility had to start paying. Agriculture weakened, cities strengthened, and within those cities emerged craftsmen, early industries, and the most dangerous new thing for the old order – money. The Renaissance began to accelerate, bringing with it science and literacy. That period also sparked the use of credit notes and gave real power to European banks and banking families (the famous Medici family, for example).

The world began to move. Money moves differently than land. It's mobile. It isn't tied to the seasons. Whoever was willing to detach from the soil and become a craftsman, a trader, someone who works with their hands and mind - could begin to move. This was a cultural shift before it was an economic one. And from there, it was only a matter of time before people began crossing oceans in search of something beyond their horizon. During the age of exploration (Christopher Columbus, Amerigo Vespucci and others) and the conquests of the New World, a flood of raw materials, knowledge and goods began pouring into Europe. And so, when Europe set out toward what would become known as "the New World," it found something that had drawn humans from every corner of history since the beginning of time, gold.

Over the years, Christians gradually loosened their attachment to fixed place (though even today, you'll still find many places in Europe where locals proudly tell you their family has worked the same vineyard for hundreds of years) and began to cross oceans in the name of trade - just like they "discovered" America while trying to get to India. The people who were willing to let go of the land and wander became conquerors and rulers, while many who stayed safely in the familiar homeland fell behind economically. One of the defining moments of that era came when the Spaniards sailed west and reached South America, where they believed they had found El Dorado (not really), mountains of gold.

Gold is important. (And here we jump briefly backward in time.) All over the world, humans tried different things as means of exchange and stores of value. On the Ivory Coast in Africa, they used shells. On the island of Yap, giant limestone stones. In China, bones. In many places - salt (that's where the word *salary* comes from, Roman soldiers were paid in salt). Spices like black pepper, cinnamon, and saffron were as valuable as gold, sometimes even more - entire expeditions were organized just to bring spices from India and the Far East to Europe. Silk, ivory, and gemstones also served as ways to store wealth.

But gold stood out for several crucial reasons. First, it doesn't decay, it doesn't rot like spices, doesn't break like shells, and doesn't rust like other metals. Second, it can be divided into very small amounts without losing value (try cutting a horse in half). Third, and most importantly, gold became the only form of payment naturally accepted anywhere in the world. If you arrived in China with black pepper, they might understand its value. But if you tried to pay in African shells in Persia, they'd probably cut off your head.

Gold is an idea that's essential to understand. Its value comes mainly from one thing - that someone else, somewhere else, at any time, will be willing to give you something for it. Even though gold has unique physical traits, it doesn't corrode, conducts electricity well, and is malleable, its economic value is far higher than its industrial or decorative use. It's essentially "natural money," chosen by humanity without any central agreement. Calling oil "black gold" is, in that sense, an insult to oil, which is far more useful to humanity. But gold is something that all of humanity, without planning or coordination, decided would be a universal store of value, a global measure of wealth through thousands of years of trade routes.

The greatest advantage of gold was its mobility and universal acceptance. A merchant could take gold from Cordoba to Constantinople and know it would be welcomed.

Spices were valuable but perishable, silk was beautiful but not useful to everyone – gold was always desired.

The flow of gold from the New World into Europe created the first true economic philosophy of the modern age, **mercantilism**. Mercantilists believed that a nation's wealth was measured by how much gold and silver it possessed, and that to grow rich, one had to export more than import, maintaining a positive trade balance so gold would flow inward. This was why European powers competed for colonies, not just for markets, but for the gold itself.

Spain, being closest to the source, became the richest nation in Europe for a short time – but also experienced one of the first modern inflations. When there's too much "wealth," prices rise. And from that point forward, Europe was in a constant race to find the next big thing, the "new gold." Something to bring from elsewhere to sell in Europe at a higher price than its import cost.

As I mentioned earlier, gold itself had little real utility beyond its appearance. Yet its price kept rising over time. That obsession with finding "the next gold" led directly to the first modern bubble, though I'd call it historical rather than modern, the Tulip Bubble in Holland.

Tulip Mania

Tulip Mania was a phenomenon during the Dutch Golden Age in the years 1636-1637, during which there was a rapidly increasing boom in the trade of tulip bulbs, which had only recently been introduced to the Netherlands, and their prices rose in a way completely disproportionate to their actual value. At the peak of Tulip Mania, in February 1637, the price of certain bulbs reached more than ten times the annual income of a skilled craftsman. The economic bubble intensified due to speculative trading, and at the end of the winter of 1637 it burst, and tulip bulb prices collapsed.

Tulip Mania is considered the first speculative bubble in history, and economists and market professionals often use the term "Tulip Mania" as an example of a financial bubble.

- From Wikipedia.

The Dutch collectively decided that tulips had a certain value, and slowly they lost their sanity. People substituted productive work for something that was not productive at all (tulips), something that could rot and therefore could not hold value in any real physical sense (plants rot and gold does not). And on top of that, tulips had high value only in the

Netherlands. The moment there was no one left to sell the bulbs to, the bubble collapsed.

This was speculation based not on something that could generate real long-term growth, but on the simple idea that someone else would buy later at a higher price. It was speculation based on price rising - not value rising. The inherent value of tulips is decorative.

Alongside the tulip bulbs themselves, an entire industry formed around the trade. People held assets that on "paper" looked extremely valuable, and that temporary feeling of wealth caused them to spend more than they could realistically afford. When local prices are inflated, outsiders spot the opportunity and bring goods from elsewhere to sell at high prices. Locals with better judgment sell overpriced assets and invest elsewhere. In the end, when the bubble bursts, the real money has already either left or changed hands.

Whenever a population behaves irrationally economically, more money leaks out. Whether it's foreigners extracting value, or locals who sold at insane prices and invested somewhere cheaper, or simply stopped spending at the right moment - timing a market consistently is almost impossible.

Another effect of such a collapse is psychological devastation. Talk to someone who was worth one hundred thousand dollars, then suddenly twenty million, and then found himself back at two hundred thousand. They are mentally destroyed. It's extremely hard to get them to move forward, invest again, or even spend normally even though they were twice as wealthy as the beginning. They will be fixated on the fact that "five minutes ago" they were worth millions - and now they have almost nothing. So bubbles don't only wipe people out financially - they freeze them psychologically for years.

This is why economies that experience major bubbles often take a decade or more to recover - it's not just that the money "disappeared", it's that people become afraid to invest, take risks, or even consume.

There are countless studies showing that humans focus more on losses than on gains. It's the same as people who panic when prices fall but forget the meteoric rise that came before. It all depends on where you start measuring and how you measure. The bubble began with Dutch prosperity, and the collapse pushed the Dutch into a recession that took them many years to recover from. Had they avoided the bubble entirely, they would have simply continued to prosper.

Tulip Mania is burned into economic history because it shows perfectly what happens when value is based solely on the idea that someone else will pay more later. A very

similar bubble happened recently in 2021-2022 with every "shitcoin" - digital coins with no real utility, that people bought only hoping someone else would buy at a higher price. Just like tulips, their value was local (specific internet communities), and when the new buyers ran out, the bubbles burst. And no, I do not include Bitcoin in that category - we will discuss that separately.

Why is this relevant to Israel today? Because in Israel we have the same question - is there a bubble in real estate? The country is currently experiencing the same psychological dynamic: a population that feels wealthy because asset prices rose. The question is whether the assets' intrinsic value is similar to what it is on paper, or have they become irrational.

The fundamental difference - on gold, tulips and Bitcoin

The fundamental difference between gold and tulips is that you could pay with gold even in China. If some Dutchman had shown up in the Philippines, Australia or Russia and tried to pay with a tulip bulb – they probably would have cooked him together with the bulb. Gold, on the other hand, was welcomed everywhere. And that is probably the strongest argument in favor of Bitcoin today: it's accepted anywhere by the local population. Even in China, where it's illegal, you can be sure there are locals who would still take it. This is maybe why authorities should have either moved quickly against it over a decade ago, or should have accepted and adopted it quickly. Authorities were too late to make a decision.

Tulipmania isn't important because of the bubble itself, but because of what it demonstrates: what happens when people detach from something universally accepted as a means of payment and begin using something new. The second thing it demonstrates is the idea of a **local bubble**. And this is exactly the huge difference between tulips and Bitcoin, which accepted everywhere on the globe. Bitcoin's price does not depend on daily use, but on its distribution. We don't pay with gold in everyday life, but a large portion of the population holds it and agrees that it has value.

Bitcoin's biggest advantage over gold is its portability. A person can walk around with billions stored in a wallet whose access he keeps only in his mind. With gold, there is no other way to do that. This is why personally I believe that it makes perfect sense for individuals to prefer Bitcoin over gold, and for large organizations to hold gold instead. Gold is much harder to steal. And hundreds of millions of dollars in Bitcoin are easier to steal than gold, and much more tempting.

The price, of course, is another story - and this is where valuation comes in. Valuing Bitcoin is extremely difficult, just like valuing gold, if not harder. Some of the variables are the size of the user base and its growth rate. On the other hand, relying on such metrics to value startups (especially during the social-media era) wiped out billions of investor dollars. This method was known as Metcalfe's Law:

"Metcalfe's Law states that the value of a communication network is proportional to the square of the number of users connected to the system (n^2). The law was first formulated by George Gilder in 1993 and attributed to Robert Metcalfe."

– from Wikipedia.

The rise in gold and Bitcoin in recent years makes many people drool and want to invest - and at the same time terrifies them. The high liquidity of the markets (especially Bitcoin) allows extreme volatility whenever public sentiment shifts quickly, and the sharp drops that happen in seconds make many people panic - while completely ignoring the fact that every time the drops end, the price ends up higher than where it started.

And here we return to valuation: when you know how to value something, you know how to identify a **wide margin of safety**. If you don't know how to value, and all you see is ups and downs, that's all you know about the asset – meaning you actually know nothing about it. You only know what Mr. Market thought about the asset at that specific moment.

And the final point: buying something just because "the price is going up" is speculative buying based on price increases that are not necessarily tied to value. Expecting Bitcoin to keep rising at the same pace just because that's what it did in the past – that's complete madness. A person must ask himself *why* he is buying something. Of course, more demand will raise the price when supply is limited. But you must consider reality. Tulips had a limited number of people who cared about them. In every bubble, eventually there's simply no one left to sell to, or the remaining buyers don't want to pay that price, or liquidity just dries up. That's a huge reason why, when people analyze the current market today, with all the data we have there is a clearer picture (although a lot of it is also hidden) they look first at liquidity and the amount of cash sitting in people's hands. M2 is a favorite metric.

And the critical point: the longer a speculative phenomenon lasts, the more likely it is that the speculation turns into something concrete – not just a temporary ghost. Bitcoin at 5 dollars was far more speculative than it is today. As the asset's usage grows and spreads from narrow communities to the whole world, the floor price – the level it falls to when speculation ends – will be higher. This allows more people to get rich along the way, and at the same time allows that “asset” to enter mainstream consciousness. Look at luxury watches, art and wine.

The bottom line is this, **more people and a longer period of time make something relatively safer, but also guarantee that speculation will eventually occur in it, only on a much larger scale (this in essence is the side effect heavily felt due to reflexivity, a subject we will be speaking about extensively later in the book).**

Meaning, in the end it almost always turns into a game of musical chairs. Even after 40 years. And the goal of every investor is not to be the one left standing without a chair at the end.

The aftermath of Renaissance for the Jews. Emancipation, and the Industrial Revolution

Out of the Renaissance emerged a wave of philosophical ideas that pushed Europe into a series of major cultural and political shifts. One of the most significant among them was the idea of Jewish emancipation. For the first time, Jews were given a simple promise: *“Integrate into society, become one of us, and we won't interfere with what you do in your own home.”*

But as Europe moved into the industrial and intellectual revolutions that followed, many Jews discovered that despite the promises the hatred toward them didn't truly disappear. The only way it vanished was through *complete assimilation*, a slow multigenerational process. In other words, escaping antisemitism in the diaspora required total detachment from the Jewish people – a process that the one who begins it will not be the one who “completes” it.

This is why, more than Jews returning to the Land of Israel out of ideological Zionism, many returned out of a deep sense of not belonging, and a basic need for physical and psychological security. It was another migration wave all due to the need of survival.

And this time, they chose the one place where they still knew, at least in some rudimentary way, how to work the land - the Land of Israel. The return was agricultural, physical, a rebuilding of homes and settlements.

After wanting to be a part of every nation that they were in, the Jews who really drove the founding of Israel ended up wanting what almost every other nation had, land, a country, normalcy – and they decided to establish the State of Israel. In many ways Israel is the global ghetto of the Jewish people. Except unlike the historical ghettos, where non Jewish guards stood on the walls preventing Jews from leaving with weapons pointing in, here Jews themselves stand on the walls, armed, with weapons facing outward, not inward. Israel is a ghetto by choice, not by an external force. And it serves as a refuge for Jews from anywhere in the world. This is why the law of the Jews will always be true as long as they exist. Just like any Jew who does not live in Israel, risks to be targeted by a member of the “majority” for being Jewish, Israel is the only place where he will not be targeted by a member of the “majority” for being Jewish. This is why rightfully so Jews in other countries are perceived as having a weird connection with Israel, whilst ignoring the fact that their own antisemitism and signaling out of the Jews is what forces this connection.

The Psychological Legacy That Still Shapes Israel's Housing Market

The failed experiment of emancipation, the Holocaust, and the mass expulsion of Jews from Muslim countries after Israel's War of Independence (which was in reality a civil war among the inhabitants of British Mandatory Palestine) all imprinted a single, unshakable truth on the population here: **there is no other country**.

Truth to be told for a large part of the Jewish population here, they are, by definition, geographically and politically trapped. Israel is a state of refugees who many do not hold a passport of the country they were forced to leave. Only a very small portion of immigrants throughout its history came out of true ideology (In my eyes, a genuinely ideological immigrant is someone who had a materially secure and comfortable life in their country of origin - and willingly gave it up for a Zionist idea).

This refugee identity is the real foundation beneath the Israeli housing market. It explains better than anything why Israel will never experience a mass emigration collapse like parts of Italy, Greece, or the Balkans. The only Jews who can be *safe* in the diaspora are those who commit to total assimilation and a full severing of ties with the Jewish people. It means that when they go to protest against Israel (if they do) they

cannot cloak themselves in their “Jewishness” to signal to their friends how righteous and virtuous they are.

The economic story of Israel begins here: Jews who chose, or were forced, to become Israelis **have nowhere else to live**, and at the same time, **there are those who want to harm them no matter what they do**. No matter how much a Jew tries to look like another nation, speak like another nation, or even fully assimilate and adopt the religion of the majority - if someone discovers he is Jewish, he may again be in danger.

This reality produces a survival mindset in Israel. For some parts of the population, this survival pressure generates extraordinary levels of resourcefulness, self-development, innovation, and readiness to fight (especially in the security establishment – alongside the expected mediocrity that exists in any large institution). It also fuels enormous local production: technological knowledge, research and development, defense industries, and the ability to create value from nothing.

From a real-estate perspective, Israel is tiny. Massive immigration waves created a chronic housing shortage. This shaped a culture where *landownership equals power*. As long as the population keeps growing, demand exceeds supply, and prices rise. Israeli demography skyrocketed, and many times there was not even remotely enough housing to provide to everyone.

In addition, most immigrants before the 2000s arrived with almost no capital. Even wealthy Jews from Arab countries, the USSR, or North Africa often lost their property or were forced to abandon it (history does repeat itself a lot if you are Jewish).

Although demand could push prices upward, the immigrants themselves lacked purchasing power. What pushed housing prices up was *rental income*, which then pushed purchase prices along with it. Housing prices in Israel were driven for the most part by the rental income they produced. It was a price increase based on income dynamics, not speculative frenzy. That is why no one spoke of a “bubble” back then.

The questions therefore are: **can this trend continue forever?**

Is there a limit to how many people want to come to Israel?

Is the demographic pressure permanent or temporary?

Many people who repeat “supply and demand” assume demographic growth is permanent (Israel has a natural population growth that is the highest in the western world. The average family size is 4-5 people). They may be right, but just like the amazing book *How To Lie With Statistics* explains, most people who quote stats rarely dive into the numbers or their deeper implications. It’s how you pose the question that

matters, and people tend to pose questions that will lead to the result they want, not the result that is more likely to happen.

Repeating a Key Point - the Advantage of Mobile and Liquid Capital

In every historical crisis, those with **mobile capital** and liquid assets were in the strongest position to survive and take advantage of a crisis. Real estate does not guarantee prosperity, it isn't liquid. In fact, in many cases, it is the one that suffers a decline that is like Hotel California –

“you can never leave” – the Eagles, Hotel California

Not all wealthy Jews moved to Israel. Wealthy Moroccan Jews moved to France. Jews from the USSR moved to the US and Canada. Mobile capital allowed them to choose alternatives that were better at the time.

Those who did come to Israel were masses with no capital, but with hands ready to work and minds capable of building wealth from nothing. Those who climbed the fastest were those whose knowledge matched the needs of the local economy, and not all knowledge is relevant here. A civil engineer who specializes in climates that have Ice and Snow all year round isn't very helpful in Israel.

The Unique Importance of the Land of Israel

This is the key factor that differentiates Israel from any other country: **the Jews have no other land**. That's the psychological engine behind the belief that prices “will always go up.” Limited territory, a global refuge function, and deep historical attachment. Every time antisemitism rises abroad, people in Israel immediately say: *“There will be a wave of immigration – prices will go up.”*

They ignore the fact that today the population is much bigger, so the impact of new immigration is far smaller. Additionally, Israeli purchasing power today is so strong that even wealthy immigrants do not necessarily outbid locals.

The average Israeli today is a very wealthy person on the global map, and even those who aren't, behave financially as if they are.

Chapter 3 - A Brief Summary and Points From the Tulipmania to Today

For all those hundreds of years, the Jews were something small inside this huge thing called “the world.” After the tulips, there were several other famous bubbles: in France there was the bubble sparked by John Law, and in England the South Sea Bubble, which wiped out even Isaac Newton and left him completely ruined. He was a man of means who invested his fortune at the beginning of the bubble, sold his shares for a huge profit, and then, after seeing the bubble continue, reinvested all his money again (capitulation is a phenomenon that happens in bubbles, when people who *know* there is a bubble can’t stand watching others get rich, give in to their impulses, flip, and invest their money anyway and get trapped in the bubble). In the end he lost everything and was completely impoverished.

"I can predict the movement of heavenly bodies, but not the madness of crowds."

- Sir Isaac Newton.

Newton's story teaches something important: even the greatest genius of his era could not withstand the psychology of bubbles. The problem wasn't a lack of intelligence, it was a lack of discipline. He knew he needed to get out, but he couldn't stop himself from going back in. This illustrates that in investing, discipline and psychology matter more than having a high IQ.

"If you've got 160 IQ, sell 30 points to somebody else because you won't need it in investing. What you do need is the right temperament. You need to be able to detach yourself from the views of others or the opinions of others."

- Warren Buffett

The reason bubbles keep happening again and again is the combination of real economic trends that create wealth, together with two biological-psychological sins: **greed and envy**.

Bubbles always start from something real: the industrial revolution was real; the internet is real; real estate prices really do rise when there are more people. But the problem begins when prices run far ahead of real value, because everyone wants a "slice of the pie" and no one wants to be the one left behind.

The Industrial Revolution

We feel terrible when others around us get rich and we don't, and at the same time we never know satisfaction - we always want more. The Renaissance was replaced by the Industrial Revolution, and suddenly the ability to create something out of nothing took on a new dimension that had never existed before. Now it was possible to invent new things and generate wealth based on activity, production and innovation. If creativity had previously been mostly artistic - painting, sculpture, literature - it suddenly also became technological and business-oriented. Instead of painting a beautiful picture, you could invent a steam engine and enrich yourself and everyone around you. The meaning of "creativity" shifted from personal expression to economic force.

Above all this stood a hierarchical culture in which wealth and power came mostly from noble status and ancient lineage, with assets inherited across generations. Opposite them rose a new population - the bourgeoisie, the nouveau riche, the new money. This created a deep social fracture: the old aristocracy, rooted in tradition and inheritance, against new entrepreneurs who relied on innovation and business ability. That clash

shaped the modern ideologies - conservatism, which tries to preserve the old, versus liberalism, which encourages change and innovation.

I want to emphasize that it is my opinion that major technological revolutions often create a kind of unemployment in what were considered white-collar professions of the era. In Europe before the Industrial Revolution, the “professional” labor force was made up of craftsmen who belonged to guilds, and they had apprentices who underwent years upon years of training.

The Industrial Revolution destroyed many of these professions, shifting manual labor to the production line. In economic terms (one of the core ideas capitalism rests on), it made sense to try to technologically replace the most expensive labor that doesn't require creativity or innovation and whose work is “monotonous.”

This process created massive changes in the internal political systems of European countries and accelerated global colonization. I have the opinion, that a way for the older elites to redefine themselves was through colonization and expansion of territories.

Different states tried to redefine their identities. They moved away from the old order, in which the social structure relied first and foremost on religion, and also on aristocracies who inherited their power from military ability. Fighting had been a crucial trait because much of the wealth of earlier eras came from conquering and holding land and exploiting its resources.

The new world revolved around the ability to invent, innovate and produce. This new world was built on philosophical ideas and ideals, and produced a new elite whose power came from the business world. European countries were in a search of identity, attempting to figure out the new purpose of their own souls.

The Soul of the Modern World

Europe drifted into wars within the continent, attempted to control faraway colonies, and eventually collapsed in World War II. After the war, only two superpowers remained. Russia sanctified the workers and the farmers. Its rival, the United States, sanctified both workers and creators, but instead of stopping at agriculture and basic industry, it celebrated entrepreneurship, innovation, and the creation of wealth out of nothing.

The only European superpower left after World War II was one that glorified both of the economic forces of the past. Russia carved into its banner the workers and the farmers. The Soviet Union had excellent scientists and engineers, but the environment did not

allow them to benefit from the competition and the free flow of ideas that characterize a free market.

So their blossoming had an artificial ceiling, created by human hands.

America, on the other hand, didn't just glorify production - it glorified those who invent, break molds, and create new value. That was the struggle that defined the 20th century: an economy based on physical labor versus an economy based on ideas.

Israel, was founded in the very heart of this struggle and inherited both approaches. On one side stood the collectivist-socialist ideal and the importance of physical labor (agriculture as an example). This is easily noticed in its health care and welfare systems. On the other stood the technological, business and conceptual capabilities of immigrants who came from societies where industry, entrepreneurship and knowledge already existed. That combination made Israel a unique society that succeeds both in agriculture and in high-tech.

As Israel became increasingly tied into Uncle Sam's pocket - becoming a country heavily dependent on the US economically - American cultural patterns penetrated deeper and deeper. American cultural behaviors entered Israeli culture (even if in a distorted version that is sometimes a bit funny). This cultural penetration did not happen only in Israel - but everywhere in the world.

But unlike the US, I opine, that **Israel does not have the privilege of abundant entertainment, leisure, and luxuries. The survival factor must always comes first.**

The American Capitalist Miracle

Amid the Renaissance and the Industrial Revolution, across the ocean, a new nation - or rather, a collection of states emerged and called itself the United States of America. Their promise was simple: a society without discrimination based on race, religion or gender (even though, in reality - throughout most of American history this was very far from the truth, but what mattered was that people wanted to believe it). The gap between the dream and the reality was enormous - slavery, the expulsion of Indigenous peoples, discrimination against immigrants.

And yet, the idea itself was revolutionary: your origins were not supposed to determine your destiny, and anyone could reinvent themselves. This pulled millions of immigrants who believed that in America they could become whoever they chose to be. The message was clear - if you want to belong, be American.

On a spiritual level, the United States was built by people of a certain temperament - the type who were willing to board a ship, land in New York, and begin a new life aimed at

personal economic prosperity. People who rode a train west to Kansas City - the last stop - and from there continued by wagon into Oklahoma and Texas, despite the personal danger.

These people were NUTS.

And even though America went through a gold rush, it did not sanctify only the gold-seekers, rather it honored those who created the jeans, a work garment born from a real need. A piece of clothing is just a piece of clothing, but jeans offered something practical, which is why they could charge more for them. Levi's, the company that invented them, still exists today - a fantastic start-up that turned into a company that has lasted for over 100 years.

This is why in the U.S people prefer those who sell the picks and shovels.

The American motto was, in theory if not in practice, equality of opportunity but not equality of outcomes - and this turned into almost mystical ability to generate value out of thin air. "Never doubt the American Entrepreneur". Not just producing products, but creating entirely new markets, new ways of doing things. Ford did not only build cars - he invented the assembly line that made them accessible to the masses. Edison did not merely invent the lightbulb - he built the foundation for the entire electrical grid. This is business creativity: not only solving a problem, but revealing problems no one knew existed.

The U.S benefited and still benefits from positive immigration of workers and people with no resources who arrived believing in the American Dream, a belief that allowed them to develop and grow. Americans sanctify the entrepreneur, the Self Made individual. Andrew Carnegie, who began as a railroad worker and became a steel magnate; John D. Rockefeller, who built an oil empire from nothing. In Europe, the aristocracy always viewed these new rich as nouveaux riches - new money lacking "real" status. In Europe, if you did not inherit your status, you were worth less; in America, if you created your status rather than inherited it, you were the hero, you were worth more.

Europeans sanctify aristocracy, which is why European culture leans heavily on the past - and why, in my view, aside from cars, historical sites and luxury clothing, Europe has little to offer. Europe is, to me, a monument to what once was, and the devotion to the past ensures a problematic present and an uncertain future.

Those who tied themselves to the Soviet Union did not enjoy to the same degree future developments, because the human spirit shapes the way an economy grows, and

government intervention usually creates crises rather than preventing them. Human beings are driven by incentives, by “what’s in it for me”. In the public sector, reward is not directly tied to outcome: a politician who wastes public funds does not pay from their own pocket, and if the project fails they will simply move to another position. In the private sector, if you waste money - you get fired or go bankrupt. This creates an enormous difference in efficiency. On the other hand, the private sector does not provide for those who cannot pay, while the state must care for people who receive services without contributing financially.

This is why, generally, politicians and anyone in the public sector (including armies) tend to be less responsible with money. The state is perceived as a bottomless resource - a phenomenon that appears even in giant corporations with too much cash, where inefficiency thrives simply because it can (Alphabet, for example, with its excessive employee perks). Thus, public-sector actors make moves that sound good externally, but the person who will suffer the negative consequences is for whoever replaces them a decade later. The need for political credit now creates extremely short-term thinking.

In a free-market economy, those who rise over time are the people who know how to manage with less - meaning they are efficient - and who invest extra resources in long-term goals even if it makes them look foolish today. Naturally, an economy driven by such people becomes wealthier - but the gap between these elites and the rest of the population grows.

This was one of Keynes's major insights (which we will expand on later): a free economy generates more wealth, but also much greater inequality. Keynes believed we need a balance - let the free market create wealth, but allow government intervention to reduce inequality and prevent crises. This debate still defines the global economy today.

Israel found itself in an interesting dilemma: on one hand it wanted to be like America, a land of opportunity that celebrates entrepreneurship and allows its citizens to elevate their quality of life through a free market. On the other hand, it inherited a strong socialist tradition from the kibbutz era. The result is a hybrid system: capitalist high-tech alongside an inflated public sector; technological innovation alongside suffocating bureaucracy.

The Israeli paradox is that the same country manages to be both one of the best and one of the worst examples of capitalism at the same time. On one hand, Israel may be the best place in the world for a smart person with no economic background to climb the social ladder - a penniless immigrant can become a millionaire through tech entrepreneurship; the army and academia provide real opportunities. The best "schools"

in Israel are nearly free for their "students" – The Intelligence branch of the military, or public universities like the Technion. In the U.S., even a public university costs more than many private institutions in Israel.

On the other hand, government corruption, suffocating bureaucracy, nepotism and crony capitalism create a closed upper class that widens the gap between rich and poor. The result is a society where a young genius can create a unicorn company, and at the same time entire families, where both parents are educated and working cannot afford to buy a home on their own, not because they lack talent but because the system favors connections over ability. And so, understandably, every sector feels that they are the ones getting screwed, because everyone here screws everyone else. There is no one who does not get screwed.

What I want you to take from this chapter

What I want you to take from this chapter is a basic familiarity with bubbles that grow out of the belief that “the price is going up” while completely ignoring the cash flow that the asset actually produces, or alternatively a speculative mistake in identifying when the pool of buyers willing to pay a higher price will simply run out. I want to establish a basic familiarity with a few evolutionary forces that quietly dominate the background when it comes specifically to the real-estate market (for example, I didn’t even talk here about something that is a major pillar in my own portfolio - the role of social status). I’m trying to highlight historical moments where something we believed would give us security (ownership of land) actually harmed many of the people who held that belief.

I want you to understand the connection between mobility and wealth throughout history. Those who succeeded economically over long periods were the ones who could adapt to change - Jewish merchants, American immigrants, Renaissance entrepreneurs. All of them chose to give up the supposed security of land in exchange for the flexibility of mobile capital and mobile skill. The irony is that the thing considered “safe” (land) often became the most dangerous once reality shifted.

I want you to grasp the difference between price appreciation and value appreciation. The tulip bubble, the dot-com bubble, and shitcoins - all were based on rising prices without real value creation. This principle is extremely relevant to the Israeli housing market today - are rising prices reflecting real value (more people want to live here, the economy is growing) or is it pure speculation?

I want you to internalize the idea that Jews returned to Israel as a survival response, not an ideological choice. This explains why Israel is a “ghetto by choice” and why the

psychological connection to land here is so strong. But it also reminds us that history teaches one clear lesson: there is no such thing as permanent safety - you must always be ready to adapt.

The main goal is to create a kind of mental liquidity, where nothing is locked, and the required mindset is one that is simultaneously paranoid and constantly questioning the existing reality - and ironically, this “pessimistic” worldview is exactly what enables optimistic behavior. When you expect bad things to happen, every surprise is upside.

I want you to understand that bubbles always start from something real. The industrial revolution was real, the internet is real, Israeli technology is real. The problem begins when prices run far ahead of true value, driven by greed and envy - “I don’t want to be left behind.” That’s why it is so hard to identify bubbles in real time.

I want you to understand the mechanism of how wealth “leaks outward” during bubbles. Foreigners see inflated prices and import goods to sell for high margins. Locals who are smart sell their assets for inflated prices and move to cheaper places. And by the time the bubble bursts, the real money is already gone. This happens in Israel as well when wealthy Israelis buy apartments in Berlin and Miami.

I want to challenge the dogma that real estate is always good and always safe. The reason I challenge it is that I see massive marketing campaigns pushing people to invest in real estate abroad, and everywhere salespeople wrap their story with emotional narratives. Because we are psychologically conditioned in Israel to see real estate as “safe,” that belief is exactly what puts us in greater danger. The deeper something is embedded psychologically and culturally, the more it blinds us to risks. Even in boxing, the punch that hurts you most is not the heavy punch you see coming, but the precise punch you don’t see at all.

The lesson from emancipation: Jews believed they could integrate into Europe - but discovered that in times of crisis they would still be the first to suffer. Germany, the place where Jews were the most integrated and the most successful, was exactly the place where National Socialism flourished and produced the greatest genocide in Jewish history. That is our greatest cultural legacy for why there must be a Jewish state, and why specifically in the land of Israel. The solution is not “moving abroad,” unless you intend to assimilate completely and hide your Jewish identity.

The Israeli paradox: a country that manages to be both the best and the worst example of capitalism at the same time. On one hand innovation and entrepreneurship in high-

tech; on the other, corruption and crony capitalism. A society where a genius can found a unicorn, but families with two working, educated parents cannot afford a home.

Our obsession with real estate in Israel comes from the fact that it is both our greatest strength and our greatest vulnerability. Again - what we think is safe is not necessarily safe. Great investors are not the ones who do all the same things as everyone else.

Great investors are those who understand that something is going to be far more successful than anyone imagines and act aggressively - or understand that something will be far less successful and avoid it entirely. **If you don't have a viewpoint that is deeper than the crowd, your returns will be the same as the crowd.**

About property values- That Israel is the state of the Jewish people - fine. That more people immigrate than emigrate - also fine. But you must be able to explain why the people who immigrate will have a stronger impact on housing prices (pushing them upward) than those who leave. I argue the critical variable is not simply the difference in numbers, but something else entirely within the same equation.

And most importantly - understand that our economic decisions are driven by deep evolutionary and cultural forces we are barely aware of. For example, the desire to buy a home does not stem only from rational financial calculation - it stems from primitive instincts of safety and the desire to raise offspring. Understanding these evolutionary and psychological forces is the first step toward becoming a more rational investor.

Chapter 4 - A Few Important Things From the 20th Century

Keynes

Keynes is one of the most brilliant economists in history, and perhaps the only serious economist who actually proved his theories by becoming a successful investor in the stock market (I am unaware of any other economist, including those working for investment firms, who was worth anything as an actual portfolio manager.)

He predicted the economic pressures that would eventually lead to World War II already at the end of World War I. His book *The General Theory of Employment, Interest and Money* still leaves me sitting with my jaw dropped to the floor, as his ideas are sharp and he manage to express powerful ideas in a handful of words what would take me pages to explain.

It's a shame that we don't teach basic economics as a mandatory subject in school, and that there isn't an entire school year dedicated to this man alone.

There's a joke among people who call themselves "market animals": no economist ever got rich from investing. The stereotype is simple, economists are great at predicting things that never happen, the best ones are right:

"Once in a row" – Howard Marks on market predictors

The one exception, the only one whose theory truly met reality and who proved it by being a good investor, is John Maynard Keynes.

Beyond all the genius ideas in his book, he lays out an idea that made me feel dumb for not understanding it earlier. It's an incredibly simple idea, and I want to focus on here. This isn't the part of his work people usually emphasize, so naturally the reader who is somewhat knowledgeable will assume that I want to speak about the concept that in a time of crisis the government must inject money into the system. His famous analogy: pay people to dig holes and fill them back up.

The idea is that during a downturn, everyone saves instead of spending, which deepens the recession. If the government spends it keeps money circulating. It doesn't matter what the money is used for, even digging pointless holes, as long as money moves, people work, they earn wages, and because they receive wages, they don't cut their spending to zero. They create their own efficient economic activity.

When the U.S. speculative bubble burst in 1929, the government and the financial system tightened the belt instead of injecting liquidity, which only made the crash worse (and it seems this is exactly what happened in China at the beginning of their recent slowdown). One of the things that helped pull the U.S. out of the crisis was that when FDR was elected in 1933, after several devastating years, he began injecting money into large government projects, also known as the New Deal, a process that accelerated even further with the outbreak of World War II. Keynes's legacy is still with us: in every crisis governments pour money into the economy (like during COVID), and if they overdo it, you get inflation, a built-in side effect of neo-Keynesian economics.

But this is not the part I want to talk about. I want to focus on another idea, seemingly marginal, but brilliant on a staggering level, because it describes with precision the global wealth gap, especially in the U.S.

The idea is this: **in any economic environment, there will always be a small group of people who will widen the wealth gap relative to everyone else. And the richer the society becomes, the larger that gap grows.**

There are three traits that create widening wealth inequality:

First, low personal needs. Some people simply need less to live. They can live with roommates, drive a cheap car (we all know the interview where Jeff Bezos, already worth \$10 billion, drives a basic Honda and is asked why not a luxury car — he answers: *it's a good car, there's no reason for anything else*), buy non-brand clothes, and eat simply.

<https://www.youtube.com/watch?v=OOmsLIZPaxA> – Jeff Bezos driving a 1996 Honda Accord at \$10B net worth

Second, skills that fit the era. Some people are born with traits that are perfect for the age they live in. Warren Buffett jokes about this constantly, his talent for investing fit perfectly into the period he was born into. Had he been born 200 years earlier, that talent would have been worthless.

"A thousand years ago, I'd probably be some animal's lunch" – Warren Buffett

Third, long-term thinking. Some people are naturally wired to plan far ahead, to think in very long horizons. This is rare and goes against basic human nature (highly recommended to listen to Scott Galloway on this).

These three traits create a situation where certain people spend less, invest a much larger percentage of their income compared to others earning the exact same amount, and are also able to earn far more because their skill set is perfectly aligned with the era. The result is a person who functions like a great business - low expenses, high income, and if they also know how to invest, their wealth grows exponentially.

In any society you will always find people who have one of these traits, some who have two, and a very small number who have all three. As a society grows wealthier, those with these traits become disproportionately richer. In other words: **as a society becomes wealthier, the distribution of wealth expands according to the distribution of these traits within the population.**

When all three traits converge, you get people who operate like highly efficient businesses, low spending, high earnings, and smart allocation of surplus. The wealthier the society, the more surplus these people have to invest, and the gap only grows. This explains why no matter what humanity does, inequality is permanent.

Funny enough, this is what communism came to address. However, in communism what matters most is political capital, which also leads to a difference of material wealth gap.

“Communism is a great idea, wrong species” – Jimmy Carr

<https://www.instagram.com/reel/DRZuMMODrqQ/>

(Please watch this, or here is a transcription).

*“Capitalism is a terrible system, apart from all the fucking others. A bunch of young people seem to have fallen in love with communism again. The fuck is going on? **Communism's a great idea, wrong species.** The Thing about capitalism is it kind of leans into what we are we're quite self-interested It works... (Jimmy Carr is asked by someone in the audience to define communism)... **from each according to their abilities to each according to their needs.** It just doesn't scale. Everyone is a communist. All of you are communists with your family. If you've got kids, you're a fucking communist at home. Each according to their needs, you take care of them.*

Of course you do. And as things get wider in your local community, you might be a socialist. You try and help everyone out. And then you get up to nation-state level and you go, yeah, fuck those guys... The problem with American communism, which is, you know, woke, is better described as American Marxism. And what it is, is instead of trying to redistribute wealth, which is a perfectly reasonable, the

thing they want to do, they want to redistribute status. That is a recipe for fucking madness” – Jimmy Carr

The best entrepreneurs, businesspeople and investors are those who spend less in the short term and allocate more resources to the long term. They think strategically and adapt tactically. There is a limit to how much a multi-millionaire can eat. If a high-income earner lives at the same standard of life as a normal family, he has a much larger percentage of his income left to invest. And if he also knows how to invest well, his growth compounds even faster.

So even as society as a whole grows richer, there will always be individuals who capture an ever-larger share of that wealth. From here, the conclusion is inevitable: **there will always be a small percentage that gets rich much faster than everyone else.**

This is why some wealth tax makes far more sense than increasing income taxes when it comes to wealth distribution, because they affect accumulated capital, not the creation of income. The divergence in wealth begins the moment someone earns more from capital than from labor, and from there it grows exponentially. High income taxes try to balance only one trait. Wealth taxes balance the wealth inequality problem.

Most of the public does not understand this, and therefore pushes (through politicians) for income taxes and consumption taxes (like VAT). They also assume that business owners are rich and therefore they support high corporate taxes, but in practice these taxes mostly hurt early-stage entrepreneurs. This is one of the reasons that in countries like Israel, the same families and tycoons remain at the top: taxation and regulation crush small and new businesses. Peter Thiel put it best: the more monopolistic a business is, the more it wants regulation and taxes, because regulation and high taxes wipe out small competitors. Big companies can hire lawyers and tax planners, small ones can't.

You might say that *you* don't push politicians to behave this way. But neglecting certain issues is itself a form of approval. While interest groups push aggressively, most of the public stays silent. Politicians almost always give in to those who act, not to those who ignore. Even when it harms the majority.

On Thinking Ahead

What I want you to pause and reflect on now is the idea of thinking ahead - the last trait I discussed, the one that allows a person to become an excellent investor. This trait simply isn't intuitive for most people. For nearly all of human history, people didn't live past a certain age, so we've been programmed - over tens of thousands of years - to deal with immediate problems: How do I get food today? How do I survive the coming season? How do I avoid an immediate threat? Our ability to measure time, understand the future, and plan long-term is fundamentally limited.

Even though financial awareness today is much better and people do think about the future from a young age, there are two major problems.

First, we still don't think far enough ahead. If someone is planning five years ahead, they probably need to plan ten. And if they're planning ten, they likely need to think twenty.

Second, our ability to grasp how dynamic the world is remains weak. We tend to assume that the world we'll live in a decade from now will be more or less the same as the one we live in today. This happens while ignoring the fact that we will change dramatically, as will the people around us. For thousands of years, the world changed very slowly, which is why psychologically we still operate like animals, hunter-gatherers, early agricultural societies. We must remember: deep inside each of us lie ancient mechanisms that shape our decision-making, and they are so ingrained that we barely notice them.

Today the world really is changing fast - but the feeling that it's changing *too* fast comes from the huge gap between our biology and the pace of modern technology (This ties back to Jared Diamond's insight about "latitude lines" - the idea that technologies used to spread only as fast as climate and agriculture allowed. It could take centuries for a horse, a plow, or a type of grain to reach a new region. Today, an idea can travel from India to Iceland in a minute.)

And here enters the psychological layer - and one of the most fundamental problems of the Israeli consumer:

“What, I don't deserve it?”

“What, I'm the only one who won't fly abroad?”

The average Israeli sees friends traveling, buying new cars, upgrading homes - and asks: why not me? Instead of comparing his life to past generations, who lived far

harder lives, he compares himself to the wealthiest neighbors. This leads to poor financial decisions - buying things he cannot actually afford, just to avoid feeling “less than” in the present. He fails to think about the long-term future.

We don't compare our health or material well-being to people of the past - we compare it to the neighbors.

And because social status carries enormous weight in Israel, people make decisions that may not be good for them in the long run. Most people simply give in to their impulses, think too short-term, and try to “keep up with the Joneses”.

As a comparison, after World War II, Americans let a genie out of the bottle. They created a generation that knew how to take advantage of a new world rising from the ruins. It was a generation that knew how to invest long-term and knew how to live modestly.

Sam Walton, Hewlett & Packard, Andrew Grove, the Watson family - all of them built companies and employed the veterans of *The Greatest Generation*. Combined with the GI Bill, this created one of the most educated generations in history, far surpassing their parents. These were hardened people, shaped mentally by the lowest places a human being can go. After you've spent two years sleeping in frozen mud in Europe or on mosquito-infested beaches in the Pacific - you don't need much to be happy when you get back home.

NIFTY 50

The biggest and most relevant bubble for today's tech giants is a bubble almost no one talks about. There are barely any books about it, and aside from Monish Pabrai (who mentions it rarely) and Howard Marks, it's practically invisible. Howard Marks often describes it like this (I'm paraphrasing — not quoting him word for word, just capturing the idea):

“When I entered the investment world in the early 1970s, everyone invested in the same 50 companies. These were considered the best companies with the brightest futures, and buying their stocks was seen as absolutely safe. There was no such thing as ‘too high a price.’ Anyone who put 100% of their money into those 50 stocks in the early '70s lost about 90% of their investment within five years.”

Who were the Nifty 50?

Companies like Coca-Cola, McDonald's, Polaroid, IBM, and General Electric, firms considered as safe as government bonds, only with growth. The idea with investing in them was simple, you buy them once, and you hold them forever.

The problem was also simple: everyone invested in the exact same companies, which pushed their prices to absurd heights, which ended in disaster.

The dramatic turning point came in 1973-1974 when the market collapsed. These companies didn't just fall with the market, they fell *far more* than the market because their valuations were so inflated. Anyone who bought the Nifty 50 in 1972 had to wait twenty years just to get back to breakeven. Excellent companies turned into terrible investments simply because the entry price was wrong.

Howard Marks argues that this event transformed investment thinking.

It destroyed the belief *that "a business can be so good that price doesn't matter,"* and replaced it with the opposite principle:

Anything can be a good investment - but only if the price is right.

"This is a safe buy, these are the best companies in the world, their future is bright..."

The story repeats itself every time. A great investor is someone who identifies these great businesses *and* buys them at a great price. Those who invest at any price always end up overpaying.

Israeli real estate reminds me of this, conceptually.

Every taxi driver and hummus shop owner says the same thing:

"Buy an apartment, it's always safe. Real estate prices only go up".

The same dangerous consensus.

The same feeling that "there's no such thing as too high a price relative to returns, that price is only relative to what someone else paid".

And when you ask about yield (rental income relative to price), the answer is:

"It doesn't matter, the price goes up."

I'm *not* claiming this is a bubble.

I'm simply trying to echo the questions I ask myself all the time:

Is this a bubble? What's similar? What's different?

But, and it's important to emphasize the "but" — there are always variables that are different, and those small differences are what make all the difference. And no, I'm not saying that anyone who invested in Israeli real estate or in the tech giants is going to lose 90% or even 50% of their money.

What I *am* saying is that social consensus is usually what creates bubbles.

Bubbles have three consistent characteristics:

1. **Social consensus** - "Everyone knows this is a great investment"
2. **Disregard for price** - "It's so good that the cost doesn't matter"
3. **Suspending economic laws** - "This time is different, the old rules don't apply"

There's another principle that almost no one talks about.

People love to demonize George Soros for his political involvement, but if there's one thing he's undeniably brilliant at, it's spotting a social consensus that's about to blow up in people's faces.

Soros's theory of reflexivity says that in markets:
Perceptions shape reality and reality shapes perceptions.
It's a feedback loop, until it breaks.

Reflexivity

"When I see a bubble forming, I rush in to buy, adding fuel to the fire. That is not irrational."

- George Soros

<https://www.youtube.com/watch?v=oCaCrWzFPYY&list=PL-Rlq65k6r6-3ZpHkgP0R1Xi8ZqWZnlfB&index=2>

(His lecture series, and I highly recommend reading his books, including *The Alchemy of Finance*.)

The idea behind reflexivity is simple: **when the public believes something will happen, people take actions that make it happen.**

Examples:

1) Rising stock prices.

If everyone believes a stock trading at \$120 is headed to \$160, they start buying it today, which pushes the price toward that exact prediction.

This is why I never take analyst price targets seriously. If an analyst is so sure that a stock will rise thirty percent, why doesn't he put his own money into it? Analysts recommend - they don't buy. And if they buy and it doesn't go up, shouldn't they be buying more? This is why price targets are silly, and I am sure many in the industry agree with me, however they are still willing to participate in these shenanigans.

If the market as a whole genuinely believes prices will rise (and not because of a buy recommendation), people buy immediately, accelerating the outcome.

That's why markets are described as *forward looking* - they price the future, not the present.

2) Inflation.

If people believe the price of goods will rise, they start buying today. Sellers see demand spike and raise prices. Others see prices rising and rush to buy as well, pushing them up further.

This is exactly why COVID created inflation - people feared shortages, so they hoarded toilet paper and dry goods. Their behavior created the very shortages they feared.

There was an increase of demand, at the same time that there was a supply shock, add liquidity to the mix, and you will have inflation (I took a big bet on rising inflation the moment the fed cut rates in 2020).

3) The Israeli housing market.

Everyone “knows” home prices always go up. So people hurry to buy before it becomes “even more expensive.”

That demand pushes prices up, confirming the belief.

4) Bubbles.

A bubble forms when an asset reaches its highest price precisely when belief in it is strongest. The more people are convinced something is true, the more aggressively they buy - which forces the price even higher. That’s the paradox of bubbles: **they peak when confidence is maximal**. What sets Soros apart, along with the people who worked with him like Stanley Druckenmiller and their friend Paul Tudor Jones and more (*More Money Than God* is excellent reading), is their ability to spot these reflexive loops and know when to pull the plug right before the system blows. They are among the very few investors known to have timed markets successfully more than once.

As Howard Marks often says (paraphrasing):

*“Most people who become famous in our field made an accurate call **once in a row**”*

Stanley Druckenmiller is known as the investor who almost never misses, and Soros was the one who told him when to go all in. This is why Druckenmiller describes himself as an investor with a high batting average and Soros with a higher slugging percentage.

Outside this tiny group, it is extremely rare for anyone to time the market consistently.

That’s why the cultural motto became: *“You can’t beat the market.”*

What usually happens is that early entrants to a bubble eventually realize the price has drifted too far from reality and begin selling to newer buyers. This continues until the pool of greater fools runs out (or simply the buyers cannot afford the higher prices).

Then sellers are forced to drop prices, which triggers reflexivity in the opposite direction. People stop buying because “prices are falling,” forcing sellers (who need to sell) to cut even more. Over time, these cycles create trauma and volatility.

The Nifty Fifty bubble followed exactly this pattern. The more investment managers believed those 50 stocks could never fail, the more the belief strengthened itself. And the sharper the rise, the more violent the fall.

But bubbles almost always require an external spark to burn down the forest.

For the Nifty Fifty, the match was a combination of Fed policy shifts, the 1973 oil crisis, Vietnam, Watergate, and then inflation. Suddenly, the belief in America’s economic invincibility cracked, and the whole structure collapsed.

From that point on, almost every piece of economic news was interpreted negatively.

My own view is this:

When a bubble is developing, the market ignores negative news. At the peak, the accumulation of bad news slowly becomes heavier than the good. When prices

begin to drop it seems that all news is bad news, and when good news begins to reappear the market ignores it. At the bottom because everyone is so pessimistic, all negative news is already priced in.

The lesson for Israel:

When everyone is convinced that real estate always goes up, that Israeli tech is “invincible,” and that taking a huge mortgage is smart because “property only rises,” that is exactly the moment to be cautious.

It’s not that every small downturn triggers a crash.

It’s the pattern: after every dip comes a new all-time high - until the cycle flips.

When a bubble bursts, the opposite happens: every small rebound becomes a lower local peak, followed by a sharper drop.

The longer a bubble lasts, the higher the likelihood it has drifted far beyond fundamentals.

The importance of the 1970s

While the dramatic changes of the 1970s were unfolding in the United States, the Soviet Union was beginning to crack. The American system was going through a historic transition from an industrial economy to an engineering economy, and what happened in that decade became one of the key turning points of the modern economic world.

The U.S. was battling high inflation that was finally crushed only with even higher interest rates. The two oil shocks - in 1973 and 1979 - exposed how dangerous it was to depend on physical raw materials. When Arab countries imposed an embargo, the American economy shook. The conclusion was clear: the future of wealth was not in oil or other natural resources (and indirectly not in how much gold you keep in a vault), but in ideas and technology.

In the same decade, the Soviet economy began to decline, while China started its path back onto the global stage. For centuries, up to the 16th and 17th centuries, China had been one of the most advanced societies in the world. Then came isolation, the Opium Wars and British imperialism, dragging it into a “century of humiliation” - economic and cultural. To make things worse, Mao Zedong devastated the Chinese economy instead of lifting it, with policies like the Great Leap Forward and the Cultural Revolution. Only after his death in 1976 did Deng Xiaoping launch reforms that transformed the country. Within forty years, China moved from poor backwater to the world’s second-largest economy.

The Chinese have always been a nation of merchants and scholars. A large share of the wealthy in Southeast Asia are descendants of Chinese immigrants. Once China was given a chance to recover - through opening up to trade with the U.S. in the 1970s - it

ran with it at full speed. The country sprinted from an agrarian economy to an industrial one, and is shifting to an engineering economy.

An engineering economy is one based on knowledge, design and innovation rather than on raw materials and manual processing. A computer worth thousands of dollars is made of plastic and silicon that cost a few dollars - most of the value is engineering and design. Engineering marvels often require relatively few physical inputs compared to the value they deliver.

This is where the beauty of the American economy lies: the ability to create value out of thin air - what Rory Sutherland calls "magic".

And once you accept that a clever piece of engineering can squeeze far more value out of the same raw materials, it no longer makes sense to anchor money to gold held in a government vault. I am not claiming this is what motivated Nixon's decision, but in hindsight it was the right move. Sometimes people make the right decision for the wrong reasons.

Until then, national wealth was measured by the treasures in the state's vault, mostly in gold. Government money was either metal coins supposedly worth their weight, or paper notes that were simply a promise: bring this note to the treasury and you will receive a fixed amount of gold in return.

But once a country's main "product" is no longer just raw materials plus physical or chemical processing, and it can instead generate wealth through design, code, brands and ideas, basing its entire monetary system on pieces of metal stops making sense. You could collect all the gold in the United States and compare it to America's ability to create more wealth - the gold cannot produce more gold, but Americans can produce more jobs, more products, more ideas.

That is exactly what happened in the U.S. - physical manufacturing moved to places like China and Mexico, but the design, marketing and brands stayed in America. Apple doesn't *make* iPhones - it *designs* them. The value sits in the idea, not in the factory. In a country where value is defined not by the physical weight of material but by the conceptual weight of the brand, you get a type of growth that is no longer limited by mines or fields. America showed the world that you can generate wealth through ideas, design and narrative. The same bag that costs 100 dollars can be sold for 800 once you put the right logo on it. The same phone that costs 300 dollars to produce is sold for 1,000 dollars because of user experience and branding. It's not just matter - it's identity. I can take that same 100-dollar bag, slap a logo on it and convince you that because the brand owner sits in Paris rather than in Sydney, it is worth more. I can do the same with a smartphone, and sell you an iPhone at a much higher margin than a Samsung or Huawei. Or Air Jordan versus Adidas. A McDonald's burger versus some other local foreign fast food burger. That's the magic of marketing (go watch and read Rory

Sutherland's book 'Alchemy'). Ordinary coffee was originally sold as an "experience" at Starbucks. They took regular sports shoes and turned them into a "lifestyle" with Nike. It's not just a product - it's an identity. The Americans are marketing experts. They have two insane marketing machines - Hollywood and the music industry. They exported "Californication" to the whole world.

"It's understood that Hollywood sells Californication" - Californication, Red Hot Chili Peppers

The clearest proof came in 1990, when McDonald's opened its first branch in Moscow. Hundreds of thousands of people stood in endless lines. They weren't there for a burger - they came to taste the American dream.

McDonald's opens in hungry Moscow, but costs half-a-day's wages for lunch, 1990

<https://www.youtube.com/watch?v=ckbfS99N6jY>

(Yes, I'm a nerd. I have no idea how many videos like this I've watched, how much I've read about the fast food industry, and how many hours I've spent just watching branches operate - even though I never planned to invest a single dollar in them. I just wanted to understand how the industry works. And if you own McDonald's stock and you didn't know this story, you should be asking yourself a hard question: why does someone else know something I don't about a business I'm invested in and he isn't? That should bother you. It should light a fire under you to go study much more).

It was never just about burgers - it was about capitalism, about the American dream. Muscovites stood in line for hours just to taste capitalism. It proved that American power was not in tanks, but in brands. In my view, companies like Disney, McDonald's and Starbucks are American geopolitical assets. When they weaken, the U.S. weakens with them. **This is a concept that Chinese government understands.**

Modern economics was born the moment the U.S. left the gold standard in 1971. The dollar stopped being a piece of paper backed by metal and adopted a new identity: a claim on the productive and creative power of the American people. America effectively told the world: lend us money, we'll invest it in our citizens, they'll create wealth, and we'll pay you back with interest.

The dollar became a currency backed not by bars of gold, but by the innovative capacity of a nation. The whole world wants to invest in American companies, study at American universities and buy American brands. That is what holds up the dollar and what enables the modern global economy.

To understand the "capital" behind a country's currency, **you have to remember that in principle, everything inside a country can, at any moment, be nationalized.** In the end, everything belongs to the state if it chooses to take it. The people decide if and when - through the government they are ruled by.

From that point on, modern economies tried to behave more like businesses. They encourage growth in order to increase future tax revenues. They try to balance between investing and taking profits. But unlike a private business that fails and goes bankrupt, a government can print money. The incentives are totally different. A business owner who pays employees who add no value goes bankrupt. A government that does the same just issues more debt.

That difference explains why one economy booms while another collapses. The U.S. can borrow more and more in its own currency - many other countries cannot. On the other hand, this ability to borrow endlessly created an addiction to debt and a structural dependence on it.

One nation quickly concluded that it was better to go down the free market route, and to do it via creating wealth from ideas rather than from raw materials - and it chose to tie its fate to America. Sounds familiar? That would be Israel. This went hand in hand with the concept of trust. Israel trusts America because it has never betrayed it and never betrayed their Jewish population.

Israel hitched itself to the U.S., joined the engineering revolution and managed to generate local wealth almost out of thin air, all from Israeli brainpower - high tech. Israel did in the Middle East what America did globally: it exported ideas instead of oil. While its neighbors sold what they dug from the ground, Israel sold products that stemmed from the brain. We'll get back to high tech when we reach the 2010s.

At a very practical level, leaving the gold standard meant the following: every dollar used to be backed by gold under the Bretton Woods system. After 1971, a dollar became a promise that if you give it to the Americans, you will get back "X" amount of goods and services produced by the American economy. It also meant the U.S. could raise money by issuing more debt: through its bonds it was essentially saying to lenders - lend us your money, we'll invest it in our people, who will generate wealth, we'll take our cut via taxes, and pay you back.

The dollar is backed by American output. The more they grow, the more profits there are for the government to tax. That is why the dollar remains the dominant currency in the world. Everyone wants exposure to American companies, American brands and American universities - that demand supports the currency.

So modern economics, broadly speaking, is built on these ideas: a state that seeks to encourage growth today in order to harvest higher tax revenues tomorrow. The goal is

to “take a percentage” without killing the host. Think of it like a business owner who wants his company to thrive while still being able to pull out dividends for shareholders.

There are many actions a government can take that do not create additional wealth - like taking profits from successful activities and pouring them into losing projects, or paying salaries to people who add no value, instead of investing in education and skills that will expand the productive base of the economy.

The problem is that governments, unlike private businesses, do not experience failure in the same way. That is precisely why governments are usually bad at allocating resources. In the private sector, only those who allocate resources well survive. **A government survives by maintaining the illusion that it is better than any alternative.**

The Modern World – A World of Mobility, Of Not of Being Tied to a Land.

Between the United States and Israel sit places like Dubai, China and Japan.

The 1970s were a decade of global inflation. In 1973 the Arab states imposed an oil embargo that left a deep scar on the American economy. It was a “punishment” for U.S. support of Israel, and it created a massive supply shock. When the supply of a critical input is suddenly cut off, its price spikes – and with it the price of everything that depends on it. At the time, a huge part of the American economy was based on industry and the movement of physical goods, and “working from home” was not an option. The embargo triggered one of the worst inflationary periods in American history and produced a “lost decade” in the stock market.

I want to pause here and add a small point that I think about a lot. Back in early 2020, I wrote an opinion piece arguing that semiconductors are the new global commodities. If China were to invade Taiwan, we would see a similar supply shock in chips. Demand for chips is rising constantly, while supply is trying – and struggling – to keep up. If supply suddenly falls, these chips will experience rising demand and falling availability at the same time. Because chips are now embedded in everything (just as metals or other raw materials), the modern economy cannot function without them – even without any further innovation. The result would be broad inflation, not just for Hyperscalers, but across every layer of the economy.

This is exactly how I think about the lesson of the 1970s and why it is so relevant today: when the supply of an element that the entire economy depends on suddenly stops (oil then, semiconductors or even vehicles during COVID), prices can spiral out of control and trigger extreme collective behavior. Anyone who didn't learn the lesson of the 1970s repeated the same mistakes in 2020–2023.

In the 1970s, following inflation and interest rate hikes, the stock market shifted from an environment in which Warren Buffett said he couldn't find anything worth investing in (early 1970s) to an environment where the market collapsed under runaway inflation. The Federal Reserve fought inflation by raising interest rates, managed to bring it down, and then ignited it again with rate cuts that came too early. Eventually, in the early 1980s, Paul Volcker, the Fed chairman, crushed inflation by raising interest rates to extremely high double-digit levels. The jump to 18% worked because it forced a deep recession – people stopped spending and stopped taking loans. It killed inflation but also created massive unemployment. The lesson: sometimes the cure is more painful than the disease, but without it, the disease kills.

Howard Marks framed his first mortgage contract and hung it on the wall of his office – the interest rate was over 18%. And here we are crying about 6%. That little anecdote hovered in the background of the macro environment in 2020–2023, and probably throughout parts of 2024 as well. Knowing that history, I have to admit, helped me navigate successfully (and not only safely) already in early March 2020.

Japan

After the American economy began to recover (until the surprising 1987 crash, after which the market continued upward, creating a bull market in the US from 1982 to 2000), Japan entered the engineering revolution at full force and seemed to appear out of nowhere to pose massive threat to American industries. In the 1980s and 1990s, Americans were genuinely alarmed. They thought the Japanese were about to overtake them quickly, and they spoke about Japan in economic terms much like they speak about China today. Japan threatened Intel, the auto industry, and a long list of sectors that had been considered “American territory.” Some of those confrontations were the direct inspiration for Andy Grove's autobiography *Only the Paranoid Survive*.

And yes, Japanese asset valuations had become wildly inflated, so a temporary crash in asset prices was due. But the deeper reason Japan struggled to recover was that it eventually hit a wall – not a technological wall, but a cultural and demographic one. Birth rates were extremely low, and the country refused almost entirely to encourage

immigration. Demography turned into a trap. When a population ages and there aren't enough young workers to support and produce, the economy slides into a spiral of stagnation. Europe and South Korea are experiencing a similar dynamic today. Israel, thanks to high fertility rates and an ability to generate some immigration, has largely avoided this trap.

At the same time, Japan's inability to "cut excess fat" for example, letting go of inefficient workers because of their seniority, locked its economy into decades of stagnation. For almost thirty years, the Japanese stock market went nowhere, despite endless attempts to "revive" the system through zero-interest rates and massive government stimulus. Japan simply got stuck in time.

During that same period, the Americans did something extraordinary: they opened the gates of their education system to the entire world. They invited the brightest minds from everywhere to study at American universities – and not just study, but stay. The United States became a magnet for human talent: Google, Tesla, and countless other companies were founded by immigrants or children of immigrants. The US attracted not only economic migrants from the developing world but also the global intellectual elite, the most brilliant young people from every continent.

Unlike most of Europe, the US managed to integrate these immigrants into its economy and society. People from almost every country of origin stayed in America. Only one country succeeded in drawing many of them back: China.

China – and Another Reason for the Wealth Gap in Western Economies

The Chinese embraced the engineering revolution with full force, produced an enormous generation of engineers, and countless young people drew inspiration from the American entrepreneurial ethos, launching thousands of companies and ventures. In the early stages, China became the world's industrial engine. While in many Western countries factory workers lost their jobs, their place in the global middle class was taken by people elsewhere — and many of them were Chinese.

Here I want to highlight an idea I have never heard anyone else express, and some of these ideas are enough to read what I write. At any given moment, there is a certain amount of wealth in the world. It is distributed unevenly among people and nations. Some countries are extremely rich where an average middle-class citizen would instantly be in the top decile of a poorer country.

Globalization shifted many jobs to other nations. For some workers in Western economies, this meant becoming poorer or unemployed if they failed to retrain. For firms, the shift increased efficiency, enabling them to pay higher salaries or grant larger stock-based compensation to employees whose roles remained or who managed to transition into more modern professions. This is why some companies fired large segments of their workforce while simultaneously raising executive pay. Those who lost their jobs sank in global economic rank, while workers in poorer countries who suddenly gained better-paying manufacturing jobs rose in global standing.

There is only one scenario in which the standard of living in third-world countries can rise while Western citizens maintain the exact same position in global wealth rankings: poorer countries must remain poorer, in relative terms, than the wealthy ones. It is impossible for *everyone* to rise simultaneously without someone else falling behind in relative terms. A Western worker may keep the same lifestyle, but he will watch his CEO grow wealthier because that CEO capitalized on global wage disparities, and shareholders reward him for doing so. You can have organic local growth in poorer nations (I can argue that there is a reason why this doesn't happen so easily) but globalization is an enhancer of growing wealth inequality in wealthier nations.

While American factory workers lost their jobs to China, the children of China's new industrial class went to study engineering. Yet beneath the surface, a new problem was forming, largely due to government intervention. A whole generation grew up under the one-child policy, where two parents could invest all resources in a single child. Many families preferred sons. Daughters were abandoned, given up for adoption, or pregnancies were terminated. This created a unique demographic crisis: a massive surplus of men.

In a society with far more men than women, a man must own property to be considered "marriage-worthy." At the same time, local governments, eager to stimulate growth, pushed for the construction of real-estate cities across the country. Without a cultural tradition of investing in the stock market, Chinese households poured their savings into concrete and steel, real estate.

Millions of Chinese bought apartments in empty "ghost cities," in places no one actually wanted to live. They assumed that someday these cities would fill up, or that someone else would buy their units at a profit. But that never happened. Instead of more people chasing a limited number of homes, the opposite occurred: because of the demographic crisis, there were fewer people and more apartments and houses. And because real estate is highly leveraged, even a small drop (relative to the stock market) in prices becomes a massive crisis. Real-estate crashes are rare and perhaps occur only once every few decades but when they arrive, they are devastating, because **the real estate market is highly leveraged by nature.**

The Chinese government, determined to push growth at all costs, issued cheap loans to people who never should have received them. Local governments borrowed unimaginable sums to fund useless infrastructure projects. This created oversupply in areas with no demand, and severe undersupply in areas with very high demand. It led to extreme competition over quality of life. Those with money lived close to employment centers; those without money spent endless hours in traffic.

Traffic jams are a showcase of planning failure. When the most productive people in a country waste two hours a day commuting instead of creating value, it is economic suicide. In Israel, a person living in Herzliya and working in Tel Aviv can easily waste ten hours a week in transit, an entire workday. This is lost time, lost productivity, and lost potential from the people whose output matters most. Those with money live in luxury apartments near work (the Israeli equivalent is central Tel Aviv); those with less money commute from Petah Tikva or Netanya.

And this brings us to Israel. The phenomenon of purchasing apartments with subsidies in the periphery by residents of central Israel is strikingly similar to the Chinese dynamic. Apartments meant for young families in Kiryat Gat, Afula, or Be'er Sheva are purchased by Tel Aviv investors who assume prices will rise "because real estate always goes up." They do not ask whether the region can actually develop, whether quality employment exists, or whether real households will ever want to live there. This is entirely different from an investor in Ramat Gan who, if needed, can live in Petah Tikva. But move to Ofakim? That's an entirely different story.

And this is exactly the dynamic that destroyed China: vast construction in places with no real demand — no jobs, no services, no community. The result in China was ghost cities: tens of thousands of brand-new apartments standing empty, investors waiting for buyers who will never come.

If Israel isn't careful, it will follow the same path. The state will pour billions into infrastructure and subsidies for housing in cities no one truly wants to live in, while the center, where demand is real, continues to suffer from severe housing shortages and poor infrastructure due to poor and insufficient planning.

Mass construction in the periphery, combined with investors purchasing units in places they will never live, mirrors precisely the real-estate bubble that crippled China. And bubbles built on empty land, absent community, and hope instead of reality tend to end the same way.

If the state truly wants, and rightfully so, to encourage migration to the periphery, it must start where every successful region begins: **jobs**. Offering substantial tax incentives for technology, finance, and advanced-industry companies is a proven way to create voluntary migration of strong populations into regions they previously ignored. That is exactly what Dubai and Ireland did and it worked. Just look at what is happening to Austin, to Miami, to Denver in the last 5 years.

Demographic Differences

The example of two countries that led major engineering and technological revolutions Japan and China, now face demographic crises that have spilled over into economic crises, each accompanied by its own investment bubble.

For Japan, the bubble was in equities; for China, it was real estate.

Interestingly, the Chinese stock market, despite its dramatic decline, was not in my opinion in a bubble. Companies like Alibaba, Tencent, and Baidu, even after years of growth, still trade at valuations far below their American counterparts. What suppressed their prices wasn't excess optimism that ended, but rather **government intervention**, coupled with fears of a potential Chinese invasion of Taiwan. Investors simply refuse, for now, to pay Silicon Valley multiples for Chinese tech. That may change or it may not.

Europe, meanwhile, faces a demographic crisis of its own, but unlike Japan, South Korea, or even China, it also failed at the engineering revolution.

As Mohamed El-Erian put it, the world today resembles a structure of *the good, the bad, and the ugly*:

- **The United States - the good**, with innovation-driven growth.
- **China - the bad**, with immense growth colliding with demographic decline.
- **Europe - the ugly**, where both engineering capacity and demographic resilience have faltered.

The immigrants Europe did manage to attract largely failed to integrate.

While the United States successfully absorbed both high-skill immigrants (engineers, entrepreneurs) and low-skill labor, Europe succeeded in neither.

As America expanded its cultural influence across the globe, Europe lost cultural footholds within Europe itself. The world experienced Americanization; Europe, in contrast, experienced Islamization and Africanization.

Here lies the decisive difference:

- **America offers a dream: “Come be American.”**
- **Europe offers welfare: “Come be an immigrant in Europe.”**

America attracts strivers.

Europe attracts welfare-seekers.

The result is structural: America receives entrepreneurs; Europe receives a population, part of which seeks to integrate, and part of which seeks to transform.

Only **a few western countries** enjoyed sustained population growth, 2 of them are: the United States and Israel.

America had the American Dream; Israel had its own national dream.

Both experienced explosive, unexpected growth.

I remember Israel in 2004, when I was ten years old: the country felt underdeveloped, perpetually behind. Everything that existed in the U.S. arrived years later, if at all.

Fifteen years later, the gap had disappeared. Israel caught up.

I didn't realize it as a child, but Israel was already on its way to becoming **the Exit Nation**, not the “Startup Nation” it likes to call itself.

“Exit Nation” means a place where entrepreneurs build companies not to operate them for decades, but to sell them - to Google, to Meta - and start again.

This cycle of rapid creation and acquisition turned Israel into a global **tech power**, though not a global **business** power.

The fundamental reason Israel closed the gap with the world from a wealth perspective, despite its lack of natural resources, is the same reason the United States became the world's engineering center.

Dubai followed a similar logic: the poorest emirate in terms of oil reserves used every dollar of oil revenue to build infrastructure, tourism, and a financial hub, an act of economic engineering.

Israel had no oil to begin with, so it had to allocate its scarce resources from day one. Instead of economic engineering (building a global financial center), Israel chose **engineering in the literal sense**: electrical engineering, software, aerospace, all through the vehicle of the IDF.

The Israeli military became a compulsory technological university. Units like Talpiot, 8200, and Mamram select some of the country's brightest 18-year-olds, train them in environments where mistakes cost lives rather than investor money, and release them at 21 with real-world experience that no academic institution on Earth can provide at that age.

After World War II, the United States did something similar. It recruited millions of soldiers from every corner of society) and then sent them to college through the GI Bill. People who had never considered higher education suddenly gained access to it. The same pattern exists in Israel: after military service, young Israelis pursue degrees. Israel has one of the highest per-capita rates of people with higher education in the world. This means more people with the tools to turn ideas into products, concepts into businesses, and creativity into wealth. The massive enrichment of Israel over the last twenty years is directly tied to this educational expansion. Most parents of my pre-army program cohort had no academic degree; almost every person in my own cohort went on to obtain one.

The electrical revolution provided the foundation for the computer and for electricity-based technology. Intel pushed the world forward, year after year, under Moore's Law. Most technological progress was hardware-driven, devices, chips, machines. With one exception: a company that during the 80s built its empire on software rather than devices.

Microsoft as a sign of the Software Revolution – and the Meaning of Profitability

Profit margin is the percentage of revenue that remains as net profit, this is one of the most important concepts in business. A software company that keeps 40% of every dollar it earns lives in a completely different universe from a car manufacturer earning 5%. This fundamental gap between hardware and software reshaped the entire structure of the modern economy.

Until the 1970s, most technological progress came from hardware: machines, chips, metals, factories. Microsoft was among the first companies to grasp the structural advantage of software, you build the product once, and then sell it millions of times with almost no additional cost. Windows was written once, but sold in billions of copies. A car factory must build each car anew: raw materials, labor, logistics, warehousing. Software belongs to another realm entirely. The initial development is expensive, but the marginal cost of each additional copy is nearly zero. That is where software's extraordinary

profitability comes from. It is also why software companies are obsessed with market share, and why short-term profitability often matters far less to them than it does to traditional manufacturers.

This quiet shift from hardware to software in the 1970s became a turning point in economic history. As programming languages became easier and personal computers spread, a massive wave of software companies emerged. The market flooded with applications, tools, and digital infrastructure, forming the foundation of today's tech economy. For Israel, this was a gift: unlike Detroit or Osaka, you didn't need a factory or hundreds of workers. Four friends after military service could write lines of code within months and build a product worth millions. Software eliminated barriers to entry. It democratized value creation. It allowed small teams to build empires.

But while technology was changing from the bottom up, the financial system was changing from the top down. Since the 1980s, the United States has lived in an era of steadily falling interest rates. Low rates allowed more people, and more companies, to borrow, and then refinance again and again at lower rates. This is classic "kicking the can down the road."

The pressure to become profitable quickly diminished, perfectly aligning with the nature of software companies, which require time and scale before profit emerges. Decades of rate cuts allowed weaker players to borrow money they otherwise couldn't, and strong players to borrow far more, pushing unprecedented amounts of liquidity into the global system. Central banks took the ideas of Keynes and Milton Friedman and injected them with steroids. Keynes believed that government spending can jump-start a stuck economy, as the U.S. did under FDR. Friedman showed that monetary contraction helped trigger the Great Depression. Modern governments took both ideas, government spends more, the central bank injects liquidity and pushed them far beyond their original scope. After 2009 the world couldn't raise interest rates back to normal. Then came COVID-19, and governments spent like drunken sailors.

This is how the modern economy was born: a system built on the hope that cheap money creates growth, and that growth will tame inflation. These are still the hopes of governments. And for many years, it seemed to work, but not for the reasons most people imagine. Two massive deflationary forces masked the true cost of money-printing: globalization, driven by "just-in-time production," which dramatically increased manufacturing efficiency; and technological progress, which reduced the prices of most consumer goods. These forces allowed central banks to create more and more liquidity without seeing inflation in supermarkets.

But the money went elsewhere, into assets.

And so the world split into two realities: coffee and televisions got cheaper, while real estate prices and stocks soared. Why? Because Walmart employees working the cash register weren't buying equities, but Google engineers were. The newly printed money flowed mostly into the hands of those who already owned assets, and they bought more.

That's one of the core reasons global wealth inequality exploded.

In Israel, the phenomenon was extreme. Between 2008 and 2022 the economy boomed. Asset prices surged. The shekel strengthened as Israeli exports broke records. Housing prices skyrocketed, yet inflation stayed low, at least until COVID and October 7th. In the U.S., the pattern held too, though the government's massive deficits eventually pushed it harder and further.

But when the liquidity mechanism is pushed too far, it turns destructive. Countless books describe this dynamic (David Landes, and in more popular terms Ray Dalio). Excess money triggers runaway inflation, which accelerates through public psychology. To break it, the central bank is forced to raise interest rates sharply. At the same time, governments try to "support the economy" by spending more, which only worsens the problem if the money flows into unproductive sectors. The result is a toxic cycle look at today's Turkey: soaring inflation, extreme interest rates, and a government still pumping money into an inefficient system.

Israel lived through something similar in the 1980s. The government interfered in the Bank of Israel (see the book *Bank of Israel* by Maman & Roznek), injected money to create an illusion of growth, and channeled funds into unproductive sectors. Meanwhile, the banks pressured customers to buy shares of the banks themselves as a condition for loans, a manipulation that inflated bank stocks. When the bubble burst, bank shares collapsed, savings evaporated, and rents exploded under inflationary pressure. It became a national trauma. Israelis lost faith in the stock market and transferred their collective hopes into real estate. A whole generation grew up being told: "The stock market is gambling, buying an apartment is safe, at least you will have where to live".

This scar still shapes the psychology of the housing market today. And in the late 1990s, the huge immigration wave from the former Soviet Union added intense demand for housing, reinforcing the pattern.

All of this, the software revolution, falling interest rates, money-printing, globalization, and Israel's unique cultural trajectory, merges into one narrative.

It is the story of the world's transition from the age of metals and machines to the age of code. It is also a story of group psychology, government interventions and liquidity.

A Fundamental Problem We Israelis Have - But Not the Only One

Uneducated, Ignorant and only critical of others who do not think like us, or we feel are beneath us

One of the deep, structural problems in Israel is how unsophisticated we are in understanding our own economic history. While the United States has layers upon layers of accumulated knowledge — established financial newspapers, serious media outlets, endless economic literature, and a deep historical consciousness — Israel has only a handful of economic newspapers, most of which are so politicized that they often just plagiarize American content without understanding it. We talk about “Qatargate” as if “Watergate” were an Israeli historical reference. We throw around concepts that don’t belong to us, chase whatever is trending, and skip the context entirely. It’s an economic infantilization of a society that has not truly studied its own story.

And this leads me to a question that drives me crazy:

How is it possible that in every discussion about housing prices or why Israelis fear the stock market, no one, absolutely no one, brings up the 1980s?

Not a word about the collapse of the bank stocks.

Not a word about triple-digit inflation.

Not a word about the fact that the state and the financial institutions caused the public to lose everything, and then walked away as if nothing had happened.

How can anyone understand the psychology of the Israeli who refused to invest in the stock market without understanding what he, or his parents, lived through?

How can anyone understand why “an apartment is safe” became a religion, without remembering who taught the entire nation that investments are gambling?

The answer is simple: we just don’t know our own history.

And that’s a deep cultural failure.

Israel, as a state and as a society, suffers from mediocrity in many areas: in public administration, in journalism, in basic economic education. Yes, we are a smart nation, but not a sophisticated one. Our only stroke of luck? We have extraordinary engineers.

The Israeli Growth Engine

And here I need to be honest:

These engineers, many of whom are friends of mine, can sometimes be truly unbearable. In the boom years of Israeli tech, when salaries went crazy, a whole cult formed around the phrase “I’m in high-tech.” People who just yesterday were sweet kids from Ra’anana suddenly behaved like demi-gods who thought they invented electricity. Even I felt the whole thing was getting absurd. And the truth? Sometimes the success did go to their heads. But, and this must be stated clearly, these exact people are the reason this country doesn’t look today like Lebanon or Jordan. It’s these engineers who built an industry that now produces 15% of Israel’s GDP and 50% of its exports.

They are the ones who put Israel on the global map.

Without them, we would be an import-dependent economy that dreams of being Switzerland but behaves like Albania.

And if criticism is due, it’s not toward the engineers themselves, it’s toward a state that leans on them like a junkie craving another dose of oxygen. It’s a criticism of a government and society that fail to build an additional economic engine. It is a criticism of the fact that the success of the high-tech sector is not a “national success,” but the success of a small group carrying the entire economy on its back and yet people have the nerve to call them “detached.”

These people come from every layer of Israeli society, from every socioeconomic background, every ethnicity. And yet both they and the broader public often fall into the same trap: **sometimes seeing only the forest when they should see the trees, and sometimes seeing only the trees when they should see the forest.**

And despite it all, it is the engineers who saved us technologically and economically- and who are also the ones going to reserve duty again and again, sacrificing themselves in every direction. Some of them are doing both things simultaneously. They may be annoying sometimes, self-important sometimes, sometimes disconnected from the social implications of their success — but they created the greatest economic revolution this country has ever seen.

They turned Israel from a country that, in 2004, looked like a late imitation of Europe, into a country closing gaps with the major powers.

They turned ideas into code, code into money, and money into growth.

They created the only industry in Israel that does not depend on gas, on real estate, or on a volatile currency.

They made this nation one that can create value out of thin air.

Every one of us, every citizen in this country, owes them a great deal.

And I emphasize all of this because in Part III of the book, I will explain why I believe this population group is about to face a major shock — and the shock they experience will affect the entire country.

This group is also composed mostly of people who originate from higher socioeconomic backgrounds and who grew up between “Hadera and Gedera.” That too is a problem. They are disconnected, not economically, not ethnically, but geographically. The political parties that claim to represent them forget about Beit She’an for three and a half years and remember it only a month before elections. This same population tends to march like a herd, even while believing it is more intelligent than everyone else - and how could they not be hated for that? They sometimes radiate elitism without noticing. Our country has filled itself with baseless hatred, populism, and neglect. The phrase “The destruction of the Second Temple happened because of baseless hatred” did not come from nowhere.

When the Romans laid siege to Jerusalem, one faction of Judeans burned enormous food supplies held by another faction because they didn’t listen to them politically — they wanted control over the food.

Jerusalem fell without the Romans having to do anything.

The internal Jewish fighting did the work.

Blaming social media is just throwing responsibility away — ignoring a historical human pattern. It absolves every person from doing the most basic civic duty: learning history and applying it.

“Those who cannot remember the past are condemned to repeat it.” — George Santayana

A stupid and trendy saying

And there is an even deeper point here:

Since October 7th, it became fashionable to say:

“I love the people, but I hate the state.” – too many people over the last few years

As if the state is some external monster, not a product of our collective choices.

It’s a fundamental misunderstanding of what a state is.

The people = the state = the institutions = the government.

We elected the people who run this place. We are the culture that produced them.

We are the DNA from which they grew. If we don’t like what we see, the problem is not “up there.” It is here. With us. In our culture, our habits, our lack of education, our abandonment of **long-term rational thinking**. A nation gets the leadership it deserves, for better or worse. And that applies equally to those demonstrating against Netanyahu and to Likud voters. We all created this outcome. We all are eating from the same bowl of porridge we cooked.

That bowl is October 7th.

That bowl is the war that followed.

That bowl is unaffordability for very simple things.

Ask yourself a simple question. Are you happy with the education system? Are you happy with the health care system? Are you happy with transportation? Do you feel safe?

Part 2 – The Balance Sheet of the Israeli Public

Chapter 5 – The Asset

As I said at the beginning, if we want to understand the state of Israel, we need to approach it the way an investor evaluates a business. **That's my mindset.** The first step is understanding the “big story” - what the business does, what its concept is, and where it stands in its competitive landscape.

The second step is diving into the balance sheet - identifying its assets and its liabilities. In Israel, an enormous share of the population holds real estate both as an asset and as a debt holder. A person who owns two apartments with mortgages - and who also holds bank stocks through his pension fund - is effectively holding both the loan and the collateral. This is the engine of wealth in Israel, but also the source of its greatest economic risk.

So in this section, we'll try to understand what real estate actually *is*, in the broadest sense.

Markets Are a Pendulum

One thing worth remembering is that markets behave like a pendulum. They swing between optimism and pessimism, and the range of movement changes over time. Sometimes they drift into unrealistic optimism - euphoria - and sometimes into extreme pessimism - outright panic. Assets can become far too expensive, and then far too cheap.

And that pendulum can get stuck on one side for a very long time - then move suddenly and violently.

Even during the dot-com bubble, prices didn't rise in a straight line. In 1998 there were scary moments on Wall Street - moments when it felt like the bubble had already burst. Then it inflated even further.

The Magic of Perspective -A Thank You to Rory Sutherland

There is a point that the brilliant Rory Sutherland repeats endlessly - and it's one of the most important insights for understanding economics in general, and real estate in particular.

Rory loves to explain that sometimes a “great product” is nothing more than a matter of perspective. He often illustrates this through marketing rather than product quality. His classic example is wine: people prefer a \$50 bottle over a \$10 bottle, even when it's exactly the same wine. The price becomes part of the experience. A high price *signals* quality, even when it tells us absolutely nothing.

Cars make the example even clearer: most people assume that a 200,000-shekel Mercedes is “better” than an 80,000-shekel Hyundai - even though both get you from point A to point B safely and reliably.

However, no one walks into a car dealership and asks: “What’s the most expensive car I can afford?” Nobody buys cars this way. But in real estate? that flips.

Real estate is almost the only category where people *start* with the question: **“What’s the maximum I can pay?”**

And then they go and buy the most expensive apartment their budget (and the bank) will allow. This is a completely different psychology.

If the bank tells you that you can take a 2 million shekel mortgage, you immediately begin looking for apartments priced around 2 million - not apartments for 1.5 million that might make you just as happy, maybe even happier.

In other words: when buying a home, people don’t ask “What’s the smartest long-term financial decision?” They ask “How much can I push myself?”

This shift - from logic to emotion, from analysis to a psychological ceiling – this is one of the key reasons real estate markets behave so irrationally.

These questions have begun to enter Israeli mainstream thinking only recently - but they are still far from dominant. This is primarily because rising asset prices during rising interest rates made it impossible to make the payments.

The Era of Falling Interest Rates - And Its End

From the 1980s until 2022, the United States (and much of the world) experienced a nearly continuous decline in interest rates. Forty years of falling rates created entire generations who got used to the idea that after every crisis, interest rates drop even lower - and when interest rates fall, money flows out of deposits and bonds and into assets.

Money moved away from fixed income and migrated toward *equity* assets - stocks, real estate, private companies, startups.

We became conditioned to believe that asset prices can only go up. Every time the markets wobbled, the central bank lowered rates and “saved” the system.

But now?

Rates are high, inflation is threatening, and the Fed *cannot* simply cut rates the way it used to.

In an opinion column I published recently, I explained that a major rate cut today would reignite inflation - and inflation is the most dangerous threat to both the American and

Israeli economies. The inability of central banks to bring rates down like before means one thing: **The game has changed.**

Interest rates will stay higher - and asset prices will eventually have to adjust to a new reality. So all those waiting for dramatic rate cuts should prepare themselves: **Even when the cuts arrive, they won't be the cuts they were hoping for.**

From the 1980s to October 7th

Throughout this entire period, from the 1980s until today, the United States experienced explosive growth. Part of that growth was real: entrepreneurship, innovation, and technological revolutions. Part of it was “artificial,” built on cheap debt and endless credit. A significant portion of this wealth leaked into Israel through the high-tech sector. The local tech industry latched onto the Silicone Valley economy that was accelerating rapidly, and as a result, a widening gap began to form between tech workers and the rest of Israeli society.

In practice, two separate economies emerged inside one country:

Economy A – the Israeli high-tech economy:

Where a 30-year-old engineer can afford a four-room apartment in Tel Aviv and pay prices that make no sense relative to the rental yield (people invested in Tel Aviv because of “appreciation,” which was really just multiple expansion⁹).

Economy B – the rest of Israel:

Where a nurse, teacher, or public-sector employee can only dream of buying a four-bedroom apartment in Petah Tikva. When both groups compete for the same housing, it feels to the group b that the asset is out of reach.

Another major beneficiary of this new wealth was the Israeli public sector and the ecosystem that feeds off it. As state revenues climbed and salaries rose, more money flowed into tenders, public salaries, and managerial compensation. Many of these workers also entered the real-estate market (estimates suggest that about 20% or more of Israeli apartments belong to public-sector workers). And as expected: when incomes rise and credit is cheap, people buy property.

The entire real-estate ecosystem ballooned, developers, contractors, brokers and money trickled through the entire economy. Everyone, everywhere, wanted to buy an apartment. Before we talk about the FOMO that took over the country, we will examine the investment logic, or lack thereof.

⁹ Multiple expansion is the increase in a company's valuation multiple, such as the price-to-earnings (P/E) ratio, without a proportional rise in its earnings.

Buying an apartment in Israel turned into a national frenzy. Almost nobody stopped to do a DCF analysis or even basic financial reasoning. People just saw their neighbor “get rich” on paper and kept hearing: “*Hurry! Buy now before it becomes impossible!*”

Historically, this is exactly how bubbles form.

The uncomfortable question: Is the housing market in a bubble?

I don’t know — and we won’t try to answer that question directly, because it’s the wrong question in the first place.

Instead, we need to understand the mechanisms and psychology behind it.

Before continuing, a few key points must be established so there is no misunderstanding:

- Buying a home is primarily driven by something deep and primitive.
- It is also cultural, shaped by national traumas, collective memory, and social conditioning. The desire to “hold onto land” is drilled into us at school and at home, a memory of 2,000 years of exile and also a reaction to the financial crises of the past 50 years.
- These forces act as a **baseline support** for prices. People will do almost anything to secure a permanent home before they let their family slide into instability. Imagine telling your children who each have their own room “we need to move to a smaller place and you’ll share.” Moving is the solution of last resort.

More points:

- Real estate has historically proven itself. With leverage, it allows for rapid wealth creation.
- Israel’s purchasing power rose dramatically due to the tech boom.
- Low interest rates gave leveraged investors outsized returns.
- Real-estate cycles easily span 40–50 years.

Israel shows every classic sign of a bubble

- A cultural *consensus* that “you must buy now or you’ll regret it.”
- Aggressive leverage, including people borrowing against pension and education funds.
- And the key reflexive point: even if prices were irrational five years ago, the fact that the trend continued made the *bad* decision become a *good* one in hindsight.

This is the essence of bubbles: Even investments that were intellectually wrong at the start turn into profitable decisions **because the bubble itself carried them upward.**

But something may have changed — after October 7th

We will examine this only after we understand the “asset side” of the nation’s balance sheet. But in short:

- **Debt has changed:** interest rates are much higher including mortgage payments (most Israeli mortgages has a built in Adjustable Rate).
- **The cost of living went up.** This means that people are struggling with making ends meet.
- **Income may change:** AI threatens tech salaries, and the war hampered economic stability and growth.

Where we go from here

Our goal now is to understand how to approach an apartment as an investment at the most basic level, and to understand what separates professionals from amateurs (most of us are amateurs; unless real-estate investing is your full-time profession, you are an amateur).

We will then examine whether rational decision-making is actually the norm in Israel, look at the public has evaluated risk, and most importantly, identify the real drivers behind the rise in housing prices.

Finally, we'll ask:

What needs to happen for the trend to continue?

What needs to happen for it to reverse?

And it is up to you to figure out, where do you think the Israeli housing market will go?

Good luck to us.

A Very Important Summary of Several Critical Points

Three massive forces have been dominating the economy. Two of these massive forces strengthened global purchasing power for decades: **technological progress** and **globalization**. Both forces are inherently *deflationary*, they reduce the cost of goods and services. They were so powerful that even extreme efforts by central banks to *create* inflation, aggressive rate cuts and massive quantitative easing, failed to push consumer prices up as expected. This explains why, for many years, people enjoyed cheap consumer goods, computers, TVs, flights abroad, despite governments printing unprecedented amounts of money.

But on the other side of the ledger, we witnessed **asset inflation**: housing prices soared, stock valuations stretched to unprecedented multiples, and private companies were sold at prices detached from their profits. Countless startups losing money year after year were acquired for billions, often with excuses like “we’re buying the technology” or “we’re buying the team”, arguments that repeated research has shown to

be rarely economical.

But that world has now changed, and changed profoundly.

Interest Rates Have Risen, and That Changes Everything

Higher interest rates produce two enormous shifts:

- **Less money chases assets.**

Now you can earn a return simply by putting money in a deposit account, buying bonds, or holding other debt instruments. Investors no longer *must* chase housing or equities at any price. This allows investors to move down the “Risk Curve”.

- **Equity type assets become riskier and more expensive.**

When money becomes costly, leveraged investments become less attractive, and the risk of bankruptcies rises. This changes how nearly every asset in the world is priced.

For 40 years, people lived in a world where “interest rates only go down.”

Now that premise is gone — and most people still haven’t digested how big that shift really is.

“Interest rates are to asset prices what gravity is to the apple,” - Warren Buffett

The World is Less Global, and That Makes Everything More Expensive

Trump-era tariffs were just another nail in the coffin. The global direction has fundamentally reversed during Covid:

- Less free trade
- More tariffs
- Less efficient supply chains
- Reshoring and local manufacturing
- Higher production costs — not necessarily with better product quality

Just because a local factory produces a refrigerator at a higher price doesn’t mean the fridge will be *better*. It simply costs more. The result is clear: **higher prices, lower efficiency, and less value for money, less bang for your buck**. This weakens purchasing power, reduces consumption, shrinks savings, and ultimately lowers investment.

A World Turning Upside Down

These are monumental changes in a world that spent 40 years moving in the opposite direction, especially in the last 15 years, when the internet connected the world more tightly than ever and interest rates hit zero. Anyone in their mid-20s during the 2010s made huge financial gains despite the trauma of 2008. Younger generations (like me) entered a world that is much harder to invest in. But on the flip side, **we have a huge advantage**:

Previous generations are mentally calibrated to a world that *no longer exists*. Many of them will make mistakes because they are unable to adjust to the new rules of the game.

Howard Marks and the “Sea Change”

When Howard Marks published *Sea Change* (a term Wall Street overused for a few months, like it does with every trendy phrase), everyone kept asking him what it meant. His answer never changed: **interest rates are going to stay higher than they were before. If earlier they were between 0-2 percent, not they will be between 2-4 percent.**

What nobody asked him — and what few people discussed - were:

1. **The risks created by higher rates**, and
2. **How to price those risks**, which is Marks' area of expertise.

And *almost no one* (besides El Erian) talked about the second big shift: The unraveling of globalization, a process that started years ago, intensified during COVID, and is accelerating now with tariffs. Even if all tariffs disappeared tomorrow, the world is still moving toward *less* globalization.

So Where Does This Leave Us?

Three major forces made the world wealthier over decades:

1. **Falling interest rates**
2. **Ultra-efficient global supply chains**
3. **Technological advancement**

Two of them have undeniably reversed:

- Interest rates have risen
- Supply chains have become costlier and less efficient

The huge question mark is **AI**:

Will artificial intelligence be deflationary enough to counteract these reversed megatrends?

Or will it *worsen* the problem, at least in the short term, by creating a large wave of unemployment, especially among white-collar workers, the middle class that forms the backbone of housing demand?

The Investment Called Buying an Apartment\House

The first layer is simply understanding the asset. An apartment is a single product whose purpose is to house people in a specific location, and its pricing begins and ends with the purchasing power of the local population.

Let's start with a basic fact that people often forget: real estate is one of the investments most influenced by macro-economics. We'll get to that in a moment, but first we need to say something that's the complete opposite of what the media tries to make us believe:

Most of the time, macro news doesn't really matter at all.

News channels, podcasts, newspapers, they all need and create drama. They want us to think that every interest-rate announcement, every central banker's remark, every headline, changes reality. Even professionals and "experts" need us to feel that way. They talk as if the stock market or bond market "signals" something and that they can act like shamans that can help us to predict the future or guide us through the chaos if we invest with them or buy their analysis and research. In most cases, it's just noise and there is no way to validate the quality of their analysis. Real estate is a slow, heavy, illiquid asset. Macro events get absorbed even more than in the stock market into long-term multi-year trends. Just like in equity markets: the short term is ruled by the story of the week, while the long term is dominated by trend. There's no "daily chart" for an apartment the way there is for a stock, but we still get daily headlines, because in Israel housing is a national obsession. Yet headlines are not economic reality. And now we begin to go deeper, layer by layer.

An investment apartment is, before anything, a business with one service\product.

The correct way to think about an investment apartment is as a small business with a single service: providing housing to a specific local population.

Think of it like a hotel with one room:

- The competing "hotels" - are all the other apartments in the area.
- The "customers" - the tenants.
- "Occupancy" - whether someone is renting or the apartment sits empty.
- "Price" - determined by local supply and demand.

If there is an oversupply of apartments rents fall. If there is a shortage rents rise. Simple economics of supply and demand. The first thing to check is the occupancy rate in a specific area. **This is why real estate is a macro game.** There is a very small limit to how much extra you can charge as a great operator.

You are dependent on the neighborhood, the city, and the country far more than on yourself. And in Israel, a country the size of one large metropolitan area, the entire market is heavily shaped by the gravitational pull of Tel Aviv and Jerusalem. If you live in a home you own, you should think of it as if you are your own customer.

Purchasing power is the central axis

If the local population becomes wealthier, purchasing power rises and rents can rise.

If the population becomes poorer, their purchasing power falls and they won't be able to pay current rents.

In Israel, in recent decades, a very clear pattern appeared:

- Salaries rose
- Physical goods became cheaper (TVs, computers, flights)
- The extra income *could* have gone to leisure, but instead largely went to housing

In reality, the share of household income devoted to housing grew steadily, both in rent and in mortgage payments. And why are people willing to pay a higher mortgage than their equivalent rent? Because paying down your mortgage is perceived as an *investment*, while rent is perceived as an “expense that disappears.” That’s psychology, and it matters.

In some cases (could be few or many depends on the situation) it is a saving vehicle and can be an investment. This depends on interest rates, rental rates and their inflation, and multiple expansion.

The hidden costs of living in your own apartment

A person living in a home they own, tends to make upgrades they would never make if they were renting it out to someone else. Even if they would easily tolerate the current condition of the property if they rented it. Psychologically (with a well-documented human tendency to believe that things we own and have invested in are worth more than they actually are), people think that renovations, customizations, and “upgrades” always increase the value of the home, even though potential buyers might feel the exact opposite.

This leads homeowners to spend tens or even hundreds of thousands of shekels believing they are “improving” the asset, while in practice they get no financial reward for the upgrades, and sometimes even reduce the appeal of the property, this is especially accurate when people renovate to bring the property up to the current design fashion, that will look hideous to someone 5, or 10 years in the future.

We all believe that we have good taste. One of the main advantages professionals have in property improvement is their familiarity with upgrades that cost little but can be sold at a much higher premium. The less professional the owner, and the more they perform personal, taste-specific upgrades, or fashionable ones, the more likely they are to fall into this trap.

Understanding the Product

Housing is an essential product, and because of that, even during severe economic crises, its price rarely collapses immediately. The problem is that this perceived stability creates an exaggerated sense of security — a belief that real estate is always safe. That illusion often leads to poor risk management which, at the extreme, can trigger deep economic and social crises. Therefore, before anything else, one must understand

the market they are operating in, to avoid being trapped inside such a market. The massive challenge in a non-liquid market like real estate is that you can't simply "exit" when you want to get out. You must have a deep understanding of the area in which you choose to operate in order to not get caught in a situation like this. The nature of leverage might make you try to bail for the exit when the doors are locked.

Because the real estate market is driven by macro forces, you must understand: **Who are the economic players? What economic "rings" does your area belong to?**

To explain what an "economic ring" means, I'll use a metaphor I like:

Imagine a large puddle into which you toss a stone. From the point of impact, expanding rings form, each weaker than the previous as they move away from the center.

This is exactly how regional economies behave.

For illustration, I'll use Haifa, but imagine any metropolitan rings you know in your own region. The "stone" for Israel's economy actually lands far away, in Silicon Valley. The first ring in Israel is Tel Aviv. The next ring is Jerusalem. Only after that does the wave reach Haifa. Haifa has its own industry and local economy, but the major drivers of regional wealth come from hubs like Nvidia (formerly Mellanox) in Yokneam and the Matam tech park. Jerusalem, on the other hand, is unique, a rare combination of two highly stable economic engines: the state (public sector) and religion.

Peter Lynch once joked that when the stock market crashes, people start praying.

Jokes aside, these are two economic engines that do not disappear in a recession.

Government jobs are cut far less than private-sector jobs, and religion does not fade during uncertainty. Religious centers are stable worldwide, Rome in Italy is a classic example.

Tourism is another source through which nations enrich themselves, but Israel's most profitable engine is engineering and technology. Despite being a major exporter of defense equipment, margins in that sector are lower, and so are salaries. Haifa therefore benefits from economic growth that starts elsewhere and trickles down, while also relying on its own industrial and commercial base. Real estate prices should rise in direct proportion to the local economy's ability to export, produce, and improve productivity.

If Nvidia's new Yokneam campus is built, for example, it will directly affect real estate prices in Yokneam and the surrounding area.

The Advantage of the Local Investor

The greatest advantage a local real estate investor has is that they *live* the market.

The farther an investor is from the area, the higher the likelihood they will misjudge the local population's purchasing power. The worst scenario is investing in a place you *do not know at all* — without understanding its demographics, employment landscape, or economic dynamics.

Charlie Munger once spoke about a friend of his, John Arrillaga, a man who lived his entire life in Palo Alto and became a billionaire through local real estate. Mohnish Pabrai described how you could point to any random building in Silicon Valley, and Arrillaga would tell you almost exactly what its rent was and what it would sell for. He simply bought when the market was too low and sold when it was too high, because he understood the area intimately. Silicon Valley benefited from massive immigration of high-earning workers, most of whom weren't local. That gave Arrillaga an enormous advantage: *he* understood the market; *they* didn't.

The less you know an area, the harder it is to understand what is really happening there.

Even if you grew up somewhere but haven't lived there for years, you won't know the market like someone who lives there today. You *can* consult friends and family, but people who show up in a region simply because they heard of an "opportunity", with no understanding of the terrain, almost always pay a premium for their ignorance.

The Nature of Rent, the Split Between Rent and Property Prices(Multiple Expansion) - What It Really Means

Rent is the business-side of real estate. When rent becomes disconnected from the property's price, that disconnect itself becomes the focus for the main question:

Why? To answer that, investors often rely on several well-known **rules of thumb** when evaluating real-estate investments. These aren't formulas — they're quick filters that help professionals eliminate bad deals instantly.

The 5% Rule Annual

This rule helps determine whether it's better to **own or rent** in a given area. This is used as a metric to gauge housing affordability. It also helps a real-estate investor understand the economic and cultural behavior of local residents. The idea is simple:

If annual rent is roughly **5% of the property's value**, buying may be worthwhile.

If annual rent is significantly lower, renting might make more sense.

Why? Because real-estate investors must account for all the extra "hidden" costs: time spent on maintenance, turnover between tenants, repairs, renovations, and more.

For example: A brand-new apartment has very low renovation risk compared to a 40-year-old apartment. Therefore, an investor *must* demand a higher return (a higher "premium") to compensate for the risk of owning an old unit. But since you can't charge tenants more rent simply because the apartment is old, the only way for the investor to get compensated is by **buying the property at a lower price**.

My personal caveat-

The biggest pricing variable here is the **interest rate on the mortgage**.

If your mortgage rate is higher than 5% - and you add renovation risk on top of that - the entire calculation becomes something completely different. We will talk about mortgages later.

The 1% Rule - Monthly

This is the classic baseline for income-producing real estate: **Monthly rent should be about 1% of the property's value**. Yearly, that's roughly **12% gross income**.

Sounds insane compared to Israel, right?

But these numbers represent typical examples from the U.S. housing market - especially in places where home prices historically stayed within a narrow band relative to local incomes. In Israel this is impossible today because price–rent multiples have expanded massively. All the classic Israeli arguments (“demand is high,” “land is scarce,” “people always need housing”) are *valid*, but they only justify **multiple expansion**, not high yield. The real question someone should ask when seeing a property offering a 3–4% yield is:

Is this growing demand already priced into the asset? If it is, there is no point in buying due to that argument alone.

How Professionals Use These Numbers

Professionals use these metrics to instantly reject 90% of deals.

If the numbers don't make sense upfront, there's no point wasting time.

But professionals also know when today's numbers **might change tomorrow**:

- Low rent today, but expected rise in local income levels will lead to higher rental rates tomorrow.
- Upcoming population shift that increases demand.
- Incoming residents who tend to buy rather than rent.
- Urban development that improves desirability.

In such cases, the investor expects **true appreciation**, not “price appreciation,” but valuation growth driven by fundamentals.

If the incoming population is one that tends to *buy*, not rent, then rent as a percentage of property value gradually shifts: **From lower income 12% → middle class ~5% range**.

This is called **multiple expansion**. People are willing to pay a much higher price simply to own the home they want. Real-estate investors in these areas typically sell when the rent-to-value ratio shrinks, because:

- The yield on their equity drops
- The capital-gain upside becomes more attractive and the shift is already priced in

- Cash flow is always at risk (vacancy, repairs, unexpected expenses)

Why Most Israeli Investors Don't Do These Calculations

I highly doubt most real-estate investors in Israel, those who are not true professionals never analyze deals like this.

Most:

- don't build financial models
- don't calculate yields
- don't study risk
- don't compare alternatives

And this is not a coincidence.

Israel contains every classic sign of the “**everyone knows that...**” trap:

- *Everyone knows* that home prices always go up
- *Everyone knows* it's better to buy than rent
- *Everyone knows* real estate is a safe investment

When such statements become absolute truths, people stop thinking like **investors**, and start thinking like **believers**.

“Everyone Knows Real Estate Is Safe

Let me give a brief disclaimer:

This is **not** my area of professional specialization. I've stayed away from real-estate investing for structural reasons, it's very difficult to generate **alpha** (excess return) in this market. A true real-estate expert is someone who built wealth primarily through real estate, for decades. They understand cycles, markets, tenant psychology, renovations, zoning, financing, and local economics, deeply. Yet here in Israel, anyone with 18 months of bull-market experience suddenly calls themselves “a mentor for real-estate investors”.

An expert is someone who lived through multiple different cycles.

For anyone who is *not* a professional, there must be one macro strategy:

Move with the market - and go against it only at extremes.

This is why **indexing** is so powerful. Trying to generate alpha is trying to compete against professionals who operate at massive scale. Within that mix, ordinary investors take active decisions, some lucky, some unlucky, some smart despite inexperience, some disastrous for exactly the same reason. If you choose to become an enterprising investor, you must accept the fact that you will most likely underperform, and you are a very arrogant prick thinking you can outperform. **I am admitting I am an arrogant prick who thinks I am smarter than others, or, have a more suited temperament than others. Investing and trading is a field where everyone has a lot of hubris.**

Understanding the Asset Itself

The first question before investing in any asset, Do I actually understand how this works?

We already established the core idea: Real estate is a basic consumption good. This gives it enormous built-in support on the downside. On top of that, it's the **only essential good that doesn't depreciate** the way food, clothing, or electronics do. This makes real estate the *baseline* of the investment world. In the U.S, you can actually use depreciation for accounting purposes on residential real estate to minimize taxation. **In Israel one cannot.** However since often Real Estate values go up and not down (which is what makes this the only basic consumption good that appreciates in value) that depreciation is recaptured at the sale (I can hear real estate investors shout at me but you can use a 1041 exchange. I am not a tax expert but if you are interested in investing in real estate, go speak to a tax professional).

In investing there is one question that is the first one that needs to be asked: Will I get my principal back?

“Before we think about return on capital, we think about return of capital.” – Warren Buffett

Even if an entire national economy collapses, people will often still be able to live in their home - at least temporarily. This is why real estate feels safe, especially when it's purchased **without leverage**. Once leverage enters the picture, everything becomes more complicated (we'll get there soon). In theory, the price of a home should rise with inflation.

So why does it often rise far more? Excellent question.

Where Does the Price Appreciation Come From?

Market prices are driven by **supply and demand**. That's why everyone repeats the same lines - “high demand,” “limited land,” “population growth.” But because everyone repeats them, they are already priced in. In Israel specifically, the *real* force pushing prices up was Wealth Accumulation. Israelis have become wealthier over the last decade.

When a group has significantly more purchasing power than before, and they compete for the same limited housing supply, that creates asset inflation, not “normal” inflation.

But real estate has one unique extra layer: Psychology

Unlike food, clothing, or transportation, when people buy a home they ask themselves: “What's the maximum I can afford to pay a month?” When purchasing power rises, people allocate an increasing % of their income to housing. This is why in strong-

demand areas, rent and mortgage payments are dramatically higher for households that are otherwise identical to households elsewhere. Two families of four eat similar amounts of food. Their monthly food expenses might differ by a few hundred or a few thousand shekels yearly. But their housing expenses? They can differ by tens of thousands of shekels per year.

Return on Investment After Return of Capital

Once the safety of principal is established, the next question is:

What return am I getting?

All investments must be compared to alternatives.

This is the essence of Opportunity Cost.

The most basic benchmark is:

The central bank interest rate.

When interest rates rise, we must demand higher returns from all assets.

What is the Risk-Free Rate?

Short lesson entire books can be written about this.

The Risk-Free Rate is the single most important concept in finance: It's the yield you can receive **with virtually no risk**. In theory, the only truly "risk-free" borrower is a government, because it can always print money to repay you. Maybe that money will lose value, but repayment is guaranteed. In practice, when people say "risk-free rate," they mean:

The yield on U.S. government bonds — U.S. Treasuries. Treasuries = U.S. government bonds. Why the U.S.? Because the United States is considered:

- the most trustworthy borrower in the world
- the issuer of the global reserve currency
- the anchor of the international financial system

U.S. Treasuries are the largest financial market on Earth. Central banks around the world hold most of their reserves in Treasuries. Even with political chaos, even with presidents like Biden or Trump, the U.S. remains the world's most credible borrower. Its military strength, economic productivity, and cultural influence back the value of its debt. **For the everyday investor:** The Risk-Free Rate sets the **minimum acceptable return**. If Treasuries yield 5%, every other asset must offer **more than 5%**, otherwise it makes no sense to take extra risk. This affects *everything*: stocks, companies, startups, and real estate. Now for the first time, some commercial borrowers have bonds at a rate very close to Treasuries. This spread is extremely narrow at the moment. This is a way for the market to signal that investors are beginning to feel that some commercial borrowers are almost as trustworthy as the federal government. This can be interpreted in 2 different ways, either investors are beginning to trust some businesses more and more, or they are beginning to trust the U.S government less and less.

Higher Rates Change Everything

When rates rise:

- Businesses become less profitable
- Companies have less cash for long-term investments
- Mortgages become more expensive
- Property yields must be higher to compensate
- Asset valuations fall

This is why investing becomes much harder in high-rate environments.

Why Pay More for One Asset Over Another? Two Reasons Only

1. Certainty of returns - The more confident I am that a business will deliver consistent cash flow - the more I'm willing to pay. McDonald's feels safer than your friend's new burger joint in Dizengoff Center.
2. Expectation of future growth - If I believe a neighborhood will develop, demand will rise, and rents will increase, I'm willing to pay more today.

A common misconception: "More risk = more reward", what it should be is "when you take more risk you are hoping for more reward". Great equity investors (real-estate falls under equity) look for: Less risk, with the possibility of much higher reward.

"Heads I win big, tails I don't lose much" – Mohnish Pabrai

The characteristics of the business called real estate, whether for investment or for living, without the main risk factor (the mortgage)

The first thing we must do is price the income the property can generate, meaning the rent. We need to be able to estimate how that income might change over time: will it rise or fall, and at what pace? Since rent is a *gross* figure, a crucial part of the valuation is also the *expenses* throughout the investment's lifetime.

Generally, new properties require fewer repairs and lower maintenance costs than older ones, which is why there is a *real* premium on new construction, a premium that should reflect the savings in wear-and-tear and maintenance compared to an equivalent older unit. But because humans act emotionally, sometimes a *psychological premium* appears: some people are willing to pay much more for something new beyond the rational savings; and sometimes the premium is for something old and unique (like Bauhaus apartments in Tel Aviv).

We must also price wear-and-tear itself: estimate aging, future renovation costs, and potential fluctuations in prices of materials and labor. Since most of us are *not* renovation contractors, these things are hard to evaluate on our own, and consulting a professional costs money. Even the *decision not* to consult is an economic decision: if the risk I'm estimating is worth 2500 NIS to me, but a contractor charges 1,000 NIS, maybe it's not worth it. If he charges 200 NIS, maybe it is.

There *is* an advantage to buying a home you plan to live in: no landlord to deal with. But on the other hand, *you* become the landlord, with all the responsibilities, risks, and headaches. And if there is a mortgage, an additional relationship joins the equation: the bank.

Financial Models — Playing With Scenarios

Since central banks around the world aim for 2% annual inflation (and in my opinion, over the coming decades it will be higher, not dramatically, but still higher), I usually model price changes using several different scenarios:

- inflation at 2%
- inflation at 4%
- inflation at 1%
- and so on

I run the numbers either with one uniform assumption across the board, or by mixing scenarios. This gives me a general sense of where I stand regarding:

- taxes
- interest rates
- net profitability
- levels of risk

The goal of these models is to identify which economic changes represent risks or opportunities for the assets I'm analyzing (and remember, stocks are assets too). It helps me understand how the numbers shift under different scenarios, and to estimate, even intuitively, the likelihood that each scenario will occur and its ramifications.

Understanding these things is what helped me make investments that yielded very high returns (relative to the alternatives) in an Iron Ore mining company and in banks during the surge in inflation, as well as the surge in interest rates.

Both of these industries are heavily influenced by macroeconomic processes that directly affect business conditions.

A Lesson from the U.S. – How Depreciation Works and What Should Real Estate Investors Everywhere Think About

I'm not a tax expert, so take this with a grain of salt and always consult with a qualified tax professional. Real estate has many tax advantages. Governments often encourage investment in real estate, which pushes housing prices upward. Yet in some places the tax system is far more favorable, and from those places we can actually learn something useful, not because of the taxes themselves, but because they help us better understand real estate pricing and future expenses.

In the U.S., real estate investors can record depreciation on investment property as a deductible expense, even when it's a residential rental property. Depreciation for residential real estate is spread over 27.5 years.

So what is depreciation? Depreciation is the decline in the value of an asset over time due to use, wear and tear, aging, or technological obsolescence. In accounting terms, you take the purchase price of the asset, divide it by 27.5 years, and deduct that yearly amount as an expense. This reduces the taxable income from the property and therefore lowers the tax bill.

What happens after 27.5 years? If you still own the property, depreciation resets and the cycle starts all over again. If you sell before the 27.5 years are up, the IRS says: "Hold on. You deducted depreciation even though the property actually went up in value."

So they require something called Depreciation Recapture, meaning you must pay back the tax you *saved* by deducting depreciation (not the full depreciation amount, only the tax you avoided).

You can defer this recapture tax in investment real estate using a 1031 Exchange, which allows you to roll the proceeds into another property of equal or greater value within a specific timeframe. This is one reason U.S. real estate can be extremely attractive for investors. However, Israelis investing in the U.S. must deal with additional cross-border tax complications, and as far as I know, Israel does not have a clear framework for some of these issues. That's why an Israeli who wants to invest in the U.S. *must* consult with a tax expert who understands both systems, something most Israeli investors unfortunately do *not* do.

Now to the subject that I wanted to discuss - Cost Segregation

In the U.S., you can hire a specialized appraiser to break down a property into separate components:

- Electrical systems
- Plumbing
- Flooring
- Roof

- HVAC systems
- And more...

Each component is assigned its own value and its own “useful life,” which is typically much shorter than 27.5 years. This allows investors to:

- Accelerate depreciation dramatically in the early years
- Depreciate individual components again when replaced
- Reduce taxable income far more efficiently

This tool can generate enormous returns for professional investors.

Balloon Loans — Why is this relevant?

Because accelerated depreciation creates large “paper losses” early on, investors don’t need to use mortgage interest deductions right away. That’s why some professionals use balloon loans. This structure can create very strong *positive cash flow* in the early stages of a deal. But balloon loans are dangerous. They are a tool designed for professionals, yet in Israel, similar structures (like “80-20 deals”) were marketed to ordinary people over the last 2 years, which is problematic.

So why is U.S. depreciation relevant to Israelis if Israel doesn’t allow depreciation on residential property? Not because of tax benefit, Israel simply doesn’t offer them. The value lies elsewhere: Depreciation reflects the true life expectancy and wear-and-tear of each part of a property. This provides a powerful mental model for Israeli investors.

Cost Segregation shows us that:

- Boilers have a lifespan
- Windows have a lifespan
- Flooring wears out
- Bathrooms need resealing
- Systems break over time

When I personally buy any product, I always ask: How long is this supposed to last?

The components of a real estate property should be no different.

Even though you cannot deduct depreciation in Israel, you *must* price it into your financial model, because these expenses are real and inevitable.

Thinking along this model gives forces anyone to think about:

- What actually breaks inside a home
- How quickly it wears out
- How much it costs to fix
- And how to estimate long-term expenses realistically.

This makes you a better real estate investor, regardless of the tax code.

On Population Growth and Its Impact on the Real-Estate Market

This is a well-known topic, but I want to sharpen it. Population growth is one of the most powerful drivers of demand for real estate, but also one of the least understood. It's easy to look at new construction and assume the city is "growing". It's also easy to think that if more apartments are being built, demand must be rising and prices must go up. But the truth is far more complex: **construction is a response to demand, not the cause of it.**

This misunderstanding is especially common in Israel regarding urban renewal (aka "pinui-binui"). I'll also add that population growth is also psychological, on a trip to Kansas City a taxi driver kept on telling me how the city population was exploding with immigration from other states because of working from home, the Chiefs, Taylor Swift's relationship with Kelce and the World Cup and that he wants to buy investment property because of that. In reality, when I looked up the statistics while he was telling me all this, the population growth in KC metro was nothing special compared to the national level.

Growth Rate – Quantity Isn't Enough

For a city's population to *truly* grow, two conditions must be met:

1. Positive natural growth – Over 2 children per woman, assuming roughly half the population is female and all women have children.

This is the minimum for long-term demographic stability.

If one woman has no children, two others must have three each (or one must have four) just to compensate.

2. Local retention + positive migration –

People born in the city must stay, and new people must move in.

If children born in the city grow up and leave for Tel Aviv, Gush Dan, or abroad, then the city isn't growing, it's simply producing young people for other cities.

In Israel, the average fertility rate is ~3 children per woman, exceptionally high for the Western world. This creates structural demand for housing.

But this demand is not evenly distributed. It depends on where high-income, educated, young populations choose to live, and what kinds of apartments they need. High fertility alone does *not* guarantee local housing demand. If a city loses its young adults to other regions, it shrinks economically regardless of how many babies are born there.

Where Does Real Growth Occur?

Real population growth happens in places that offer:

- Quality employment opportunities
- Strong transportation accessibility
- Culture, entertainment, commerce, and good educational institutions

This is why looking at “how many buildings are under construction” does *not* indicate real demand.

Construction is an *effect*, not a cause. And it is a speculation of developers. Just like any other investment field, speculators here make mistakes too, and psychological bubbles occur as well. In a nutshell, a city that fails to attract young adults will, eventually, hollow out. Young adults are the fuel of every urban economy, they rent in developing neighborhoods, use services, take public transport, work in tech, culture and commerce, and attract business activity. If a city loses young families, no amount of construction can save it. Thus the most important conclusion is this the key metric for a real-estate investor is the city’s population growth rate, not the number of cranes. A good investor looks not at buildings, but at people.

The Critical Question: Who Is My Tenant\Buyer? To understand real demand for apartments, you must ask: “Who are the people my property is meant to serve?”. This is the most important question in real estate. In London today, luxury landlords are suffering. The city is losing millionaires and multimillionaires at a rapid pace. Meanwhile, landlords renting low-cost apartments to lower-income tenants have never seen higher demand. Why? Because what matters is not the growth of the total population, but the growth of *your target tenant group*. If your property serves a high socioeconomic class that is leaving the city, and is replaced by weaker populations, that lowers property values. Not because of “bad neighbors,” but because there are no buyers with deep enough pockets to purchase the property.

Developers build because they *believe* demand will rise not because they magically create demand. If many towers are being built, it means developers expect future buyers.

But a smart investor checks:

- Are the developers right, or is this hype?
- How much of the construction will actually house new families, and how much are “investment apartments” that won’t create real population growth?
- Is the city truly expanding—or is this just “growth on paper”?

The ability to invest *before* developers flood the market with supply is a skill only top investors have.

Everyone will tell me this is obvious, but have a look at China. The Chinese are just as smart as anybody, and looked at what happened there.

Urban Renewal & Peripheral Marketing to Center-Based Investors

In Israel many people invest in old neighborhoods expecting urban renewal (pinui-binui).
But:

- The process takes many years.
- The “premium” for future renewal is often already priced in.
- The same capital invested elsewhere might yield higher returns.

More importantly, people assume new apartments created by urban renewal will be valued like other new apartments in the area.

This is simply not always true.

Why?

1. Renewal projects dramatically increase *supply* of similar units.
2. Unless the new neighborhood attracts stronger buyers with real purchasing power, prices cannot rise.
3. Old neighborhoods chosen for renewal often lack natural demand from high-income populations, unless they are in extremely central locations (e.g., Tel Aviv).

“The three most important rules in Real Estate are location, location, location”- an old American proverb

When renewal projects in the periphery are marketed on giant billboards *in the middle of the Ayalon Highway*, in central Tel Aviv, it is a red flag:

It signals that local, organic demand is weak, so they must sell to investors from outside.

This is a warning sign, not an opportunity.

Income & Expenses – The Obvious Part

Most landlords in Israel operate on “market averages”:

- Average rent
- Standard leverage
- Standard maintenance
- Standard returns

To earn above-average returns, one must master:

1. Understanding population growth of *your* target tenants, not the whole city
2. Managing leverage responsibly, not more than the asset can handle
3. Renovating cheaply but effectively, making a 70,000-NIS renovation look like a million
4. Making the property attractive relative to cost, not relative to emotion
5. Choosing a location with *real* population growth, not just “a place with lots of construction”.

When you buy your own place to live in, you need to factor in the premium you are likely paying. This means that more likely than not, you will underperform someone who is investing in an equivalent property and is managing the investment from a financial perspective.

Now I cannot express this enough. There is only 2 ways to get rich. Either you win because you are good and/or lucky, this is the Enterprising Investor. Or others lose because you were a Defensive Investor and the majority tried to be an Enterprising Investors and were wrong. When you buy a property in the area, and that is your biggest investment in your portfolio (as it is to most people) you are likely going to get average returns. It will not make you rich. You have to accept this. You have to understand this. An I express this, because so many Israelis talk about buying a property like winning the lottery. The only way for you to be the rich guy in your neighborhood is save more than others and invest it well. Usually most people harm themselves and do not live below their means, or go on financial experiments. This is why you want to be Invincible. Just do not beat yourself, and you will not lose. That is how you win the Losers Game¹⁰.

A Few Words About Land

Most land in Israel is owned by the Israeli government. Land prices in Israel are determined mainly through government tenders. The state sells the land, developers compete for it, and the price is essentially dictated by how much construction companies are willing to pay while still maintaining the profit margins they want to achieve in the project. This is a critical point: developers are businesses, and their goal is profit. They will bid on land according to how much they believe they can earn from it. Developers' room for maneuver depends on two key factors:

1. The state of the industry and the financial health of the competing firms – if there are fewer competitors, or if they are financially weak, the price they need to offer will naturally fall.
2. The profit margins they expect to achieve – the more they believe prices will rise or supply will remain tight, the more they can afford to bid for the land.

But lower land prices *do not automatically* mean lower housing prices. This is what I want to explain clearly, since I think the public has some serious misunderstandings about this.

Also, in Israel everyone blames someone else, instead of looking at everything as being parts in the same mechanism.

So let's address the question, will releasing more land for construction lower prices? Theoretically yes, and this is a very common belief among the Israeli public. But practically, not really. If the state releases a large volume of land at once, competition

¹⁰ Winning the Loser's Game: Timeless Strategies for Successful Investing – Charles D. Ellis

over each tender will decrease, and the land prices might fall. But here's part one of the more complex reality: revenue from land sales goes directly to the state budget. Lowering the price of land is essentially reducing a major public revenue source. This shortfall must be compensated elsewhere, typically through higher taxation or reduced government services. Even if apartment prices fall, the public eventually pays the difference in other ways. In that sense, maintaining high land value is seen as a kind of national interest. But even if developers *do* acquire land at a discount, it is far from guaranteed, and in my opinion, unlikely, that the discount will reach the public.

Why? Because developers want to get rich too. Developers and their employees also want to build wealth. If they manage to acquire land cheaply, they have no incentive to lower home prices. They can simply keep the additional margin. This is a well-known economic phenomenon: when the market is willing to pay a certain price, producers will not reduce it on their own. We see this in countless sectors. Importers bring goods at cheaper prices, the shekel strengthens, global commodity prices fall, yet Israeli consumer prices barely move. Israelis are willing to keep buying when prices rise, and are willing to keep paying high prices even the producers costs fall. In general the Israeli consumption habits are quite interesting and we will follow this too later. But in the meantime, chocolate prices are a recent perfect example: cocoa prices fell globally, the shekel strengthened, yet chocolate prices in Israel barely budged after skyrocketing earlier. This happened across the board everywhere in Israel over the last 2 years.

Why doesn't competition between existing developers reduce prices?

Because all of them already hold expensive inventory. If a developer were to lower the price of new units just because land became cheaper, he would immediately damage the profitability of the units he already owns and needs to sell. Therefore, they will do everything in their power to maintain uniform high prices across the entire market.

This creates an almost impossible dynamic:

- They must protect profit margins on existing projects
- Which prevents them from lowering prices on future projects

The result: even if the state reduces land prices, nothing guarantees the public sees any benefit.

So how do prices actually fall in other industries? Almost always, real price declines come from only one direction, a new, aggressive market entrant. Exactly what Rami Levy did when he sold whole chickens for 1 shekel as his supermarket chain began to take off.

Exactly what Robinhood did to brokerage fees when it introduced zero-commission trading.

"Your margin is my opportunity." – Jeff Bezos

Existing players typically avoid price wars. Lower margins mean smaller profits. But a new, hungry player can grow earnings rapidly even with thinner margins because he is increasing his market share. In real estate, bringing in new competitors is difficult. It requires massive capital, high risk tolerance, and navigating a heavy regulatory system. You cannot disrupt the construction industry the way you can disrupt other industries.

And candidly: some regulation here is necessary. You don't want poor-quality construction or dangerous shortcuts.

What can lower home prices without raising taxes? Not the price of the land, but the number of housing units allowed on that land. When you increase building rights, the cost of land per square meter drops automatically. This is what reduces the price of apartments not cheaper land, but more units per plot.

Israel's real issue is timing. Municipalities and the state usually recognize demand too late, approve plans too late, and supply arrives years after the price spike has already happened. A real estate investor must understand where he is operating and take this into account.

Before buying, you must understand:

- Local employment trends
- Real housing shortages
- Whether development is genuine or superficial
- Whether new players are entering the market
- Whether municipal authorities are increasing building rights
- Whether large-scale projects are in the pipeline

Many people never check zoning plans. I know cases where buyers purchased apartments where they thought they will have “eternal sea views,” only to discover a new building rising in front of them a few years later because they never checked the zoning of the adjacent lot. The same happened near massive “price for buyer” projects (a subsidized housing program where first-time home owners can buy at a discount): thousands of cheap units entering the market at once crushed the value of nearby free-market apartments. Prices don't have to drop officially all it takes is the arrival of large new supply.

NIMBY and the political barrier

Many homeowners oppose densification. More units mean more competition and, indirectly, pressure on their asset value. Taller buildings means “blocked views”, or more congestion since the population density explodes. This creates the NIMBY phenomenon, *Not In My Backyard*. But densification is exactly what Israel needs.

If you dramatically increase the number of units, you can finally create meaningful supply.

But this comes with challenges. To significantly increase density, you need massive supporting infrastructure:

- Parking
- Roads and access
- Utilities (electricity, sewage, water)
- Public transport
- New lanes
- Load planning
- Commercial zones
- Schools and kindergartens

This requires a long-term plan of at least a decade.

The public must accept short-term pain for long-term benefit. But politicians are elected every few years. Infrastructure work is noisy, slow, and unpopular, like the light rail in Tel Aviv, which “destroyed streets” in the short term but was essential long term.

To make this work, the public must support elected officials making decisions that are tough now but essential later, and the state must appoint capable professionals to plan before construction even begins.

The real problem is most residents already own homes

They don't want more supply. More supply might lower their home value and higher density without good planning and execution means a reduction in the quality of life. Meanwhile, their children cannot afford to buy, so parents often help financially, a behavior that may eventually destroy some families' wealth in the very long term (I'll address this later).

The only real path to change

1. Accept short-term pain for long-term gain
2. Elect leadership that plans ten years ahead, not one term
3. Appoint real experts to plan infrastructure before construction begins

Infrastructure must be ready before neighborhoods are built, not after.

Israel has many neighborhoods populated without adequate infrastructure.

In summary, If Israel wants affordable housing prices, it doesn't need more tenders — it needs strategy. Real planning. More competition. More players. And above all:

Dramatically more building rights per plot.

Releasing land alone will never solve the problem.

Apartment on Paper, Ready New, and Second-Hand

Most people don't truly understand what it means to buy real estate "on paper." In my view, it isn't an apartment purchase at all – it's the purchase of an option. The developer, on his side, holds an obligation. In his accounting books the unit may be marked as "sold," allowing him to balance credit with the bank, improve his cash flow, and pay subcontractors. But for the buyer, the transaction looks completely different. To understand why, we need to start with the basic distinction between a ready new apartment and a second-hand apartment.

Just like with a brand-new car, people tend to pay more for a freshly built apartment simply because it's new. Its condition is supposed to be better, and in theory the wear-and-tear should take longer. Materials change over time, construction quality changes over time. Sometimes the older product is even better, but in the mind of the public, "new" carries a premium. A second-hand apartment, on the other hand, is often the better economic choice relative to the utility it provides, but it comes with risks of maintenance and renovation. Still, in both cases you receive a real, tangible apartment in exchange for your money – immediately.

Buying an apartment on paper is something entirely different. It's a classic case of "a bird in the hand is worth two in the bush." The buyer pays money today, even with a balloon loan, and *hopes* to receive something in the future. Because construction takes time and the buyer must wait before receiving anything, the price must logically be lower than the price of an identical ready unit. The buyer gives the developer something he urgently needs now, while the buyer gives up something that could have served him immediately (even in a simple bank deposit). That gap is the essence of the deal.

Delays in delivery are also part of the risk. Every month of delay is worth money. That's why developers are obligated to compensate buyers for late delivery. A rational buyer must calculate the cost of these delays, and benchmark them against his personal "risk-free rate." Most use the central bank rate. Personally, I use the long-term average return of the S&P 500 (I do this to keep up not with inflation, but with American wealth as a whole). Any investment must provide a meaningful return on equity that justifies the risk and time. And since real estate is leveraged, the "return" must be measured on equity,

not on the property's nominal price change (which is part of the appeal of real estate as an investment).

Beyond delays, a far more serious risk exists – the collapse of the developer.

There are two main types of collapses:

1. A liquidity crisis in which the developer cannot refinance debt.
2. A full-blown systemic crisis in which developers fall like dominoes.

In the first case, a replacement developer might continue the project, but it takes time and creates uncertainty. In the second case, like Evergrande in China or post-2008 in the U.S. buyers may be left with obligations but no house. In such a scenario, even solvent developers can't step in because the entire financial system is tight on liquidity. In Israel, if something similar happens, the state may be forced to intervene to avoid a systemic crisis. A real estate collapse triggers an economic collapse because of the leverage, it never stays contained.

"If money isn't loosened up, this sucker could go down."

- President George W. Bush

If such a crisis hits while inflation is already problematic, the impact could be explosive. This is why any risk in an on-paper purchase must be translated into price. The buyer must demand a *significant* discount, not a cosmetic one. But because the market is irrational, and buyers don't analyze risks like professionals, developers can continue selling apartments on paper without a proper discount. A rising market forgives every mistake. Irrational buyers enjoy accidental success. Professional investors hesitate, while amateurs feel invincible. That is why a sophisticated investor must separate noise from signal. And above all, sleep well at night.

The real danger appears at extremes:

- shrinking purchasing power
- rising unemployment
- inflation that erodes salaries
- banks limiting mortgage supply
- housing affordability collapsing (classically, when housing costs exceed 30% of net household income)

"Only when the tide goes out do you discover who's been swimming naked."

- Warren Buffett

When the tide goes out – and it will, someday – some people who bought real estate will be fine. Others will see their lives collapse, including developers. And for some, it will be the best buying opportunity of their lifetime. Even if you aren't liquid enough to buy at the very bottom, you can still benefit from the reset in prices.

Peter Lynch said, it is far safer and more profitable to buy *out of the dip* than inside it. I am not claiming there is a bubble that will explode next month. I *am* saying we see cracks. And it possible the Israeli economy will recover before cracks become fractures.

In fact most economists and “professional” think so, although I think they are ignoring some serious factors. But any investor must think in terms of extremes, not daily noise.

“Far more money has been lost by investors trying to anticipate corrections, than lost in the corrections themselves.”

- Peter Lynch

It is extremely difficult to know when you’re at an extreme. Howard Marks’ book *Mastering the Market Cycle* is essential reading on this.

And I promise in the next chapter to explain why developers and banks use every trick in the book to avoid lowering prices, including the notorious 20-80 deals.

Also, the real estate professionals will talk about cap rates, vetting renters and other aspects, we will deal with those too before Part 2 is over.

Chapter 5 – The Balance Sheet of the Israeli Public: Debt

Mortgage, mortgage, mortgage

I recommend that everyone watch the Yale University lecture on the history of real-estate finance by the legendary Robert Shiller. It explains how the financial tools we use today were born:

https://www.youtube.com/watch?v=y_IMH8erqds&t=2180s

Until 1929 in the United States, a mortgage was essentially... a balloon loan.

Yes, almost identical to today's Israeli 20–80 developer schemes.

The borrower received high leverage, and then, in one shot, had to repay the entire principal. When the bubble burst and the Great Depression arrived, hundreds of thousands collapsed financially. The Americans learned the hard way: loan structure alone can bring down an entire economy. After the crash, policymakers decided these kinds of loans were far too dangerous for regular people and reinvented the modern mortgage — the long-term, fixed-payment structure we know today. And here we are, a century later, falling back into the same dangerous assumptions. From a macroeconomic perspective, developer promotions like 20–80 are not that different from the risky mortgages of the early 20th century. They push risk into the future, hide it behind shiny marketing, and create an illusion of affordability. But the simple truth is this: **The mortgage is the core expense that accompanies us throughout the entire life of a real-estate investment — and it is also the central risk factor for bankruptcy.**

Bankruptcy When the Cash Runs Out

Most people think bankruptcy means “there is no money.” That’s not accurate.

Bankruptcy occurs when **cash** runs out at the wrong time. This can happen to anyone, even a billionaire on paper. You can own assets worth a fortune, but if you’re not liquid on the day the payment is due, you’re finished.

“Cash is an option on the future” - Sam Zell

This is a lesson the investment world doesn’t always teach: Liquidity is not a luxury, it is oxygen. And the problem with illiquidity is that it arrives at the worst possible moment.

When markets fall. When the real estate market freezes.

When unemployment rises. Those are precisely the moments when it is hardest to sell assets or refinance debt. This is also why private-credit firms seek out excellent businesses with terrible balance sheets. Why? Because they know they can restructure payments, spread out obligations, and let the business breathe again. The issue isn’t profitability, it’s cash flow. There are two types of bankruptcies in the business world:

1. The soft kind (chapters 11\13), you restructure your payments, maybe shut down some operations, and come out with healthier cash flow.
2. The movie kind – Chapter 7, aka Liquidation, you sell everything, your bank accounts are restricted, credit cards frozen, and portions of your salary are garnished automatically.

Real-estate investors must understand both.

Renter vs. Buyer Who Has More Freedom?

The Israeli mindset is: “Renting is throwing money away.”

But the truth? Renting and buying are both forms of debt, just structured differently. A renter commits for a year at most (this is Current Debt¹¹). Often with an exit clause or the option to find a replacement tenant. Personally, I always make sure I can leave within 30–60 days notice without needing to provide a replacement. A buyer ?A buyer commits for **20–30 years**. There is no exit. No pause. No “changing direction” easily. Want to move cities? That’s an ordeal. This distinction is crucial. A renter can adjust the expense to match income. A buyer must adjust their life to match the mortgage. When something happens for example a pay cut, unemployment, rising interest rates, difficulty renting out the property, the buyer becomes far more vulnerable than the renter. And this leads us straight to the real wild card of the Israeli real-estate market.

The Israeli Mortgage is The Elephant in the Room

In Israel, mortgages are not fixed for 30 years like they often are in the U.S. There is no way to lock in one stable payment for decades. People do not fully internalize how significant this is. In the U.S., millions of families locked 2–3% mortgages during COVID. Life moves on. Income rises. The mortgage payment stays the same.

In Israel? The Bank of Israel raises interest rates and within weeks your mortgage becomes more expensive. Not in five years. Not in two. Within thirty days. This makes Israeli assets extremely sensitive to macroeconomic shifts. Every rate hike creates shockwaves exponentially larger than in the U.S. It adds an additional layer of risk to any real-estate investment in Israel. Worse still, during the low-rate era, when it was obvious rates would eventually rise, buyers were aggressively pushed into adjustable-rate mortgages.

An adjustable-rate mortgage is essentially buying an option. You are speculating on the future direction of interest rates.

¹¹ *Current debt* refers to any short-term financial obligation that a company or individual must repay within 12 months from the date of the balance sheet. It includes liabilities that are due soon and require the use of current assets or the creation of new short-term liabilities to settle them.

Real Estate Is Math and Risk Is the Variable

Real estate is full of numbers, and we barely scratched the surface. Much of the work is Excel: building equations, playing with variables, identifying when the math is in your favor and when it turns against you. The risks are precisely what flip the equation. Calculating those risks is the art. A property can look brilliant on paper, until something changes. Rate hikes, A tenant who stops paying. A temporary crisis that creates a liquidity crunch.

Real-estate investing is not just “buying a property.” It is **an equation with many variables**, and the risks are what suddenly twist the entire formula against you. The true skill of an investor is not predicting the future, it is understanding the risks, pricing them properly, and learning to live with them.

“Real Estate Is About People”

People tell me this all the time, usually as a way to dismiss spreadsheets. And frankly? It's nonsense. Everything in life is about people. But unlike startups or certain businesses that are extremely hard to quantify, real estate *can* be placed into an Excel model, and often must be. I do not want at all to discount the value of being a great operator. But there are deals that are hopeless to save even for the best operator. And even a horrible operator can make money if he buys well.

“I could have been more aggressive throughout my career” – almost any conservative investor who has lasted over 20 years, ignoring the fact that that behavior probably is what kept him from losing more than he would have gained from a more aggressive nature

Yes, there is a human layer: negotiation, understanding the other side's pain points, managing contractors, marketing a property to the right tenants or buyers.

But Excel is not optional, especially for beginners. With time, an experienced investor will recognize patterns instantly without running the numbers because they've done it before. As Warren Buffett famously said, great investments jump off the page.

Of course, operating is a huge part. But before you get to operating well, you have to buy well.

The Israeli Scenario, When the Stars Aligned

When mortgage payments are low or nonexistent, real-estate investing becomes extremely cheap and extremely profitable. Especially in a country where we know:

- Demand will grow (fastest population growth rate in the Western world)
- The economy, driven by tech, is likely to expand
- The cost of most goods trends downward globally (globalization)

These forces created a near-perfect storm for Israeli real-estate investors over the past two decades.

So, What Makes Real Estate Such a Powerful Investment?

Leverage. In real estate, more than in almost any other investment accessible to ordinary people, leverage is the tool that turns a moderate return into a dramatic one. The more highly leveraged the property is (that is, the larger the portion financed by the bank rather than by your own capital), the more the return on your equity grows exponentially.

Let's take a simple example:

- You buy a property for 1,000,000 ₪.
- You put down 20% equity (200,000 ₪).
- You take an 80% mortgage.

Now the property price rises by 20% and is now worth 1,200,000 ₪.

What truly matters is not the increase in the property's value, it's the increase in your equity:

- Your equity was 200,000 ₪.
- It is now effectively 400,000 ₪.

That's a 100% return on equity, even though the property itself rose "only" by 20%. This is the entire power of leverage.

Why Don't People Use Leverage the Same Way in Stocks?

Two simple reasons:

1. Companies are already leveraged.
Borrowing money to buy shares is "leverage on top of leverage," which is far riskier.
2. Housing is a basic consumption good.
People almost never reduce consumption by moving back with parents or doubling up with others.
Demand for housing is inelastic, which makes leverage in real estate far safer.

This is also why:

- Even a 5% rental yield,
- Combined with just 2% annual price appreciation,
- And 80% leverage

can generate very high returns on equity, far higher than most investors realize.

The higher the rate of appreciation, the higher the return on your equity. The lower the leverage, the more that return shrinks. So any person who tries to convince you that "stocks perform better than real estate because historically they rise faster" without comparing return on equity is almost always one of two things:

1. Someone who simply doesn't understand leverage, or

2. Someone who relies on the fact that you don't understand leverage to sell you a narrative.

Leverage Cuts Both Ways

The biggest risk is not the price of the property dropping. The real danger is much simpler:

The gap between rent and your mortgage payment. Because real estate is tightly linked to the credit market, the most powerful force in the entire system is interest rates. Not tenants. Not contractors. Not developers. The interest rate.

Real estate does not move without the loan market. This is why you cannot talk about real estate seriously without talking about:

- Rate changes
- Interest-rate exposure
- Cash-flow sensitivity
- The speed at which mortgage payments can rise

Leverage is a double-edged sword

- In stable or rising markets, leverage supercharges your returns.
- But when interest rates rise, rents stagnate, or your personal income drops, leverage becomes the very thing that can turn a "perfect investment on paper" into an existential financial risk.

A Final Word About the Nature of the Real-Estate Market

Real estate is a much, much less liquid market. Partly because selling a property is complicated, and partly because people are not mentally prepared to pack up their lives and move, or go back to living with their parents every time they think prices might go down.

My main point is this, the stock and bond markets are liquid markets. Their liquidity creates much higher volatility, but it also gives people the ability to do something that, in many cases, is exactly the wrong thing to do, sell their assets when they are afraid.

"Time in the market beats market timing" – Kenneth Fisher

Staying inside the investment prevents real-estate investors from making mistakes caused by short-term thinking. This creates a kind of "forced investing" that works in favor of the investor the vast majority of the time. But there is also another side to this coin.

This same illiquidity can become a curse when things really deteriorate:

- It becomes very difficult to adapt when your personal circumstances change (job loss, divorce, illness)

- You become stuck with an asset that might be draining cash exactly when you need cash

Still, the massive advantage is this “forced investment” that I want you to think about. A person who puts their entire wealth into a single apartment is invested at extremely high levels (sometimes 90%). Most people I know could never tolerate being this heavily invested in stock markets. And bonds often don’t yield returns at the rate that equities or leveraged real estate do. The bottom line is that in many cases, being invested in real estate is excellent for investors, but not for the reasons they think. It forces them to stay invested during bad times. From liquid financial markets we know that most people sell exactly when prices are lowest, and buy when prices are high. Real estate lets them sleep better because they don’t see their property value rise and fall every day.

“The stock market is a mechanism for transferring wealth from the impatient to the patient” – Warren Buffett

Personally, I actually see market liquidity as a great thing, because I look for opportunities to buy assets at a great price (for example, Amazon dropping to \$160 per share in August 2024). Liquidity is what allows me to generate excess returns, something that is very difficult to do in real estate because of its illiquidity. Therefore, if someone realizes that they struggle to hold a portfolio that is mostly equities, and market downturns affect their ability to sleep, it is very reasonable for them to turn to real estate as a large portion of their investment portfolio because it protects them, first and foremost, from themselves.

The Second Player – Interest Rates

The second major player in the background of our discussion, alongside the local economy and how it is structured (the macro), and the real-estate asset itself (the micro), is interest rates. Interest is the *price of a loan*, or the price of the time during which the money you lend me stays in my hands.

(Recommended reading: **The Price of Time: The Real Story of Interest** by Edward Chancellor.)

Governments can borrow money from us (via government bonds), and so can banks (via deposits). Both typically offer us a relatively safe return. There were periods in history when corporate bonds of certain companies (meaning loans to businesses, including preferred stock, convertible bonds, and other forms) offered *lower* interest than government bonds of the same period (for example: IBM vs. the U.S. Treasury several decades ago).

Interest rates are determined in a free market based on the demand for debt from each issuer. But there are artificial situations where a central bank intervenes, such as when it buys government bonds directly from the government. In practice, most of the time

institutional investors and banks buy those bonds from the government, and then the central bank buys part of those holdings from them. (That is one form of QE.) There is a *lot* of financial engineering in this space.

Let's Make Some Federal Reserve Terms Clear

QE (Quantitative Easing)

This is the modern version of money printing. The Federal Reserve buys U.S. government bonds and mortgage-backed securities from the market, preferably from banks. This injects cash into the banking system and increases liquidity. A massive buyer entering the bond market pushes yields down while the money supply in the system goes up.

QT Quantitative Tightening

The opposite of QE. The Fed stops buying bonds, or in extreme cases *sells them*, in order to pull liquidity out of the system.

The Fed Funds Rate

The Federal Funds Rate (FFR) is the *shortest-term interest rate in the U.S.* These are overnight loans between banks. Banks must hold a required reserve. At the end of each day, some banks have excess reserves and some have shortages. They lend to each other for one night. The interest they charge each other is the FFR. This rate sits at the base of the entire interest-rate system. When the Fed raises it, *every* interest rate in the economy responds upward.

When the Central Bank Intervenes, This is An Inflation Warning

When a central bank intervenes heavily and artificially pushes interest rates down, that is an inflationary signal. Early-stage inflation boosts economic activity because people feel richer and spend more, as a result the economy heats up. The central bank's goal is to stop the artificial stimulus *in time* so that the economy continues by itself without overheating.

Remember Keynes? This is exactly his idea: an artificial push that ignites real activity.

In a normal economic environment, interest rates and inflation are roughly aligned.

This is why placing money in a bank deposit preserve purchasing power, it tracks inflation. This concept is also called the neutral rate: the interest rate at which inflation stays at target without overheating or slowing the economy. Since banks are backed by the state (up to certain limits), depositing money in a bank is considered almost as safe as holding government bonds. (SVB – Silicon Valley Bank had deposits that were not FDIC insured, which is why a bank run began before the government stepped in).

Basic banking principle:

Banks borrow short-term and lend long-term.

Taking Risk Beyond “Safe Loans”

When an investor lends money beyond “risk-free” government rates, he demands compensation for the added risk, meaning higher returns. This is the origin of the popular saying: “High risk, high reward”. This applies extremely well to the bond market. In the bond market, investors try to limit their risk, while simultaneously limiting their reward.

In equities, entrepreneurship, and real estate, the *best* investors seek the opposite: opportunities where risk is *much lower* than what the market thinks, and there is a potential for unlimited reward (in theory).

I prefer this:

“The potential for high reward is when everyone else is suffering from an illusion of higher risk than truly exists.” – self quote

The famous Peter Lynch quote

“You can’t go bankrupt if you have no debt” – Peter Lynch

echoed loudly in my head when Palantir collapsed to \$8 per share. Once they announced profitability (backed largely by U.S. government contracts, which I personally believed were unlikely to be cut), the formula became clear: Limited downside, large upside. I bought aggressively all the way down from \$20 to \$8, and all the way back up to \$20, ending with an average of \$15.

This Is Where Investing Gets Subjective

Beyond government bonds, capital can be deployed in many ways:

- Loans to businesses
- Entrepreneurship
- Investing in someone else’s business
- Corporate bonds
- Rental real estate
- Public equities
- VC funds, private equity, etc.

Anyone with a pension fund, education fund, or investment property is already invested across these buckets. When lending, the investor locks in a return but gains priority over assets in case of bankruptcy, this is usually safer than buying equity. Equity investors, whether in stocks or real estate, seek something called the Equity Risk Premium. Because they risk their own capital more than a lender does, they must demand a higher return. Although even equity investors should think of first

“Thinking about the return of the capital comes before thinking about the return on the capital” –Warren Buffett

Mr. Buffett reminds equity investors as well, that the first priority is to get your money back.

only then you should think about what you will earn. The higher risk investors take on their capital the more they expect. This is why you will see investors take crazy risks in the stock market hoping their investment will ‘Moon’.

Residential Real Estate Is A Special Case

Residential real estate resembles any essential consumer good. Demand is relatively stable and relatively predictable, therefore returns *should* be low. This is why in most in most developed countries, home prices grow roughly in line with purchasing power over time. The only reason investors can earn stock-like returns in real estate is leverage.

The Exceptional Israeli Case (Last 15 Years)

In Israel, something unusual happened: The purchasing power of the average Israeli *skyrocketed* relative to the price of foreign-produced goods.

Think of:

- Flights and vacations abroad, once rare, now routine
- Access to brand-name products
- More TVs, laptops, and devices per household
- Cheaper global imports due to globalization

This freed up Israeli household budgets and allowed more money to flow into housing. Because shelter is such an essential need, rent has insane pricing power, second only to water, electricity, and food. Wherever something is safe and essentials-driven, returns *should* be low. If something is both safe *and* generates high returns, money will rush in, competition will rise, prices will climb, and returns will fall back down. This is how an efficient capitalist market behaves. Whenever a high-return, low-risk opportunity appears, the market “smells” it instantly. Capital flows in, prices rise, and the extraordinary return disappears. This principle applies to financial markets, credit markets, and real estate.

Real estate stands out to the average person simply because it is visual, tangible, and easier for people to understand and that is why they think that it is simple and easy.

The “Smart Money” and Its Stupidity

Something very common that the so-called “*smart money*” does (a nickname for investors who think they are sophisticated, which in practice usually signals their stupidity and in a moment you’ll understand why), is this: They take assets with a **very low probability of failure**, assets that therefore carry **very low interest rates**, and **then leverage them aggressively**. And the reason I say this is a stupid move made by “smart money” is simple:

the moment something small goes wrong, it can bring down an entire financial system. From **Portfolio Insurance** (which worsened the one-day crash of 1987, something almost no one in Israel talks about), through LTCM, and all the way to the GFC, aka the Great Financial Crisis (notice the Americans call it that, *not* “the sub-prime crisis”).

Why is it called that? although the spark began with sub-prime mortgages, the *real* problem was the massive leverage built on top of those assets. The actual “assets” being traded were the mortgages themselves, packaged into financial instruments, and then insurers added layers of guarantees and swaps on top of that pile creating a monster. When the leverage collapsed, a massive liquidity crisis emerged, and money was effectively “deleted” from the system. When money disappears from the system, what’s being damaged is the Money Supply. And this is absolutely critical for anyone investing in real estate to understand. Why does this matter for real-estate investors? Because in real estate, your investment is almost always leveraged, and it relies on a financial system that is itself highly leveraged. Unlike investing in stocks, where the company continues to exist even if you personally don’t receive financing, in real estate the central tool is the mortgage. Everything depends on the ability of buyers to obtain credit. Therefore, you *must* understand the deeper financial mechanics behind the scenes. The critical point: If tomorrow, people cannot obtain mortgages due to a liquidity problem in the banks, and someone *must* sell their apartment, the price of that apartment should fall sharply. Because there are no buyers without credit, and people do not buy homes in cash. The classic solution to bank liquidity problems injecting liquidity back into the system usually by the state or central bank.

But that creates other problems:

- inflation
- bubbles
- price distortions

Why my friend thinks the entire economic system is one big scam and that banks "invent money"

"Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output."

- Milton Friedman

One of the reasons central banks sometimes struggle to control inflation is that inflation is tied to factors beyond their control. And even the tools *they* do control take months before their effects are felt. With such delayed feedback, it's extremely difficult to steer inflation precisely. In the previous decade, central banks *failed to raise inflation upward* to 2% (an arbitrary target chosen decades ago by the New Zealand central bank). Inflation remained *below* 2%. Today, the global economy struggles with the opposite problem: bringing inflation *down* toward that same 2% target. Central banks have only a few tools, and they're very blunt. They use QT and QE (Google these if the earlier explanations weren't enough), in addition to raising and lowering interest rates. QE and QT are essentially methods for adding or removing liquidity from the system, which means influencing how much money circulates in the economy. They do this by buying or selling assets, foreign currency, or other instruments, which injects or withdraws money from the economy.

Through interest rates, the central bank influences the very shortest-term rate in the country, the overnight lending rate between banks. That rate affects the prime rate, loan rates, and deposit rates throughout the economy.

Types of Money Supply

The Bank of Israel defines money supply using several levels:

- **M0** – Cash held by the public + bank reserves at the Bank of Israel
- **M1** – Cash + demand deposits (checking accounts)
- **M2** – M1 + short-term shekel deposits
- **M3** – M2 + long-term deposits and savings accounts that aren't liquid

In Israel, the main measures used are typically **M1** or **M2**.

Two important points to understand:

1. The central bank controls money supply through monetary policy

It sets the interest rate, the overnight rate which directly affects the prime rate, loan rates, and deposit rates.

- Expanding the money supply → lower rates → more borrowing → more money in circulation

- Contracting the money supply → higher rates → less borrowing → less money available

2. Commercial banks also “create” money

When a bank issues a loan, it uses customers’ deposits, interbank borrowing, or loans from the central bank. This means a large part of the money supply is created by banks, not just by printing cash.

The magic of money creation, “the scam”: how one dollar becomes ten

In principle, every one dollar the central bank injects into the system becomes ten.

A friend once told me, “Banks invent money.” And in a sense *we all* invent money with the banks together.

Here’s how it works:

1. The Bank of Israel buys government bonds from a commercial bank.
2. The bank uses the money to grant a mortgage to someone buying a property.
3. The contractor deposits that money back in the bank.
4. The bank takes, say, 80% of that deposit and lends it out again.
5. The employees who receive that loan-funded money deposit it back into their banks...
6. Those banks lend it out again...

And so on. The result:

For every dollar in the system, ten different people believe that dollar is “theirs.”

The only person who truly has the dollar is the one holding it as physical cash. The paper itself is a promise by the financial system (i.e., the state) that it can be redeemed for goods and services. Banks must estimate daily withdrawals and deposits, ensure they have enough reserves to meet obligations, and ensure their assets don’t collapse in value (like mortgage-backed securities). This is why bank failure is frightening, the money deposited there isn’t really “sitting” there. Hence the fear of a bank run also known as a Panic. That’s why governments insure deposits up to certain limits and supervise banks closely.

Why this isn’t a scam, it’s a feature, not a bug

The role of banks is to allocate credit intelligently, deciding who deserves a loan and who doesn’t. Credit is the real engine of modern economic growth. We lend an entrepreneur 100,000 dollars because we trust that they can generate enough return to repay the loan plus interest. Investors trust entrepreneurs to produce returns higher than the interest rate.

George Soros, in *The Alchemy of Finance*, discusses this from a trader’s perspective. Historically, abundant credit fuels expansion, and tightening credit creates recessions. This is the essence of the system, and the reason it works *most of the time*.

The Risks with Banks

The main problem in the banking world begins when banks fail to properly price risk. When they issue bad loans and accumulate losses, they may not have enough liquidity to meet their obligations. An even more dangerous risk is when they leverage that risk further: one bank gives a loan and then pledges that same loan to another bank as *collateral*. The second bank then records this loan as an “asset” on its balance sheet. This is how a financial house of cards is built (By the way, “Collateral” is also the name of the excellent movie with Tom Cruise and Jamie Foxx.)

We, the public, through the central bank, rely on banks to be conservative, almost paranoid when assessing the quality of the loans they issue and hold. Because if they take too much risk, the entire system is in danger. If you want to see what a conservative banker is, look at Jamie Dimon through the 2000s.

In principle, banks have a simple job:

- Provide reasonable customer service (ideally- amazing customer service) so clients don't leave.
- Issue loans that are *not terrible*, meaning: avoid excessive risk and don't blow themselves up.

The truth? I don't know a single person who is satisfied with the customer service of their bank in Israel. Sometimes it feels like the Israeli model is: “Let's all give terrible customer service, where else will they go?” And yet, historically, the big advantage of Israeli banks was their extreme conservatism. This is exactly why the Israeli banking system survived 2008 without significant damage. But and this is a big “but” history shows that banks (not necessarily Israeli ones) tend to fall into the same trap. When markets are booming, banks become greedy. They issue bad loans, underprice risk, and bonuses grow fat. Why not? The bonus comes this year, and if the bank collapses in five years that's not their problem.

American banking executives in 2005–2007 earned hundreds of millions. Not one returned a dollar to shareholders whose equity was wiped out. No one faced personal consequences. This is exactly what makes the system so fragile: beneath the surface, there is a lot of money that doesn't really exist, and it can disappear instantly. Losses in the “first-layer” loans the loans that served as the basis for additional layers of leverage create a chain reaction. That is why the 2007 housing crisis became the 2008 global financial crisis.

The American Spiral Why It Worked... Until It Didn't

From 1980 to 2007, interest rates in the U.S. fell almost nonstop. What does falling interest enable? Refinancing mortgages at a lower rate. Every time rates dropped:

- Monthly payments fell

- More people could afford homes
- Home prices rose
- Anyone stuck could sell their home at a profit and pay back the loan
- Everyone looked like a genius

This created a deadly illusion: “**Nobody can lose money on real estate**”, “**Prices always go up**”. When a bank “learns” that losses don’t happen, what does it do? It lends more, to weaker borrowers, on increasingly loose terms. This is classic reflexive behavior identical to every bubble in history. The paradox: The safer an asset *appears*, the more aggressively banks lend against it, which makes the asset itself far less safe.

“The worst loans are given in the best of times.” – Old Wall Street proverb

Why This Matters for Israel Today

Israel today shows the same psychological pattern.

You hear everywhere:

- “Apartment prices only go up.”
- “Nobody loses money on real estate in Israel.”
- “Worst case, we’ll sell and pay off the mortgage.”

But if enough people struggle to make their payments and go to the bank for refinancing, and the bank agrees, because they (the public) have no alternative the public essentially re-enslaves itself to another 30-year mortgage just to reduce the monthly payment (and the banks show mo. Large-scale refinancing in a high-interest-rate environment is a major event. It “buys time” for the system but pushes the risk further into the future where the eventual crisis may be even bigger. This is exactly how the mortgage market can be boiling hot while the housing sales market stagnates. The Israeli banks are betting that households’ purchasing power will improve not deteriorate.

“If something cannot go on forever, it will stop.” – Herbert Stein

Some Lessons from Cases Where Companies Everyone “Could Trust” Taught Us We Shouldn’t Trust Anyone

The Warren Buffett Adventures – If It Can Happen to the Best, It Can Happen to You

Back in the 1980s, Berkshire Hathaway was a satisfied client of Salomon Brothers and eventually became a shareholder of the investment bank. But to understand what happened there, we need to start with a short lesson on how U.S. Treasury debt auctions actually work. When the U.S. government needs to raise money to fund its operations, it issues government bonds (Treasury Bills, Notes, and Bonds). The method used is called a *Dutch Auction*, also known as a *Uniform Price Auction*. It works in several stages:

1. Announcement - The Treasury announces how much money it wants to raise (for example, \$10 billion in 10-year notes).
2. Submission of Bids – Participants, usually large banks designated as *Primary Dealers*, institutional investors, and the public submit two types of bids:
 - Non-Competitive Bid - The investor says: “*I want \$1 million worth of bonds, whatever yield you decide is fine.*” These bidders get guaranteed allocation.
 - Competitive Bid - The investor says: “*I want \$100 million of bonds, but only if the yield is at least 4.5%.*”
3. Price Determination (The Clearing)
 - First, the Treasury subtracts all non-competitive bids from the total.
 - Then it begins accepting competitive bids, starting with those requesting the lowest yield (meaning they’re willing to pay the highest price).
 - It continues upward through the yield levels until the full amount is raised.
4. The Result - The Uniform Price

The highest yield needed to complete the auction is called the Stop-out Yield. *Every* participant, even those who bid lower yields, receives the bonds at that exact uniform final yield. **To prevent any single participant from cornering the market and manipulating prices, the Treasury imposed a rule prohibiting any one entity from acquiring more than 35% of any given issuance.**

Paul Mozer

Paul Mozer was a senior executive at Salomon Brothers and oversaw trading U.S. government bonds. He violated the 35% rule in 1991 by:

1. Purchasing 35% of an issuance, *and then*
2. Submitting additional huge bids under the names of clients, without their knowledge, and transferring control of those bonds to Salomon.

This artificially drove up the price of the bonds (also known as cornering a market) and generated enormous profits. The scandal wasn't only the action itself, it was the fact that his managers discovered the violation and did nothing. Later, Mozer repeated the scheme and was caught. That is when the djinni came out of the bottle. The U.S. Treasury considered banning Salomon from future auctions, a move that would have meant the end of the investment bank. Buffett persuaded the Treasury to allow the bank to survive and served as interim Chairman and de-facto CEO. During the congressional hearings, he delivered one of his most famous lines:

"Lose money for the firm, and I will be understanding.

Lose a shred of reputation for the firm, and I will be ruthless." - Warren Buffett

The lesson? Even in the most prestigious, respected institutions, a single rotten apple driven by greed can create massive damage. But the more interesting lesson Buffett shared during his Salomon adventures was the following story.

"It's a Plug Number."

In another story, when Buffett was serving on the board, he noticed a number in the balance sheet he didn't understand. When he asked what it represented, he got this answer:

"I was told it was a plug number. 'Without it, it just doesn't balance'." - Warren Buffett

Every time they re-worked the books, the accounting department simply inserted whatever number was needed to make the report balance. This was a firm with thousands of employees, among the most sophisticated in the world, and it had a line item in its books no one could explain. Worse, the external auditors didn't catch it either.

General Re

In 1998, Buffett acquired the massive reinsurance company General Re for about \$22 billion. Everyone, including Buffett, believed it was a conservative, stable insurance business. What he didn't know was that hidden inside the giant company was a small subsidiary called General Re Securities (GRS). This group was run by traders who dealt in extremely complex financial derivatives. They showed impressive profits, earned huge bonuses, and those profits were reported in General Re's financials, inflating its perceived value. But the trades were long-dated, sometimes stretching decades forward. The phenomenon was this:

- They entered a trade.
- The counterparty entered a "mirror" trade.
- In many cases both sides recorded immediate profits, even though the real economics wouldn't be known for 20–30 years.

When Buffett asked how they knew the trades were profitable, they explained that they used a pricing method called Mark to Model instead of Mark to Market. Because there is no daily market price for a one-of-a-kind 30-year derivative, the traders simply fed inputs

into their own model, and the model conveniently gave them the profit number they wanted.

Buffett interpreted it this way:

- The traders set the assumptions optimistically to record immediate gains,
- Took massive bonuses that year,
- And left the future explosion of risk to the shareholders.

He famously called their approach:

“Mark to Myth.”

Cleaning up this fiasco cost Berkshire hundreds of millions of dollars.

The Deeper Lessons

These stories carry moral lessons far deeper than their surface narrative. Warren Buffett established his reputation through decades of extraordinary performance across credit cycles, business cycles, and countless asset classes. Yet even he, arguably the most knowledgeable person alive regarding insurance and financial companies, found himself in situations he never imagined. At Berkshire shareholder meetings, he and Charlie Munger shared experiences that would terrify any investor:

wildly unrealistic forecasts, hidden risks, and unbelievable behaviors in companies that were supposed to be “the safest.”

If the best investors ended up with problematic investments, how much more cautious must we be?

You cannot blindly trust someone just because they work in a prestigious institution. (Buffett called Mozer a “pyromaniac.”). You cannot rely on external audits to catch everything. Look at Enron and Wirecard. Look at what happened to GE after Jack Welch left. The man hailed as the greatest CEO of all time built a company whose true value was far lower than believed and loyal shareholders lost almost everything. Welch famously said his legacy would be measured by how the company performed after his departure in the same number of years after he left. It didn't take 20 years to see that GE had been driven straight onto the highway to hell and its driver got off one stop earlier promising it's a highway to heaven.

Some Accounting

In the recent real estate market, we are witnessing a flood of aggressive marketing campaigns by homebuilders. While the specific terms differ, the mechanics in Israel serve as a perfect case study for what is happening in the US market with "Rate Buydowns" and massive builder concessions. In Israel, the most common tactics are the "20/80 Deal" (pay 20% now, 80% on delivery) or "Contractor Loans," where the

developer subsidizes the mortgage interest for the first few years. Sometimes, they waive the "Index of Construction Inputs" (an inflation tracker linked to the debt), which is effectively a massive, hidden discount.

The goal is clear: make the buyer feel the deal is affordable and that they are "saving" money, without officially lowering the sticker price. This makes the buyer feel like he is making an instant profit. But buyers, whether in Tel Aviv or Texas, must ask: Why are construction companies acting like banks? Buyers look at the monthly payment and think the deal is cheap. But to understand this phenomenon, we must look at Book Value.

Book Value: The Accounting Reality

In accounting, Book Value is the value of an asset as it appears on a balance sheet. It is the money left over if you liquidated everything today to pay off debts. For a homebuyer, the "price" is simple: Equity + Mortgage. But the day after purchase, the True Book Value is whatever the market will pay. If you sell for less than you bought, you lose equity. If you sell for less than the mortgage balance, you are "underwater."

LTV: The Bank's Shield

People avoid selling real estate at a loss unless forced. In a liquid market, assets are "Marked to Market." Bank appraisers try to estimate this value, but their job isn't to price the home for *you*, it is to protect the bank from a "bad loan." A bad loan is one where the risk is mispriced. This brings us to LTV (Loan to Value). If a bank lends at 75% LTV, the borrower's 25% equity is the "shock absorber." The bank wants to ensure that even if prices drop by 15%, they can sell the foreclosed home and cover the debt. The Trap: In bubble markets, appraisers rely on "Comps" (comparable sales). If the "Comps" are the bank's safety net is an illusion.

DSCR

The bank is also interested in the borrower's DSCR. Beyond the question "How much is the asset worth?", the bank has a more urgent and daily concern: "Does the borrower have enough breathing room to pay me every month?" Here is where the Debt Service Coverage Ratio (DSCR) comes into the picture. Simply put, this metric examines the ratio between Net Operating Income (NOI), whether it is a private individual's salary or rent collected from an income-producing property, and the total debt payments. If the DSCR stands at 1.0, it means the income covers the debt exactly, with zero margin for error. Banks, who hate risk, usually look for a healthier ratio (for example, 1.25 and above for investors, or a repayment-to-net-income ratio not exceeding 30%-40% for households) to ensure that even if interest rates rise, or the apartment stands empty for a month, the borrower can still meet their debt obligations. The major problem in the current market is that rising interest rates have "killed" the DSCR. Due to the nature of variable interest rates, the monthly repayment has ballooned significantly, while

incomes (salaries or rents) have not risen at the same pace. This creates a dangerous situation where a borrower might hold an asset worth millions "on the books," but is cash-flow suffocated and liable to face insolvency. This forces the bank to liquidate the asset—exactly the scenario it tries to avoid. Today, we are witnessing landlords injecting personal cash on top of the rent just to cover the mortgage, whereas previously they did not have to do this. Generally, a mortgage is considered a safe loan for the bank because there is a collateralized asset, and there is a "safety cushion" in the form of the buyer's equity (usually at least 20%). Even if the property returns to the bank, it can sell it for 20% less and still recover the principal. Therefore, the bank's appraiser will usually value the property on the lower end of the scale, just to be safe.

But it is important to remember: An appraiser is not an investor analyzing cash flows. He doesn't truly know the Intrinsic Value of the asset. He performs a valuation based on Relative Valuation, meaning he guesses the Book Value based on similar transactions.

And a Little Something for Stock People – Current Ratio

I'm going to take advantage of the fact that real estate is relatively simple for most people to understand in order to explain a few things about financial statements. I've explained in the past that rent is like debt. When a person rents, they commit to meeting their obligation to the landlord. That is the reason a landlord asks to see pay stubs to see if the tenant can actually handle the rent expenses (DSCR). That is also why they ask for a security deposit; that is their collateral. If we use this comparison from the real estate world for a moment and move on to analyzing business reports, we'll discover that there, debts are classified into two types: Current Liabilities (a range of one year) and Long-Term Liabilities (over a year). Although lease payments in financial statements don't always fall under the debt section, I like to put them there (something I learned from Aswath Damodaran).

Now, we as investors want to verify that the business we are investing in will meet its obligations and won't go bankrupt. Therefore, we are interested in the business's *ability* to meet its obligations. A tool to measure this is the Current Ratio.

Think of the Current Ratio like the DSCR of the business world. The principle is exactly the same: we take everything "liquid" that can turn into cash within a year (Current Assets which for a regular person is usually their income), and divide it by everything the company has to pay within a year (Current Liabilities).

$$\text{Current Ratio} = \frac{\text{נכסים שוטפים (Current Assets)}}{\text{התחייבויות שוטפות (Current Liabilities)}}$$

Current Assets are cash, inventory, and income expected to come in within the coming year (sales that happened, or debts owed to us). Current Liabilities are the Current Debt we talked about earlier, and all other debts that must be paid this year like suppliers,

salaries, bills, and loan payments (and as I said, I like to add the rent that needs to be paid here).

I like to include here anything I know *must* be an expense this year and add to it.

And I'll note one more thing on this subject. There are rules that accountants follow because things need to be reported in a certain way (GAAP). We can interpret the data *for ourselves in a way that differs from what is presented.*

“If options aren't a form of compensation, what are they? If compensation isn't an expense, what is it? And, if expenses shouldn't go into the calculation of earnings, where in the world should they go?” – Warren Buffett on GAAP Accounting

When doing the calculation, exactly like with DSCR, the number **1** is the "watershed line". If a company has a Current Ratio of 1, it means it has exactly one dollar in the coffers (or inventory) for every dollar it must pay. On the other hand, when we see a company with a Current Ratio of 2, we know that for every dollar of debt, it has two dollars on the side. A ratio of 0.5 means that for every dollar of upcoming expenses, there is only half a dollar available. A high Current Ratio corresponds to a high and healthy DSCR in real estate.

However, some businesses like to operate with a high Current Ratio, while others like to operate with a low Current Ratio. This doesn't mean one is better than the other. This is a classic mistake of people who study accounting. Apple, for example, has been operating since I started reading reports (which has been quite a few years) with a Current Ratio lower than 1. They can do this because they can obtain the necessary money with ease. No one will think that Apple is a riskier borrower than anyone else.

A Note to Real Estate Investors - how to use “Stock Investing Practices”

Since Real Estate Investors rent out their property, they want to get an understanding of the tenants finance situation. This is why I find the concept of accusing owners of “Income Discrimination” absolutely crazy. It is obvious that a landlord will prefer a renter who is better off financially (although most landlords will likely prefer a renter who is less wealthy and will take great care of the property than someone rich who will trash it). When trying to assess a renter's income, one has to also take into account the idea of a downturn in that person's financial situation. If they are employed and lose their jobs, they will be collecting unemployment benefits. If they are a business owner or self-employed, their income could get cut at any given moment. This is why banks and many lenders like lending salaried employees. This is another reason why many business owners will hire themselves as employees to make borrowing easier. A landlord should always think of his collateral (a deposit) and also take into account the risks with the renter. Screening the tenant is the most important thing as a landlord. The real estate investor has to think about the financials of himself. A landlord has to think about the

financial aspect of his renter. Even if they do not have a lot of income, but they have a lot of savings and have proof of this, this is part of their current assets (be wary of forged documents). Just like a business goodwill has value, so does a renters personality carry financial value too(if they take care of your place, they are saving you money).

Valuation

This is the time to introduce Aswath Damodaran, often referred to as "The Dean of Valuation." His books and lectures (such as the linked YouTube channel) are highly recommended for anyone seeking a deep understanding of finance.

https://www.youtube.com/watch?v=znmQ7oMiQrM&list=PLUkh9m2BorqnKWu0g5ZUps_CbQ-JGtbI9

His books are excellent, though challenging, and are unequivocally suitable for those wishing to master corporate finance. However, in the specific lecture linked above (and his YouTube channel is a treasure trove of free educational content), he explains asset pricing based on comparable assets.

This concept, Relative Valuation, is the primary method used in real estate. Take, for example, a seller who lists her apartment for 200,000 NIS more than her neighbor's recent sale price (a scenario often highlighted in Israeli investigative reports). Real estate valuation relies almost exclusively on the question: *"How much did a similar property in the same location sell for?"*

The problem arises when the housing market is in a bubble about to burst. In such a case, the appraiser's valuation (which is based on the recent past) will be fundamentally flawed, leaving the bank exposed to significant risk. The risk to the bank isn't just a loss on a single loan; it is a Liquidity Crisis. Banks "live" on the spread between short-term liabilities (public deposits) and long-term assets (mortgages). If a borrower does default, the bank sells the collateral to recoup the losses. If many borrowers stop paying simultaneously, the bank faces a severe cash flow crisis. The bank will have lots of real estate and will have trouble to sell fast enough without heavy losses. Therefore, the bank will always prefer to refinance ("recycle") a mortgage and do whatever it takes to keep cash flowing, rather than getting stuck holding real estate assets.

Developer Financing & The "Shenanigans"

The Shenanigans

The situation in Israel is even more complex because many buyers have taken loans against their pension funds and "Keren Hishtalmut" (tax-free study funds), funds that are themselves invested in many cases in real estate stocks and bonds, and bank stocks, in order to increase their down payment equity.

This creates a circular feedback loop: It inflates the profitability of banks and real estate companies, boosts their stock value, and in turn, allows the next borrower to take out an even larger loan against those inflating assets. Additionally, a new profession has emerged: "Investor Mentors" who teach people how to take out "supplementary loans" to bypass equity requirements. Many parents and families have helped their children with equity to buy apartments. By doing so, they have "pulled demand forward," a factor that may unconsciously distort the true Supply and Demand equation for the "professional" public (Supply and Demand being the central argument of real estate bulls as to why prices must inevitably continue to rise).

Furthermore, many developers cross-collateralize their income-producing assets to finance new projects. A decline in value endangers this entire house of cards. This entire system is fueled by the single fact that people are still meeting their loan payments. As the incestuous nature of "supplementary equity loans" and various financial engineering we aren't even aware of (and there is always at least one rotten apple) become increasingly tangled, involving more players, or in the worst case, a very large and important player, the result could be far more destructive. The day this stops, when the cash flow of enough households can no longer sustain it, it could create a problem far more devastating than we realize.

Due to inflation, public purchasing power is eroded by rising household expenses. From the other side, due to rising interest rates, the DSCR has deteriorated, further eroding the public's purchasing power. Landlords are trying to roll the mortgage hikes onto tenants, a public that is already losing its ability to save. Current homeowners are failing to save enough to sell their current home and add the necessary equity in order to "upgrade" and buy the next one. A situation has emerged where the DSCR is down and savings capacity is shrinking, which threatens future demand. If the average Israeli family stops providing financial assistance at the same pace, and Israelis run out of sources to borrow "fake equity" for home purchases, we could see further drops in demand. Which would force Real Estate prices in the "Second Hand" market down, beginning a downward spiral.

This is the banks' nightmare scenario. Consequently, banks and developers could find themselves stuck between a rock and a hard place in a worst-case scenario. Due to the illiquid nature of real estate, they lack the option to "rip the band-aid off" quickly and painfully, as can be done in the stock and bond markets.

Asset Differences in Balance Sheets: Stocks vs. Real Estate

In the capital markets (stocks and bonds), the situation is different because of a mechanism called "Mark to Market" marking the value of assets every day and every

moment. We can verify daily what the market would pay for these assets. Based on this liquidity, one can take a loan against them from an investment bank, known as trading on Margin. The investment bank takes those assets as Collateral; they are pledged to secure the loan, and the investor can use the funds to invest in other assets. This is distinct from a mortgage, which is a loan specifically for purchasing the asset itself. If you took a loan against a stock portfolio and the portfolio's value drops significantly, the bank can demand that the borrower provide more assets or cash against the loan. If they don't do so quickly enough, the bank immediately executes a Margin Call (Interestingly, there is no Wikipedia page for "Margin Call" in Hebrew, and people wonder why I think they need to learn about finance in English...). The bank forcibly sells your assets to cover the debt. This is, for example, what happened on March 26, 2021, to Archegos Capital Management, which faced a massive Margin Call.

https://en.wikipedia.org/wiki/Archegos_Capital_Management

In Real Estate, due to illiquidity, you cannot execute an immediate Margin Call on developers. Even if they have pledged existing income-producing properties to the bank (and there are quite a few "developer apartments" on the market rented out for 5-year terms...), banks cannot simply liquidate them. Dumping enough of these apartments onto the market at once would create the exact systemic danger the banks fear most. Therefore, banks have no interest in lowering apartment prices, even when those apartments are controlled by the developer, because the danger is identical. When apartment prices drop, the LTV (Loan to Value) spikes. Consequently, banks will do everything they can to assist a distressed developer.

This brings us back to the "20/80" deals. A developer has "Inventory" (apartments) and "Liabilities" (bank loans) on their balance sheet. To continue receiving credit in order to continue with construction, the developer must show sales and maintain the book value of their inventory. If the developer officially lowers the listing price, they devalue their entire remaining inventory. This worsens their balance sheet position vis-à-vis the bank. Therefore, the developer has a massive incentive to "engineer" the deal: Keep the nominal price high, but offer financing benefits (like inflation index waivers or interest subsidies) that are equivalent to a real discount (a reduction in the *real* price).

- The apartment gets sold.
- The developer gets cash flow.
- But on the "Books," the price remains high, and the bank remains calm.

This isn't just about the specific apartment you bought; it's about protecting the valuation of all the other apartments the developer still needs to sell, and all their collateralized assets. It is crucial to understand that a sharp drop in real estate values doesn't just hurt bank profitability; it tangibly endangers their loan portfolios and hits their Liquidity.

When developers have unsold apartments (even on paper), they hold Debt (to banks) and Inventory with a specific Book Value. Banks are not in the business of holding apartment inventory; they want money. To receive continued funding for a project (or future ones), the developer needs to move inventory off the books and get a cash infusion from buyers to progress construction or strengthen their balance sheet (or even to pay the bank for a different loan).

To progress with construction, a developer typically wants to pre-sell (e.g., 70%) of the units. But let's assume the requirement is lower; they still need to sell *more than zero* to move forward. If they struggle, it is natural to think they might lower the price. On the other hand, lowering prices hurts both their books and the bank's books.

This creates an excellent incentive to find "patents" (like these sales campaigns) that lower the price in *real terms* but leave it identical on the books. It's not about this specific unit; it's about all the others. In my opinion, this is also why they are desperate for any cut in interest rates, to ease the burden on borrowers and inject a little more demand into the market.

There is a common opinion in the Israeli market that there is a conspiracy to keep paper prices high to make massive profits at the public's expense. The reality is that if developers and/or banks took risks we are unaware of, they are forced to do this. For them, a drop in apartment prices is not a risk to *profits*; it is an existential threat. Because real estate companies operate on debt, they require constant cash flow. These "20/80" deals and their likes allow these companies to receive a critical injection of cash right now and ensure continued financing from the bank.

The "Term Out" Trap Why the Banks are Doing Well While Housing Sales Stall

In the current environment, Israeli households are rushing to refinance, not to save money, but to survive. They are "termining out" their debt, taking a 20-year mortgages and stretching them to 30 years simply to lower the monthly payment and get some more breathing room. For the Banks, this is a goldmine disguised as a lifeline. First, they generate immediate fee income from the refinancing process. Second, and more importantly, they get to re-price the debt. They take a customer who was paying a lower rate and get then into a new loan at a significantly higher interest rate for a longer period. This massively increases the total interest the bank will collect over the life of the loan.

This creates a fascinating market anomaly: A rise in the mortgage market alongside dropping housing sales. Normally, mortgage volume should track home sales. When they diverge, when you see billions in new mortgages but fewer new keys being handed over, it means the money isn't funding growth, it's funding survival. By engaging in this widespread refinancing, the banks are effectively doubling down on risk. They are

betting that by giving struggling borrowers "more rope" (lower monthly payments now), they can bridge the gap until the economy improves. This is the source for the book's title.

It is a "Double or Nothing" strategy: If the market recovers, the banks emerge with higher profits and a larger loan book. But if they are wrong, if incomes continue to erode or prices drop, they will have exposed themselves to even significantly larger losses from borrowers who were already bordering insolvency, just later and with a bigger debt burden.

Unconventional Strategic Thinking

Here is a strategic thought about what household should consider as long as they understand the risks involved. This play should not be considered if you have nowhere to downsize too (like if you own a 1bd condo). In order to bolster their returns, throughout the life of the mortgage a household can refinance and pull out their equity and invest it elsewhere or in another property. Later on when they are ready to downsize, they sell the property to cover the mortgage. This will make the return on the equity left in the house much higher, and will allow the rest of the funds to compound at a higher rate. This is because the return on the equity shrinks as you pay off more and more of the mortgage.

It is a common goal for people to pay of the mortgage completely, but this may not be the best financial decision in the long term.

Strategic Mortgage Management and the Hidden Power of Leverage, when should one refinance, and how

Real estate is one of the few investment arenas available to ordinary households where leverage is not only allowed, it is encouraged. The mortgage is the engine that turns a modest return into an extraordinary one, but it is also the same engine that can destroy a family's financial stability when misused, misunderstood, or mis-timed. To understand real estate, you must understand the mortgage. And to understand the mortgage, you must understand leverage, interest-rate cycles, and the true behavior of equity over

time. This chapter dives deep into how leverage truly works, why paying off your home *completely* may be one of the *least efficient financial decisions*, and how sophisticated households can accelerate wealth creation by managing their mortgage strategically across decades while fully understanding the risks.

Why Real Estate Generates Outsized Returns – Why Paying Off The Mortgage Completely, May Be The Wrong Dream

The reason real estate helped millions build wealth is not because “property always goes up.” It’s because: Leverage + Relatively Stable Demand = Accelerated Equity Growth

If you buy a property for 1,000,000 ₺ with 200,000 ₺ equity (20% down), and the property rises 20%, it is now worth 1,200,000 ₺. Your equity doubled from 200,000 ₺ to 400,000 ₺. A 100% return on your equity even though the underlying asset rose only 20%. This is the mathematical magic of leverage. Now comparing this to stocks, the S&P500 rises more over time than real estate, but you typically do not buy stocks with 5× leverage. Companies themselves are leveraged, so adding your own leverage is equivalent to leverage on leverage dangerous and often irresponsible for households. Real estate is unique because demand is sticky and generally predictable: people rarely “reduce consumption” of housing. Banks allow high leverage at low interest rates. You control a large asset with little capital. Those three forces combined are why households-built wealth through homes than through any other investment, despite the mediocre average appreciation rate.

The Dark Side Leverage Works Both Ways

Leverage that doubles your equity in good times can also erase it in bad times. The true danger is not falling home prices it is cash flow pressure:

- Rent does not cover the mortgage
- Interest rates rise
- Income drops
- Vacancy increases
- Repairs spike unexpectedly

When there is a reduction in a household’s purchasing power meets rising interest rates, they become vulnerable. When their cash flow turns negative they become *fragile*, which eventually leads to distress sales (aka a very motivated seller). In real estate, the real killer isn’t price. It’s the owner’s liquidity.

Understanding Interest Rate Cycles

Interest rates move in long multi-decade waves. Each full cycle has four stages, 1. Falling Rates - Mortgage payments on new financing get cheaper. Real Estate investors with deeper pockets will buy for cash at this instance because it tends to be

during a recession and the appetite for risk is small, or people are waiting on the sidelines for interest rates to come down. This is assets normally can be bought cheaply. Those who borrow may buy now and refinance at the bottom if it is worth it.

2. Bottoming Phase - Rates stabilize at a bottom. This is the *best time in the cycle* to lock long-term financing. This is when real estate investors will refinance currently owned properties. This is also when the markets tend to normally heat up the most. Many home buyers upgrade at this phase, and the beginning of this part is the “out of the dip” moment Peter Lynch describes in his famous quote.

3. Rising Rates (the tightening era) – Normally due the economy over-heating or pessimism by lenders. Because rates move higher, payments spike on new loans or AR(adjustable rate loans). Affordability collapses.

4. Peak Phase (stress test) - Prices stagnate or fall, Households feel maximum pressure.

Sam Zell explains in his book *Am I Being Too Subtle* that the economic and credit cycles appear in the real estate market with a lag.

Households who understand this cycle do not simply “buy a home”. They time and structure their mortgage to align with the best parts of the cycle. They sit down and calculate at the bottom of the cycle should we refinance now the house we own. A family should sit down and figure out does it make sense to pull out some equity (if let’s say 80% is already paid off). This will increase the ROE (return on equity) on their current home, and will allow them to get a higher ROE on the equity they pulled out. However, this brings a higher degree of risk than a completely paid off home from a leverage perspective, however, this you reduce some risk by being more diversified (one has to be careful from ‘di-worsification’ – a term coined by Peter Lynch).

The Strategic Play - Refinance, Extract, Compound, Downsize

This strategy is not suitable for everyone. It is not suitable for people who cannot tolerate this form of risk. It is not suitable for people with poor money management. But for financially disciplined households, it can dramatically increase long-term wealth. Families tend to get to the ‘final’ house when they raise their families. This is where they will likely spend the next 15-20 years. When the kids are out of the house, or people retire, they look to downsize. This strategy only works for people who are likely to downsize to a cheaper property.

The strategy:

1. You buy a home with a mortgage.
2. Over time, the mortgage amortizes and the house appreciates.
3. Your equity grows, but your return on equity shrinks.
4. You periodically refinance, increasing the mortgage and pulling equity out.

5. You invest that extracted equity into:
 - another property, or
 - stock index funds, or
 - diversified investments
6. Near retirement, you downsize:
 - sell the large home
 - pay off the remaining mortgage
 - Buy the downsized house with the remaining equity from the larger house (so you don't have that monthly mortgage payment when you are retired).
 - keep the invested capital that compounded for decades.

Why This Works

- You keep the mortgage working for you instead of dead equity sitting idle.
- Your external investments grow faster than the home's appreciation.
- When downsizing, the sale of the larger property clears the remaining loan.
- The extracted equity you invested continues compounding *forever*.

The Key Insight - you don't get rich from paying off your mortgage. You get rich from the capital that was NOT trapped inside the mortgage.

Risks You Must Acknowledge (I will speak about risk more extensively in the next chapter)

This strategy is powerful, but dangerous if misunderstood.

1. Purchasing power risk - If a household's purchasing power drops, high mortgage payments can become lethal.
2. Rate Risk (especially in Israel) -Most Israeli mortgages are not fixed for 30 years like in the U.S. Rising rates can destroy cash flow.
3. Investment Risk – Your other investment may be unsuccessful.
4. Discipline Risk - If extracted equity is used for consumption instead of investment, the strategy collapses.
5. Liquidity Crisis - In periods of recession, unemployment, or credit tightening, refinancing may not be possible.

This strategy requires:

- A stable long-term income
- A long time horizon
- Discipline
- High financial literacy
- Emotional tolerance for volatility
- Backup liquidity

Without these, the strategy becomes destructive, not constructive.

Leveraging the Bottom of the Rate Cycle

The most powerful moment in the mortgage lifecycle is the bottom of the rate cycle.

When rates bottom one can theoretically (and savvy people do in reality):

1. Lock in financing for as long as legally possible
2. Acquire quality assets at cheaper financing
3. Avoid variable-rate exposure
4. Build liquidity for the next rising-rate era
5. Refinance if possible (to reduce interest or extend fixed periods)

This is when fortunes are built quietly.

Households who secure cheap long-term financing enjoy a decade or more of:

- Predictable cash flow
- High leverage efficiency
- Rising rents relative to payments
- Increasing equity with low risk

When rates rise, the return on leveraged real estate skyrockets for those who locked low rates earlier.

Why Most Households Completely Miss This

The average person:

- focuses on the monthly payment, not rate cycles
- fears debt irrationally
- pays down the mortgage too quickly
- does not reinvest extracted equity
- reacts emotionally instead of strategically
- treats the home as sentimental instead of financial
- **THIS IS THE BIG ONE:** takes on more credit risk with other liabilities, and can borrow less. People tend to buy nicer and more expensive cars after they buy their house, since they do not need to save anymore for that down payment. They will buy somethings on credit, make upgrades with borrowed funds, or do silly things like buying financed vehicles. No financial mistake is as common as borrowing to buy a vehicle. Especially luxury vehicles. SO if you feel envious of someone else driving a car you can buy with financing, assume that they are an idiot and that you are smarter than them. This will instantly make you feel better. It is uncommon for someone to buy a car with a single cash payment. My cousin did that with his BMW, which is uncommon. You want that luxury car? You can save that money that you would spend on car payments in a savings account; get interest for it, and then when there is an economic downturn buy it for cash and cheap. That's what my cousin did. He is a smart guy.

The result?

They miss the most powerful wealth-building window of the last decade.

The woes of my generation

The majority of my generation did not have the personal wealth, family assistance, financial education or were not in the stage in life to be able to put down the down payment or be mentally there to take advantage of the previous cycle. At this stage it is unclear if housing will become more affordable in the near to mid future. I will speak about this more in the third part of the book.

How to Think Like a Strategic Household

If you want to apply this chapter intelligently, ask yourself:

1. Do I have a long-term plan for my mortgage, or am I "winging it"?
2. Do I understand how my equity behaves over time?
3. Am I monitoring interest-rate cycles?
4. Do I have the discipline to invest extracted capital rather than spend it?
5. Do I have a realistic future downsizing plan?
6. Do I understand my cash-flow sensitivity to rate changes?
7. Do I know my worst-case scenario?

A household that treats its mortgage like a strategic asset, not a burden, is playing a different game entirely.

Final Thoughts

Real estate rewards those who understand leverage, and punishes those who use it blindly. In fact, if you choose not to play, you are being played. No matter how you look at it, you are part of the economic machine. A family household can not afford not to think about these things. A rate cycle will affect your business, your employer, your investments. This is why being a passive investor is a myth. There is no such thing. Everyone takes active financial decisions with how they choose to operate their cashflow, how to manage their balance sheet. How much debt can they manage without going bankrupt in order to increase wealth. Wealth is not just financial. It is your quality of life, the time you spend. Wealth is subjective. If you want to drive a luxury vehicle (I know I was critical about this), travel more than others or anything else, that is perfectly fine, just understand the consequences. Understand the cost of other opportunities. No one is a passive investor, everyone is active, they just might not know it. There are only 2 kinds of investors, the enterprising and defensive.

All people need to know that the mortgage is not something to fear. It is not something to "get rid of" as fast as possible. It is the most powerful financial instrument the average family will ever use.

Used wisely, it can:

- Multiply equity

- Expand investment capacity
- Improve long-term financial security
- Create real family wealth (I hate the “generational wealth” term)

But just like any other powerful tool, it can be destructive.

This chapter is not about taking more risk; it is about an introduction to the risk you and an entire economy carries. So, think about how to use it intelligently rather than emotionally in order for you to gain the maximum utility from managing your life from a financial perspective. The game of real estate is not about the house. It is about the financing. And a massive part of the economy revolves around these 2 asset classes.

The house, and the mortgage. When investors and lenders take on too much risk, it can take an economy years to recover. Some households get destroyed, but the households that understand financing win.

Chapter 6 – The Balance Sheet of the Israeli Public - Risk

“At all times, in all markets, in all parts of the world, the tiniest change in rates changes the value of every financial asset.” - Warren Buffett

Continuing the Conversation on Interest Rates

“Interest rates are to asset prices what gravity is to the apple.” - Warren Buffett.

Why Do Investors Take Risks? The Price of Money, Equity, and Investing

So, interest rates determine the price of money for us at the time a loan is given; that is, the price for the time during which the borrower holds the money until they return it all, along with the interest. If they are late on payments, interest is added to that original amount (The Principal), and interest is charged on top of that based on the determined rate.

Why Do Investors Choose to Take Risks?

Investors have no reason to invest in a business unless they believe they have a good chance (probability) of receiving a return on the risk they take on their equity.

Specifically, they need the [Return on Equity] to be higher than the interest they could receive from simply lending that money out (which is considered a safer activity).

And that is how it works, whether with real estate or investing in a business (which is expressed through stocks). The most significant difference between investing in bonds and investing in Equity (real estate, stocks, or private businesses; stocks are simply investing in a public business) is variable returns. Meaning, in equity investments, the return is unknown.

In two sentences: An Equity investment is an investment where we take 100% of the risk and plan to receive unlimited profit. A "Loan" investment (which includes money in a checking account, deposits, money market funds, bonds...) is an investment where we lower the risk, but in exchange, we cap the maximum profit at a pre-determined number. As equity investors, we want to receive a premium relative to bonds for the risk and uncertainty we endure. What does this mean? In bonds (or any other loan; for the sake of simplicity, let's categorize all types of existing loans under "bonds," including those taken on black markets and from loan sharks, You might think that is a joke, but to the

population that is “unbanked” and cannot get a loan, loan sharks are their only option), as we said, the investor limits the amount of profit they are supposed to receive in some way. No matter what happens, the ‘bond’ investor will not receive more than that amount (while there is a chance they will receive only part of the expected profits, no profits at all, only part of the principal, or potentially nothing at all in the end).

Never in life does a situation occur where a business says, "I had such an amazing year, I feel like giving the bank extra on the loan they gave me just because they are nice guys."

This is the difference in equity investing. In real estate, there is the hope that we can raise the rent, or that our business will grow or become more efficient, thus becoming more profitable over time. In an investment where we are the asset owners, if the assets earn more money, they have more excess cash to give to the shareholders (dividends). Meaning, the asset owner receives more money the more successful the business is.

The Equity Risk Premium – P/E Ratio and Speculation

I am reminding you, because we discussed this in the previous chapter: in simple words-how much *extra* return do I need to receive so that I am willing to forego the safety of government bonds and step into the mud of the stock market or buy real estate?

This "extra," the difference between the return I expect to receive in stocks and the safe interest rate, is the Equity Risk Premium.

For every person, this is subjective. Let's assume the "loan" instrument a person wants to give is a corporate bond; then the premium is the excess return they would want to receive to hold the stocks rather than invest in the bond. Naturally, when interest rates rise, the premium an investor must demand is higher, and vice versa. This is because when interest rates rise, there is a higher risk that businesses will manage to yield a lower return or no return at all. Therefore, an investor must demand a larger premium because their risk trend has increased, and furthermore, they have a real, significant alternative. This is one of the reasons why, historically, when interest rates rise, the stock market and real estate market fall.

Here enters the component of speculation/P/E ratio. In English, I don't know why, but the only investment field that has good vocabulary for its domain are Equity Investors in stocks. Real estate, which in the U.S. often attracts slightly less sophisticated people (though not necessarily less smart), takes concepts and applies them to things that miss the mark (in my opinion), while investors in the bond market, who are considered "smart investors," overcomplicate things with their words. In Hebrew, the situation is worse.

Price to Earnings (P/E) ratio

is the relationship between the price of an asset at a specific moment relative to its total earnings in that same year. A P/E ratio means that for an apartment you bought today for 100,000 dollars, which brings you 5,000 dollars **net** per year, it has a P/E of 20.

There are only 2 reasons someone would buy an asset with a higher P/E than another asset:

1. They believe that the growth rate in earnings of the allegedly "more expensive" company (higher P/E) will be higher.
2. They trust the "more expensive" asset more to provide the earnings it provides today over a number of years. Meaning, the business won't go bankrupt, will meet its obligations, etc. In other words, they trust the asset's ability to continue supplying the yield it gives today (Earnings are sustainable).

The Investor's Equation

We live in the balance between these two factors: confidence in the investment versus the expectation of profit. After all, if there were a safe option that could yield high returns, we would all flock to it. Since our sense of security varies across different times and situations, and because we possess biologically inherent flaws (as history demonstrates time and again) in our ability to accurately assess growth or risk, most of us make incorrect valuations.

The best investors are those who manage to lose less, meaning they assess risk better, and who, in rare cases, identify investments where the rest of the population underestimates the growth potential. As Mohnish Pabrai relates regarding Warren Buffett, that looking back, the "Oracle of Omaha" stated that 4% of his investments made all the difference. Meaning, the role of the other 96% of his investments was simply not to interfere, or to enable him to execute those other 4%. In the words of Mohnish Pabrai:

"If God can only do 4%, what does that say about us mere mortals?"- Mohnish Pabrai
We all have opinions on why a business might grow or shrink. Since we are dealing with real estate, let's talk about apartments. The reflexive problem works like this: The process begins when a very small fraction of people identify that real estate in an area is about to become more profitable compared to the risk. They see a stronger population moving into an area (gentrifying), and consequently, landlords in the area can raise rents.

Stage 1: The Identifiers. The first investors begin purchasing apartments and raising rents. Long-time landlords begin to raise their rents as well.

Stage 2: The Magnetic Effect. The population with the stronger socio-economic status attracts more and more people from that same demographic, creating higher demand for rental apartments. Restaurants, bars, cafes, and other businesses begin to open in the area to serve the new population with its stronger purchasing power.

Stage 3: The Speculators Arrive. Newer (though less sophisticated) investors see the rise in rental prices and notice that veteran investors are starting to sell apartments at higher prices. They tell themselves, "This is a place with rising prices, it's worth investing," and rush to buy an apartment there.

Stage 4: Expectations Surpass Reality. What happens is that people look at the rent increases in the recent past and decide (sometimes correctly) that the increase will continue. Therefore, they are willing to pay a higher price relative to the *current* rent because they believe that over time, the rent will continue to grow and close the gap.

Stage 5: The Real Improvement. The increased activity in the area causes certain landlords to renovate properties (to increase attractiveness and be able to charge more), and developers become interested in building there as well. The housing market in that location has indeed become more valuable in reality. The condition of the assets has improved, and the economic status of the customers has improved (since a stronger population has moved in).

Stage 6: The Bubble Begins. Slowly but surely, the public in that area enters a sort of cognitive coma, where they stop paying attention to the growth rate of rents and start looking only at the rising property prices. Meanwhile, those early investors who identified the pattern sell their assets, or decide to hold them with the understanding that even if asset prices get slashed tomorrow, they have still earned more than enough on their investment. In contrast, in this situation, the new investors are liable to get significantly burned (and in real estate, lose more than they invested because it is leveraged).

The Biggest Mistake of the Average Israeli Real Estate Investor

This is the single largest error I hear when people talk to me about real estate in Israel. They speak about value appreciation, but *value* depends exclusively on the rent the asset can generate. Therefore, as the disconnect between the purchase price and the rent grows, what actually happens is an expansion of the P/E ratio, shifting from a P/E of 20 to a P/E of 40. Consequently, in such a scenario, there is no *value appreciation*, only *price appreciation*. The value rises only when the profits (rents) the assets yield rise.

Americans refer to this specific situation as "Price Appreciation." Sometimes, price increases halt or slow down significantly, while earnings growth continues until it finally closes the gap. Hence the argument that "Markets are forward-looking." There are places where it makes perfect sense for an apartment's P/E to be higher than that of

other assets. Tel Aviv is a classic example because one can assume there will always be people in Israel wanting to live in Tel Aviv either for work, social life, or culture. However, sometimes the market errs in the premium it is willing to pay for an asset. The sensation that the market is always right is exactly what causes bubbles. Because if the market is always right, then every price is justified. Then people buy apartments at prices that cannot be supported by any mathematics, simply because "the market knows." The best way for me to spot this, when I speak or listen to people in the investment field, is if they speak of the market as a single, all-knowing entity. They take the concept that the market is efficient *on average* and treat it as if it is efficient *all the time*.

"Never forget the six-foot-tall man who drowned crossing the stream that was five feet deep on average." – Howard Marks

The Bottom Line: When price disconnects from earnings, it is not necessarily that "the market foresees the future"—it might be that the market is beginning to lose touch with reality.

The 5% Rule Comes into Play Here - A P/E Ratio of 20

This is the classic benchmark for housing affordability for the average middle-class population. In a historically healthy interest rate environment (mortgages around 5%), it works out that the person living in the property pays a mortgage payment equivalent to what it would cost to rent the property.

A P/E ratio of 20 reflects growth at a "healthy" inflation rate of 2-3% in the asset price. A P/E of 20 reflects very high confidence in "asset stability" (the nature of real estate) alongside value growth that keeps pace with inflation. Additionally, a homeowner living in the property keeps their income growth, which is (usually) at a higher rate than the increase in their mortgage payments. Furthermore, as they pay down more of the mortgage, the interest amount of the payment decreases, and a growing portion of the mortgage payment converts into their equity in the property (amortization).

The wealthier the population in a "better" neighborhood, the more reasonable it is to see the P/E ratio expand, because property owners receive value beyond just the utility of the asset itself. The "right" to say they live there (status signaling), better schools, etc. It is interesting to note that specifically in Israel, in many cases, such neighborhoods are actually *less* safe regarding burglaries and even 'protection' rackets.

Back to Rory Sutherland

It is crucial to revisit a point we touched upon earlier, as it is key to understanding market psychology: Real estate is a consumer good that customers approach in a manner completely different from any other product.

The primary reason for this is that it is the *only* consumer good we purchase where, historically and in most cases (barring economic extremes), its price, even if not necessarily its real value, rises over time. Consequently, when people buy real estate, they bank on being able to sell it tomorrow for a higher price. This mindset is what pushes people to stretch their limits and spend "a little more," rationalizing that this money will pay for itself, and perhaps yield even more.

The Problem with Purchasing Psychology: "What is the Maximum I Can Afford?"

When most people look to buy or rent an apartment, their starting point is the absolute highest price they can afford. This stands in stark contrast to our standard consumer behavior. When we walk into a regular store, we compare an expensive product to a cheaper one, trying to determine if the price gap truly reflects added value. In real estate, however, people tend to look for properties that scrape the ceiling of their budget from the get-go.

A person with a budget of X for a purchase in Tel Aviv will rarely stop and say: "You know what? I'd rather spend less and live in Givatayim, or buy a less 'fancy' apartment in Tel Aviv and save the difference." People set a budget and choose based on the maximum price they can pay, usually without considering cheaper options that would leave them with a surplus. "Expensive" and "cheap" are relative terms; the real question is the price you pay relative to the value you receive from X versus Y.

The "It's Mine" Trap

And don't tell me, "I bought the apartment I live in, so it's different." Let's examine this: Even if you are truly saving money because your monthly mortgage payment is lower than rent for a comparable property, are you *actually* investing all of that surplus?

Doesn't that money eventually go toward renovations and upgrades to tailor the property specifically to your whims, just because "you live there and it's yours"?

The sensation of "mine" versus "the landlord's" is a powerful economic engine. It causes people I know to suffer in a rented apartment rather than fix a simple issue out of their own pocket, while their landlord invests the absolute minimum possible. That exact same logic works in reverse when they become homeowners: suddenly the taps open, and they overspend on the "dream apartment", expenses that do not pay for themselves financially, but only emotionally, and odds are the emotional utility isn't worth the sum.

The Premium on Peace of Mind Has Real Economic Value

There is real economic value to owning a primary residence: Certainty. As long as you live in a home you own and have the ability to service the mortgage, you neutralize the risk that the landlord will raise the rent, decide to sell the property out from under you, or refuse to renew the contract. Purchasing a home provides a high level of certainty regarding housing, allowing many people to sleep soundly at night.

And it is important to remember: a threat to one's peace of mind (stress and uncertainty) is also an economic threat. You will be far less productive at work and in business if you aren't sleeping well at night, fearing your lease ends in two months and hoping the landlord agrees to let you stay without raising the rent.

Author's Note

I am sure you have noticed that I repeat many points. There are several reasons for this.

First, no one manages to learn something the very first time they encounter it—unequivocally so when learning a vast amount of new information. I have divided the book into parts, chapters, and sub-chapters to make it easier for the reader to take convenient breaks upon completing each section. Since we are discussing investing and economics, there are simply so many moving parts. Therefore, in order for us to conduct the upcoming discussions properly, I must ensure that we are fully aligned. Additionally, each time I revisit a topic, I add new details that I could not mention earlier because we were missing other components that we had not yet discussed.

The Psychological Mechanism: Why the Wealthy Overlook Potential Yields When Buying a Home, or Why Rental Yields Are Higher Specifically Where People Are Poorer

Real estate has one huge advantage when you are the owner: it is a basic consumer good. This fact allows for aggressive leverage of the investment because the cash flow (rent) is relatively stable and predictable. When you sell real estate, you are selling to an audience driven by a "what is the maximum I can pay" mentality.

The more you sell to a wealthier population, especially when the property is intended for residence rather than investment, the less the buyers look at the rental yield and the more they are willing to pay for amenities. This is where you can add something for a small price and charge a serious premium for it.

This is exactly the reason for the growing gap between apartment prices and rent in luxury areas. When a wealthy person sees that rent is too high relative to the asset price, they simply buy. Therefore, paradoxically, in high-demand areas (where a population with high equity lives), percentage yields will be lower. Once the gap between rent and price closes enough, people prefer to buy because they have the capital to do so.

Unlike the middle class, wealthy people do not hold the majority of their capital in the home they live in; therefore, they do not need the same level of return [on the home] as they require from the rest of their portfolio.

Conversely, in weaker areas, percentage yields are higher. Why? Because the gap between renting and buying is a chasm that local residents find harder to bridge (they

lack the equity). Therefore, even if rent is high relative to the apartment price, the local population lacks the ability to purchase the asset, and there is no strong upward pressure on purchase prices as there is in high-demand areas.

Valuation by the Book: How Investors Are Supposed to Work (In Theory)

A professional investor is supposed to work methodically: take their capital, map out investment options, and run a "Discounted Cash Flow" (DCF) model to understand the intrinsic value relative to expected profits. Beyond the dry numbers, they are supposed to build a probabilistic model for every scenario, based on known information as well as "unknown information."

This unknown information ultimately becomes a component of "gut feeling" or intuition, which is why high-level investing is considered more art than science. Howard Marks once said at a Goldman Sachs conference: "I can talk about what I do all day, but there is no chance you will manage to do it too."

"If you can't imitate him, don't copy him" – Yogi Berra

Each of us has a different spectrum of understanding, a different spectrum of available options, and a different ability to cope with different kinds of risk. You cannot simply "copy-paste" someone else's strategy. Therefore, in my view, there is no such thing as a passive investor. Everyone must sit with their options and actively think about which scenario seems most likely for them.

"No amount of sophistication is going to allay the fact that all of your knowledge is about the past and all of your decisions are about the future." – Ian Wilson, former GE executive, maybe my favorite quote of all time

The Effect of Coffee and Other Expenses on Your Financial Future

Since investing is never detached from life itself, every economic decision, even if it seems small, is an investment decision. Buying coffee out regularly is 1,000% more expensive, and this means I have less money to invest. In the short term, it sounds negligible, but over a decade, it will affect my ability to buy that same coffee.

Why? Because around me are people currently making coffee at home, taking it to go, and investing the savings. In ten years, those same people (who got richer from compound interest) will start consuming coffee out, push its price up, and price it out of my reach. They got richer, and I stayed in place. And something people hate more than anything is a decline in quality of life. This coffee is a motif for many other things (there simply aren't many things with a 1,000% markup, but for many items, the price gap is significant in a quantitative sense).

Here we return to Scott Galloway. He claims that in a group of 5 men earning the same salary, you will always find one significantly richer than the others, and one in significantly worse shape. The difference is not income, but conduct: who saved, who

invested, and who spent and gambled. (I will add that sometimes one of them just got lucky with Bitcoin or Nvidia, but that is the exception that proves the rule).

The Simplest (and Hardest) Rule

There is no reason in the world to invest in one thing if something else exists that I know will yield better profits, unless there is a gap in risk.

This sounds trivial, but it is the hardest rule to apply. Why? Because someone will always come along and say: "Listen, I have an investment that will give you 20% a year with no risk," or worse, they will convince you that if you *don't* invest in it, *that* is the risk. Meaning, everyone is investing in apartments, so hurry and buy now before the price gets too high and you won't be able to buy at all and you will never own your own home. At this point, you need to be smart enough to understand it's one of two things: either he is lying, or he is an idiot who doesn't understand his own risk. A smart person talks about risks. A person who says "no risk" is either stupid, or thinks you are stupid. In Israeli real estate today, many people are convinced they found the formula: good returns with no risk. The big question is not whether the risk exists, but whether they took a large enough margin of safety or prepared for things to sour mentally.

Risk: A completely abstract concept with consequences so real they cost human lives.

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." – Mark Twain

One of the things I love is hearing interviewers ask Nassim Nicholas Taleb what he thinks the next "Black Swan" will be. He always replies: if I knew, it wouldn't be a Black Swan. This creates a paradox, because the very concept expresses the idea that you don't know what the bad thing will be that surprises you and ruins all your plans.

"Everyone has a plan until they get punched in the face." – Mike Tyson

I strongly recommend that everyone listen to Howard Marks on this subject of risk. So, honestly, you'd be better off stopping right here and going to listen to him or read his work, or that of Nassim Nicholas Taleb.

For those who made the mistake and are still reading my words, let's continue.

Why Are People Willing to Accept Lower Returns?

The only reason someone would agree to invest in something expected to provide a lower return¹² is because they believe that thing is safer. The central component pushing an asset's price upward (thereby lowering its potential yield) is the perception of "low risk."

Take, for example, shares of a large supermarket chain. This is considered a relatively "safe" investment because people will always need to eat, even in a recession. Because the security is high, investors are willing to settle for narrower profit margins and a lower annual return compared to a risky technology startup.

How Does It Work in the Bond Market?

In the bond market, this equation meets us in its purest form: the more the borrower can be trusted, the lower the interest rate they will have to pay. This is where credit ratings come into play. The rating is essentially a score expressing how "safe" it is to lend you money. This doesn't mean that rating agencies like Moody's or Standard & Poor's are always right (they were colossally wrong in 2008), but they represent a consensus that the investing public agrees to align with.

Beyond the dry rating, banks and sophisticated investors use complex models to calculate risk. For those who wish to dive deep into the history and philosophy of risk, I warmly recommend the book *Against The Gods* by Peter Bernstein. But conceptually, the bond market is what determines the basic "price" of risk in the market. It works according to supply and demand: as a specific bond is considered safer and more attractive, more people want to buy it, its price rises, and the yield (interest) on it falls, up to the point where investors say, "this is already too expensive for this return."

The Efficient Market Hypothesis: A Beautiful Theory, Detached from Reality

"Most institutional investors in the early 1970s, on the other hand, regarded business value as of only minor relevance when they were deciding the prices at which they would buy or sell. This now seems hard to believe. However, these institutions were then under the spell of academics at prestigious business schools who were preaching a newly-fashioned theory: the stock market was totally efficient, and therefore calculations of business value, and even thought itself, were of no importance in investment activities. We are enormously indebted to those academics: what could be

¹² Yield = Return = How much money you made in percentages on the money you invested.

more advantageous in an intellectual contest: whether it be bridge, chess, or stock selection than to have opponents who have been taught that thinking is a waste of energy?"

- Warren Buffett in a letter to shareholders

This brings us to one of the most famous concepts in finance, which happens to be one of the most harmful to investors. The intellectual father of this theory is Professor Eugene Fama of the University of Chicago, who even won a Nobel Prize in Economics for this work. In the 1960s and 70s, Fama made a claim that sounds very logical on paper: The market is full of smart, rational, and competitive investors. Therefore, the stock price at any given moment fully and immediately reflects all available information about it.

According to Fama, if everyone knows a stock will be worth \$100 in two days, but it is trading today at \$80, investors will immediately pounce on it and push the price up to \$100 right now. His conclusion: You cannot find "bargains," because the price is always right. The market is always efficient (This is another reason why putting out stock price targets is a silly practice that is still being done today although everyone agrees it is silly but no one dares to say so). Today, we know that the claim that the market is efficient is a very, very stupid argument (and therefore, anyone who still believes in it is an idiot).

Why Does This Theory Collapse in the Real World?

With all due respect to Fama's Nobel Prize, the real world does not operate like the models at the University of Chicago. Here are four reasons why the market is far from efficient:

1. **The Human Factor (We Are Not Robots):** The assumption that everyone is rational is a joke. We say the public is stupid, or sometimes that it is smart, but one thing is certain: it is emotional. Fear and greed drive markets far more than Excel spreadsheets do. People sell in a panic at the bottom and buy in a frenzy at the peak. The market is schizophrenic, not efficient.
2. **Information is not Knowledge or Intelligence:** Even if we assume everyone is rational, not everyone possesses the same information. There are people who understand specific industries in depth, and there are those who only read newspaper headlines. There are people who live next to the factory and know what is happening, and people who live on the other side of the world. Furthermore, there is a limit to the amount of information a human can process. Just because a financial report is available to everyone on the internet ("accessible information") does not mean everyone read it, and it certainly doesn't mean everyone understood it. How many times have you read a paragraph for a test four times and your brain simply didn't register it? That happens to Wall Street investors, too.

3. Different Interpretations: Information is not an absolute fact; information requires interpretation. Two investors can look at the exact same data point (e.g., "The company fired 10% of its workforce"). One will see it as a sign of distress and collapse, while the other will see it as a brilliant streamlining move that will increase profits. Who is right? The market doesn't know how to decide "efficiently" in that moment.
4. Reaction Time: Not everyone has the ability to act at the same speed. A hedge fund with supercomputers and fiber optics reacts to information in microseconds. A portfolio manager for a pension fund waits for approval from a manager or an investment committee to authorize a move. This gap creates distortions.

For years, academia taught the theory that the market is efficient. They called Warren Buffett an anomaly, until finally, they folded and started teaching investing the way he sees the world. The reality is that the market is full of mistakes, and the market can remain wrong for a long time.

"Markets can remain irrational longer than you can remain solvent." - John Maynard Keynes

And this is exactly where Enterprising Investors make money.

Defensive Investors are supposed to ignore the market, continue investing a fixed amount at a fixed pace, and pay attention to the market only in a single extreme case: when no one is willing to buy anything.

The additional problem is that people start to believe in the Wisdom of Crowds. The idea behind the wisdom of crowds is simple: There is a correct opinion. Some people are too pessimistic, some are too optimistic, they cancel each other out, and you are left with a 'median'/'average' answer (depending on the question asked) that is quite accurate. This is true in many cases in a rational market.

The problem arises when irrationality grips the public, and we know for a fact that this will happen. That is why I spoke so much about historical bubbles in the first part of the book. Instead of the Efficient Market Hypothesis and "other market" laws, here is a law you should always remember: Eventually, every human acts in an irrational and stupid manner. All the more so when they are in a large group.

"Insanity in individuals is something rare, but in groups, parties, nations, and epochs, it is the rule" - Friedrich Nietzsche

Therefore, for all those who want to rely on the wisdom of crowds, who are afraid of being left behind, who suffer from FOMO, remember this:

The fear of being left behind, the fear of falling to the bottom of the socioeconomic ladder, is a primal and real fear/risk. But surrendering to this fear is liable to lead you to exactly what you are afraid of, or worse, to not surviving at all.

The Dangerous Paradox: When the Market Is "Too" Efficient

The truly big problem with the "Efficient Market Hypothesis" is that it creates a destructive paradox: If the market is always right, it implies that every price is justified. If every price is justified, then there is no such thing as a "bubble." And if there are no bubbles, people stop being wary of them (as happened with the Nifty 50). This is exactly the moment when the largest and most dangerous bubbles are formed.

In Israel today, most people operate under the assumption that real estate prices are "efficient." That is, they assume prices fully reflect economic reality. They assume the market knows all the answers simply because "a similar apartment sold for the exact same price a month ago".

But they do not stop to ask the truly hard questions:

- What happens if interest rates remain high for a decade?
- What happens if the "High-Tech Engine" contracts significantly?
- What if the purchasing power leaving the country (Relocation) exceeds the capital entering it?
- What happens when we are required to face painful tax hikes to finance the deficit caused by this war?

It is exactly in these blind spots that the Black Swan waits. The greatest risk is not what you know you don't know. The greatest risk is what you are sure you know, but is simply untrue. In Israeli real estate, there are plenty of things everyone "knows for certain", and there is a material chance that at least one of them is a complete illusion.

Remember:

"Never forget the six-foot-tall man who drowned crossing the stream that was five feet deep on average." - Howard Marks

The Partial Solution: Dollar Cost Averaging (DCA)

The assumption that the market is efficient *on average* (rather than at every given moment) is a strong concept, well-suited for defensive investors utilizing Dollar Cost Averaging (DCA). The method is simple: Investing a fixed amount in a specific asset, at fixed intervals, over many years. With this method, we sometimes buy when it is expensive, and sometimes when it is cheap, and things balance each other out. This is an excellent method for neutralizing psychological risks. We effectively take the "pricing danger" out of our own hands.

This is an ideal solution for a person who has savings but is paralyzed by the fear that the market will drop tomorrow morning. If they assume the market is efficient and invest their entire fortune in one shot, and a week later the market experiences a crash that lasts two years, they will be traumatized. But with DCA, they minimize the risk of an

immediate drop. The price? They give up the potential for sharp gains on their entire capital from day one.

Investing is a business of compromises. We must choose where we want to be on the scale between High degree of certainty and the potential for opportunity.

"I think it's helpful to take an organized approach to what I call the "twin risks." What I'm talking about here is the fact that investors have to deal daily with two possible sources of error. The first is obvious: the risk of losing money. The second is a bit more subtle: the risk of missing opportunity. Investors can eliminate either one, but doing so will expose them entirely to the other. So most people balance the two. What should an investor's normal stance be regarding the two risks: evenly balanced, or favoring one or the other? The answer depends mostly on one's goals, circumstances, personality and ability to withstand risk (and on the same things with regard to one's clients, if any). And separate and apart from his normal posture, should the investor alter the balance from time to time? And if so, how? I think investors should try to appropriately adjust their stance if they (a) feel they have the requisite insight and (b) are willing to expend effort and bear the risk of being wrong. They should do this based on where the market is in its cycle. In short, when the market is high in its cycle, they should emphasize limiting the potential for losing money, and when the market is low in its cycle, they should emphasize reducing the risk of missing opportunity." - Howard Marks

The Big Problem: You Can't DCA into Buying a Real Estate Property

The massive problem is that there are investments where this privilege simply does not exist. You cannot buy "half a room every month." In a real estate purchase, you are going "All-in."

You are placing your entire capital (along with the bank's capital) on a price at one single specific moment. Therefore, the concept that the market is "efficient" is seven times more dangerous in real estate, because it removes the responsibility from the investor to check if the price at that solitary moment is logical, or a bubble.

On the flip side, to the people who say "I won't buy an apartment, so this doesn't interest me at all," I have a sharp message: Life changes. People change.

The frequency with which we see a post along the lines of "My wife decided it's time we bought a home of our own" is a clear indicator. Even if one partner truly and honestly does not want to purchase a home, there is a probability that the other partner's opinion (which was previously synchronized with yours) will change.

One of the best ways to look at the world is as a Distribution of Outcomes. There is a spectrum of possibilities for how things will develop. Many people try to find a

probabilistic number to guess the chance of something happening in a specific way, but the chance of that being accurate is nil, because there are always alternative universes we cannot conceive of.

What *is* possible, however, is to get a general idea.

The Mistake in Classifying Volatility as "Risk"

For decades, finance faculties and business schools have taught students that risk is measured by volatility, also known as **Beta**. The concept is simple—and stupid. If the price of an asset jumps sharply up and down, it is considered "risky." If it moves moderately, it is "safe."

In general the field of Financial Mathematics has evolved, and that is what quants deal in.

<https://www.youtube.com/watch?v=wwXDB9dMdEo&list=PLUI4u3cNGP63ctJIEC1UnZ0btsphnnoHR>

(The MIT intro course to the subject. Seriously, these universities should put old classes online for free like they do, and then charge something much smaller than they do for their tuition to do their testing)

Beta is a statistical metric that measures the Volatility of a specific asset (a stock) relative to the volatility of the entire market. In simple terms, Beta checks how "jumpy" the stock is compared to the general behavior of the stock exchange.

- Beta = 1: The stock moves exactly like the market. If the market rises by 1%, the stock rises by 1% (e.g., an Index ETF).

- Beta > 1: (e.g., 1.5). This means the stock is 50% more volatile than the market. If the market rises by 1%, the stock tends to rise by 1.5%. But if the market falls by 1%, the stock falls by 1.5% (typically: technology stocks, chips, growth companies).
- Beta < 1: (e.g., 0.5). The stock is less volatile than the market. If the market crashes by 10%, the stock will drop by only 5%.
- Negative Beta: (Rare). The stock moves inversely to the market. When the market falls, it rises (e.g., Short ETFs).

For years, they taught that volatility equals risk, and to this day, many still believe or speak this way. This is absolute nonsense.

Volatility is not risk (Unless you are using leverage and in risk of a margin call or dealing in some kinds of Option Trading). Risk is the possibility of a permanent loss of capital (losing the money and never getting it back). Volatility is merely a change in price over the short term.

"The stock market is there to serve you, not to instruct you."

- Warren Buffett (explaining Benjamin Graham's gift to the world, The Intelligent Investor, and its chapter about Mr. Market)

Why Is Beta a "Stupid" Measure of Risk?

1. It Looks Only Backward: Beta is calculated based on history (usually 3-5 years back). The fact that a stock was stable in the past says absolutely nothing about the risk that the company will go bankrupt tomorrow morning.
2. It Punishes Upside: If a stock jumps sharply upward because the company succeeded, its Beta rises (because volatility increased). According to academia, the stock became "riskier." According to a value investor, the stock simply yielded a profit.
3. The Drop Scenario: Suppose a stock dropped by 50% without any justifiable reason.
 - According to Beta: The stock became very volatile and is therefore riskier.
 - In Reality: If nothing changed in the business itself, the stock became significantly cheaper relative to its value and is therefore safer.

In other words, Beta measures "how much the chair wobbles," but it does not measure "whether the chair is about to break." A smart investor worries about the chair breaking, not the wobbling (sometimes the wobbling chair is the safest chair it just wobbled more than others prior to the rest breaking).

Warren Buffett, explaining the philosophy of his mentor Benjamin Graham, clarifies this best when he argues that volatility is the investor's best friend. The market, or the famous "Mr. Market," is an unstable partner. One day he is euphoric and offers to buy

your asset at an exorbitant price, and the next day he is depressed and offers to sell you the same asset at an extremely low price.

The rule of Graham and Buffett is simple: Mr. Market is meant to serve us, not to instruct us.

A good investor loves volatility because it creates opportunities to buy cheap and sell dear. Whoever fears volatility does not understand what they bought.

How We Are Fooled by Numbers: The "Fear Index", the VIX, Why Financial Media Loves It

How many times have you seen the nonsense of the "Fear Index" in the headlines?

The VIX is an index of volatility in S&P 500 options. It measures the rate of change in prices. It is not a survey asking people if they are scared.

The first mistake we try to prevent is the thought that fear is linked to volatility. We know this is untrue. Stock prices can be very volatile even in euphoria when prices are rising, or even when they remain relatively static but the range widens.

The Mess with "Beta", When a Volatility Metric Becomes a "Risk Metric"

The investment profession tried to turn Beta, a measure of volatility relative to the market, into a way to quantify investment risk. This variable is marketed to the investing public as a way to measure risk, even though it is the exact opposite.

A stock or apartment price that rises at double the pace of the market will have a Beta of 2. Another apartment price rising at half the pace of the market will have a Beta of 0.5.

And notice, I said price, not value. Because Intrinsic Value is the total earnings the asset will generate until its final day, and aside from bonds, it is impossible to know this with certainty.

Why Great Investors Love Volatility

"Charlie (Munger) and I would much rather earn a lumpy 15 percent over time than a smooth 12 percent." - Warren Buffett

On the contrary, a great investor will prefer volatility. It allows them to exploit overly low prices to acquire assets cheaply and, conversely, to sell assets at a high price.

Ironically, most of the population does exactly the opposite, which is why in extreme conditions there are either too many sellers or too many buyers.

Personally, I have managed, using stocks that rose at a slower pace than the market on average, to achieve a yield higher than the market average because I bought well. That is, I bought at prices relatively low for the stock.

The Real Risk

The real risk is not volatility. The real risk is buying something that isn't worth the price you are paying for it.

- Stock of a great company that is volatile = Low Risk
- Stock of a bad company that is "stable" = High Risk
- Apartment in a high-demand area at a fair price = Low Risk
- Apartment in a high-demand area at an inflated price = High Risk

The next time you see a headline about the "Fear Index" or are told an investment is "safe" because it isn't volatile, remember: The press wants clicks, not to explain to you how investing actually works.

Volatility is not your enemy, your enemy is: paying too much for something that isn't worth it.

"Price is what you pay, value is what you get" – Warren Buffett

I remind you again that Intrinsic Value is the total profits the asset will generate until its last day. Aside from bonds, this is impossible to know.

One of the best ways to view the world is as a Distribution of Outcomes. There is a spectrum of possibilities for how things will develop. Many people try to find a probabilistic number to guess the chance of something happening in a specific way, but the chance of that being accurate is nil, because there are always alternative universes we cannot conceive of. What *is* possible is to get a general idea.

Technical Analysis – A Misnomer for a Psychological Product

This brings us to the concept known as Technical Analysis.

In my view, even in English, this is a flawed and misleading term. It shouldn't be called "Technical Analysis," but rather:

"Analysis of the historical market opinion regarding an asset's price at a specific time and an attempt to project the market's opinion into the future" (This is the term I use). I don't have a shorter, catchier name, but this description is accurate. Truly "technical" things are dry, numerical facts that can be quantified. For example: Mountains of cash sitting in the public's current accounts ("cash on the sidelines") available for investment in case of a drop, a technical data point that supports prices from below; or the constant flow of funds into pension funds that pushes prices up in a Dollar Cost Averaging style. These are facts.

What traders do with charts, trying to interpret where the public will take the price, is not technical. It is pure psychology.

Psychological analysis in the classical sense works like this: Traders look at charts and try to guess the behavior of the herd. The problem is that they often try to do this in a

vacuum, without context regarding events, macro-economic psychology, or the state of the businesses themselves. They draw lines on charts and sometimes behave like shamans staring into a fire to understand what will happen.

I am probably opening a serious front here, but I have read and studied these methods, and I have heard countless times people say a certain pattern is "amazing." The problem is threefold:

1. The "Mentors": Many of these figures are inconsistent. In the name of "mentorship," they sell prediction services to their followers. Like any excellent salesperson or cult leader, every prophecy that fails finds the next excuse.
2. The Gamblers: This is a method that tends to attract gamblers. And like any gambler, there are people here and there who bet and succeeded.
3. The Elite Exception: There are people who *do* use some of these things to succeed. Let's start with the fact that their numbers are few and far between, much, much smaller than investors who buy and hold. They tend to be very smart, highly educated people capable of incorporating a multitude of variables into their train of thought.

I recommend listening to the conversation between **Stanley Druckenmiller** and **Paul Tudor Jones** to understand the nature of serious players.

[YouTube Link: https://www.youtube.com/watch?v=S_x0n5BS1Pw&t=1646s]

The elite, play on very liquid playing fields, and their connections help them exploit the market in various directions. They usually make their big money from one very aggressive bet every once in a while. Whether these players work for them, or at Citadel, odds are it's not you (because if it were, you wouldn't be reading this book).

The average person will eventually get tangled up in this place and end up losing. Brokerages used to promote this activity because it encouraged trading, which meant more fees. The massive advantage of those who use these methods (or give them space) is that they are not stuck in the mental fixation of the "other religion", aka Deep Value, who miss changes in the world and fail to adapt in many cases. Many of them thought as far back as 2016 that the market was overvalued, and like Jeremy Grantham, have been waiting a decade for the big crash.

Charlie Munger recommended learning business in a completely different way (beyond actual entrepreneurial practice):

1. Choose a specific business.
2. Study the history and economy of the period in which the business operated.
3. Study the specific sector.
4. Only then study the business itself, and simultaneously see how the markets priced its stock and bonds during that period.

And here comes my note: When you do this, I believe the brain starts to identify patterns "in the charts" subconsciously, which may grant that coveted "Shaman ability" that some were lucky enough to be born with and develop (like Paul Tudor Jones). This is an ability I do not claim to have.

When you combine this perspective, you understand "technical" concepts differently. For example, a "Support Line." In technical analysis, it is a line on a graph. In reality, it is simply a price regarding which the market has reached a consensus that it is the "lowest price" the asset deserves right now. At this price, the number of buyers exceeds the number of sellers, and demand pushes the price up. That is why I always tell people:

"It's like in stocks, you are measured by how much higher you fall each time."

Meaning, every time the support line stabilizes at a higher price than the previous time, it is proof that there is market agreement that the fundamental value of the asset has risen.

One of the basic rules taught in technical analysis is that a support line is a "previous resistance line." Technical analysts love to say that the market "digests" or reprices that asset. When the resistance line gets broken, they rush to buy thinking it will go up, generating a reflexive event. The question that rises is if there are enough people in the momentum to actually push the price and break through the line, which is a volume of trading question.

The massive problem with these preoccupations is that, on one hand, they assume the market is efficient (because they bank on the current price including psychological opinions on knowledge); but on the other hand, they assume they can predict market behavior regarding unknown information.

The massive problem arises when a new piece of information arrives "from outside the box" that completely changes the market's psychological thinking regarding the asset's price, in a significant way that could not be foreseen in the charts. Those same shamans then find new excuses for their followers as to why their prediction was wrong, and with complete conviction, give them a new prophecy.

Investors who deal in businesses should not, in principle, care about the market's opinion regarding the asset. What should interest them is the state of the business itself. The main problem with investors who call themselves "Value Investors" is that many of them focus more on the Messiah than on his teachings. They try to mimic Warren Buffett and Charlie Munger, instead of taking those same principles and applying them to the new world (as he tries to explain one needs to do in his famous essay "The Super Investors of Graham and Doddsville").

In markets where there is no "business" where all that exists is relative pricing, such as Foreign Exchange, Commodities, etc. the only style that can be useful is an analysis of

market psychology (what is called Technical Analysis) and technical data (geopolitical situation, etc.) and an understanding of how this will be expressed in those markets. So, the next time they try to convince you to perform technical analyses on stocks, I recommend looking at long-term charts. You will discover that almost every "law" or pattern, like the "Golden Cross" of technical analysis, breaks eventually. (I highly recommend the book *A Random Walk Down Wall Street* by Burton Malkiel, which expands on this).

The Psychological Opinion and the Final Outcome

I *do* think that psychological opinions expressed in price are very relevant, especially in extreme situations. When there is high volatility and asset repricing, I use market psychology to understand: Is the market too optimistic (**Greed**) or too pessimistic (**Fear**)?

Therefore, when people ask me "Do you do fundamental analysis?" or "Are you a value investor?", I don't know how to answer. What I do is take all the information technical, psychological, economic, and business pass it through my mental filter, and calculate possible outcomes.

At the end of the process, one of three conclusions emerges:

1. **"It's clear as day"** (Opportunity).
2. **"It jumps off the page"** (Danger/Opportunity).
3. **"It's too complicated / I don't know"** (Too Hard).

The State of Israel is unequivocally a situation where I would not invest because it is **"Too Hard."**

In investing, I am a **Passive Investor** (as defined in English). A passive investor is a person who picks their own investments but, beyond the annual shareholder vote, takes no active role as a shareholder (I have written letters to CEOs but I doubt anyone read them). In Israel, people have translated this to mean "investing in an index and doing nothing." In the investment world (which is conducted in English), a passive investor doesn't try to force changes even when investing in a specific company.

“...management in place (we can't supply it)” - Warren Buffett

An Active Investor (known as an Activist Investor, or Private Equity style investors) analyzes businesses they deem complicated, and examines what changes a business needs to undergo to become more efficient and improve.

Here, I am wearing the hat of a Private Equity/Active Investor. Although I am not going to make any investment or active move here, a situation where an investor is supposedly forced to ignore the fact that it is "Too Hard" falls into these realms.

One of the hardest principles for people to grasp is the randomness with which things develop. A year or two ago, Bloomberg was obsessed with questions like:

1. "Is good news bad news for markets?"
2. "Is good news good news for markets?"
3. "Is bad news good news?"
4. "Is bad news bad news?"

This obsession revolved around when the US Federal Reserve would lower interest rates, the same Federal Reserve that was fooled by inflation.

Beyond the fact that Warren Buffett wrote about how inflation swindles us all, our successes and failures have behind-the-scenes effects we don't know how to quantify. Therefore, there is a completely random effect on how things developed. Nassim Taleb's amazing book *Fooled by Randomness* deals extensively with the question: When you look back, do you really see a Method to the madness, or are you simply fooling yourself? Did you succeed due to luck and not ability? Did you fail due to luck and not ability?

The Methodology Mismatch

The massive problem we find ourselves in time and again is that the required methodology for every asset in every situation is completely different. Publicly traded businesses differ from one another; even investment apartments are fundamentally different in terms of their risks, like a house "on paper" (pre-construction) versus a second-hand condo requiring massive renovation.

The risk lies not only in the failure to execute the investment analysis well, but in the failure to identify the correct methodology (I refer you again to Aswath Damodaran and his books) to diagnose the investment in the first place.

The greatest risk is not just losing money, but not knowing how to match the correct methodology to the right asset. You cannot analyze an apartment on paper using the same method you use to analyze a dividend stock or a fixer-upper. There is huge room for error here. Therefore, in investing, one should always be careful, and love the volatility that helps you buy cheaply.

When the Scenario the Market is Pricing Turns Out to Be a Completely Different Story

You know how in a movie there is suddenly a plot twist? As we said, in investing, this is called a **Black Swan**... These things happen in our lives all the time. We have a picture of the world, and then it shatters.

The Classic Example: Divorce

The most classic example is betrayal in a relationship. It is known that a very, very high percentage of people get divorced. But many, many people get married believing it

won't happen to them. They don't plan at all for "what if" something happens. A very small percentage of people draft a relationship agreement or a prenup before marriage. This demonstrates, once again, that the market's reaction is irrational. Because in an efficient market, everyone would take this into account, since in Israel, more than 25% of married couples divorce, and you don't know if you will fall into that category. Without planning, the process becomes much more expensive, much more complex, and much uglier during the divorce. And for many people, it comes as a total shock that their spouse wants a divorce, or when they discover their partner is cheating.

The Mistake the Majority Makes

When I talk to people about prenups, I usually get the answer: "Why would you think about the failure of the marriage?"

The point is that everyone lies to themselves that their love is "true love" like in the movies. That their relationship is a fairy tale. But the evidence suggests otherwise. And it doesn't matter how they met, whether via an app or at a bar, a quarter will divorce, and another quarter *should* have divorced.

The job of all of us is to manage our risks in life, and therefore we are required to constantly plan for the undesirable to happen. We must be ready for the unexpected.

"To expect the unexpected shows a thoroughly modern intellect." - Oscar Wilde

In markets, when it turns out the picture is much darker than it seemed, people try to liquidate assets in absolute panic. They are caught like the Emperor who suddenly discovered he was naked.

Part of risk pricing is to always think about the worst-case scenario. Paranoids (I am a chronic paranoid) actually calm down when something bad happens. Because as long as nothing bad is happening, they are sure something bad *will* happen, and they endlessly search for the piece of information that will confirm they aren't totally crazy. In his book *Only the Paranoid Survive*, Andrew Grove talks about the need to constantly be on guard against the next thing that might happen. He talks systematically about the need to be grounded, to be connected with junior managers (like Platoon Commanders or Squad Leaders) and to understand what the simple employees (the "Grunts," the simple soldiers) see in the field.

The best place to learn about risks, about dealing with crises, and about the collapse of plans is on the battlefield.

Why Everyone Must Study War Theory

“Plans are useless, but planning is indispensable.” - General Dwight D. Eisenhower

There is an element in war that draws out the most basic instincts in people. These are the primitive elements we spoke about at the beginning. When you have a general strategy, and you break it down into tactics, you also plan how you will react to tactical disruptions along the way. A tactical retreat in the stock market is selling an asset where developments didn't go as expected, sitting on the fence, and watching that asset with the thought that when things align, it will be the time to get back in the game. Mao Zedong, thanks to tactical retreats, conquered China in its civil war and turned it communist. This is what the Russian did to everyone (except the Mongols), allowing General Winter to join them at combat. And how many times has it happened that a guy asks a girl out and she refuses, and after some time and a few encounters, he asks her out again, and in the meantime, her opinion changed and she said yes?

Everyone understands they need to read *The Art of War* by Sun Tzu because it's popular, but they don't dig a little deeper to discover that there are many books with that name (just like there are many *Django* movies). And why don't people read books beyond that? Why does Israeli society, which lives by the sword, not study this subject more? They don't read and they don't learn. In the same way, when people approach investing, they arrive without any plan for what happens when what they want doesn't happen.

“I like to say, ‘Experience is what you got when you didn't get what you wanted.’” —

Howard Marks

This is the ABC of risk management: A plan for the day after. In investing, the most important thing is to live to play another day. And if what I am saying is so obvious, why do so many people lose everything they have in one investment or another?

War theory and history teach us again and again how things develop differently, how people act and think, and how something that looks impossible on paper actually happens. History shows a sufficient number of times how a small, well-managed army defeats a much larger army when it chooses a strategy that is favorable to itself rather than the other.

- This is exactly how Alexander the Great conquered the Persian Empire.
- This is how Leonidas and the 300 Spartans halted Xerxes.

- This is how the Maccabees defeated the Seleucids (known as the Greeks), a war we celebrate and commemorate during Hanukkah.

This is how a small business sometimes defeats a big business. This is how a small software development team sometimes defeats large corporate teams.

In the book *The Mythical Man-Month* by Fred Brooks, considered the bible of software project management (which most Israeli engineers haven't read), he describes what would later be called Brooks's Law:

"Nine women can't make a baby in one month." - Fred Brooks

He talks about how, in certain software developments, there is a number beyond which adding more people to the development team will not help and may even harm the development itself.

You need to take all these things into account when investing. It is possible that you will buy a house on paper and the contractor will go bankrupt in the middle (as happened in China with Evergrande), or that a new business will arrive out of nowhere and completely change the rules of the game (as Amazon did to shopping malls). And sometimes things won't happen at the pace you want them to happen. As illustrated by a similar quote:

"No matter how great the talent or efforts, some things just take time. You can't produce a baby in one month by getting nine women pregnant." - Warren Buffett

The greatest generals in history are those who, even when surprised (even if this happened rarely), had a contingency plan. Now, I'm not saying you need to live in total paranoia that something bad is happening right now. The wisdom is to understand that usually something bad *doesn't* happen, and simply try to minimize the chance that something bad *will* happen to us.

"I predict one day Amazon will fail. Amazon will go bankrupt... If we start to focus on ourselves instead of focusing on our customers, that will be the beginning of the end, we have to try and delay that day for as long as possible." - Jeff Bezos

Therefore, you need to prepare for something bad to happen, or at least investigate the possibility of it. That is why when giving a loan, you verify there are assets to collateralize. When investing in a business, we look for a CEO we trust to navigate the ship safely when the storm gets crazy.

When buying a house on paper from a contractor, you verify (especially if it is a publicly traded company) that the chance of bankruptcy is very low and that you won't get stuck with just plans. People tell me all the time, "It's a reliable construction company, it's traded on the stock exchange." Even Evergrande in China was traded on the stock exchange. And before you tell me, "Oh, they are Chinese," there are plenty of companies that were traded on the stock exchange and turned out to be frauds or cats in a bag, leaving their customers and investors with nothing. We've had enough cases

in Israel that turned out to be stock market frauds. And the punishments in China for those they catch are much, much worse.

When buying an apartment with leverage, you ensure that even if, heaven forbid, one of the spouses becomes unemployed while interest rates rise (and it is likely these two things will happen together, because interest rate hikes have a direct impact on the ability of businesses in the economy to employ workers), you can still meet mortgage payments. You prepare for the fact that an investment property might stand empty for a long time. You mentally prepare for war and for tenants potentially leaving the property. Yes, yes, yes, expect something bad to happen. And no, the State is not supposed to pick up the tab for such things. Entrepreneurs take risks, including the risk of war.

Let me give an example. I emphasize this so my words are not misinterpreted: Residents of Kiryat Shmona should demand rehabilitation plans for Kiryat Shmona **before** there is a war. In the State of Israel, a war on the border is a question of *when*, therefore the plans need to be ready before and not after, and the benefits need to make it worthwhile for residents of Kiryat Shmona to live there.

"Si vis pacem, para bellum" / "Igitur qui desiderat pacem, praeparet bellum" ("If you want peace, prepare for war" / "Therefore, let him who desires peace prepare for war")
— Publius Flavius Vegetius Renatus (On Military Affairs)

The Other Side

You cannot expect the State to take the economic risk without backing it up later with higher taxation. These things must happen in advance.

There is a mental error in thinking that preparing for something bad that doesn't happen is a waste. That is a mistake. You must constantly verify yourself and be ready for a crisis, because it is certain that something bad will happen eventually. But if we prepare, there is a reasonable chance we will say:

"Thank God these are my troubles." (My own quote. Generally, the voice we love to hear most is our own.)

Thus, the risk of a Black Swan is a significant risk that must be thought about constantly, with the understanding that we don't know what it is and it will surprise us. Thinking about risks is the exact opposite of worrying, because by thinking about risks we solve them in advance, and practice our ability to deal with problems. In war, the enemy constantly tries to surprise; the way soldiers have dealt with surprises in many cases can be a source of very many lessons.

"Don't worry about the future Or worry, but know that worrying Is as effective as trying to solve an algebra equation by chewing bubble gum The real troubles in your life Are apt to be things that never crossed your worried mind The kind that blindsides you at 4 p.m. on some idle Tuesday" - Mary Schmich

The Two Poles Are Always a Different Version of the Same Thing

Just as extreme fascists and extreme communists ultimately did the same things to their own people who disagreed with them; just as extreme progressives or extreme neo-Nazis ultimately use the same extreme means, violence and anarchy. Just as the North Pole and the South Pole contain the same temperature... So too, extreme optimism and extreme pessimism lead to the same result: Inaction.

"I think extreme optimism and extreme pessimism ... they're somehow the same thing. Extreme pessimism means nothing can be done, and extreme optimism means nothing needs to be done..." - Peter Thiel

The Greatest Risk: Ourselves and Our Priorities

A whole generation grew up in a bubble. When people ask why there is so much anger and rage in the streets today, the answer, in my opinion, is simple: This is a generation raised on Disney movies where there is always a happy ending. Our parents drilled into us that we are perfect exactly as we are, and that we can be anything we want.

But as you grow up, you discover the unpleasant truth: You are not special, and usually—you don't get what you want.

Many bought the lie of "Don't worry, get a degree, and life will sort itself out." This is the "Participation Trophy" syndrome, the idea that just showing up to the field entitles you to a prize. When this bubble bursts, and they wake up to a reality different from what was promised, they look for someone to blame. On the other side, many sink into despair, believing the game is rigged from the start and there is no point in trying.

To deal with this gap between fantasy and reality, people fall again and again into the trap of Cognitive Dissonance. Cognitive Dissonance is a state of internal discomfort created when there is a contradiction between our belief or feeling and the reality we see with our eyes. That is the feeling. Then instead of realization people choose racialization.

The healthy solution should have been: to change, to learn, or at least to try to deeply understand the other side in order to better understand ourselves. But what do most of us actually do? We invent a new narrative that justifies our previous thought. We lie to ourselves to avoid changing a habit or opinion, and direct the anger outward, against the "enemy."

I will give an example from Israeli politics (and I emphasize in advance: the examples are balanced not out of political correctness, but out of deep despair at the level of discourse on both sides):

- The "Bibist" Side (Netanyahu Supporters): When a person who supports Netanyahu encounters the fact that he was Prime Minister during the disaster of

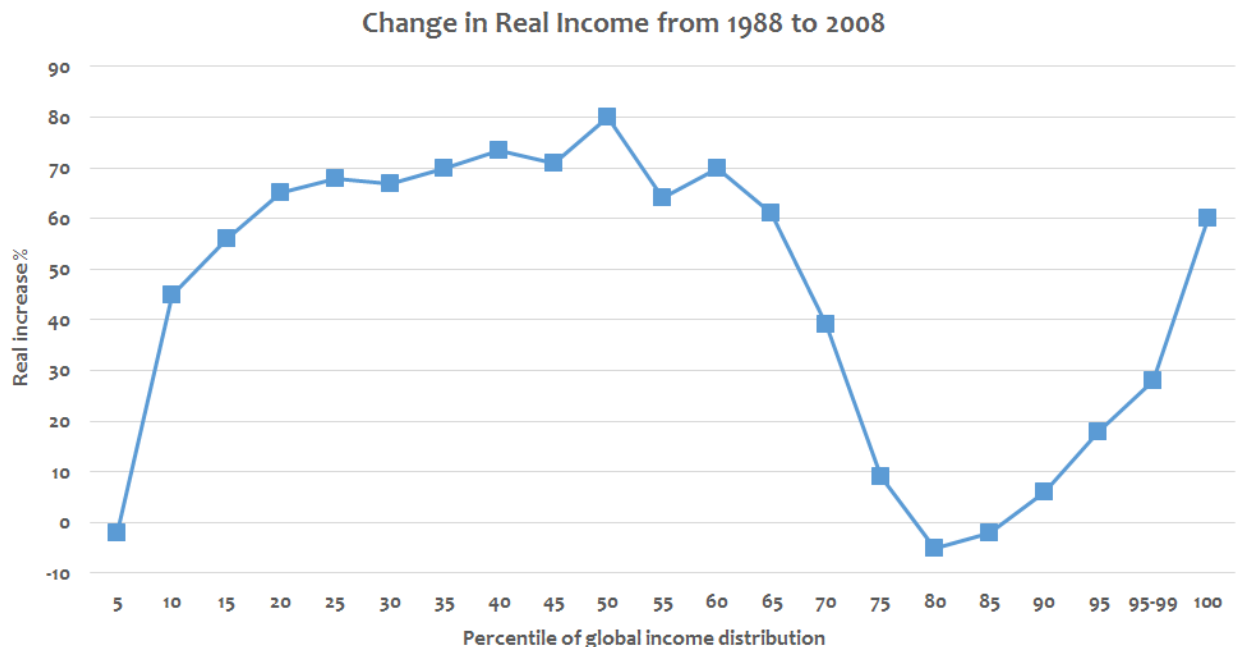
October 7th, the dissonance hits him. To settle the contradiction, he rushes to claim: "If anyone else had been there, the situation would have been much worse." Thus, the belief remains intact.

- The "Anyone But Bibi" Side: When a person demanding that *everyone* resign and go home encounters the possibility of firing the Head of the Shin Bet (who was also responsible for the failure), he suddenly hits the brakes. The argument becomes: "Bibi is doing this out of personal motives; the Shin Bet chief must not be fired now." Suddenly "everyone must go" transforms into "only those I hate must go."

The exact same mechanism works in the US surrounding Donald Trump. Facts do not matter, because the goal is not the truth, the goal is to protect our ego from admitting we were wrong.

One of the great "lies" of the last few decades, following the fall of the Berlin Wall, is that the era of wars has ended. That all human beings are identical, and that globalization is a wonderful thing. If we look at the world as a class-based ranking system, the bitter truth regarding the consequences of globalization is revealed. For decades, the mere fact that you were born into a middle-class family in America guaranteed you a high spot in the global financial hierarchy. But globalization shifted the tectonic plates. The financial standing of the Western middle class plummeted, simply because ambitious people in other nations climbed up and seized their place. This is not a political critique of globalization; it is simply a fact regarding its consequences.

Anything that generates positive outcomes will also have negative repercussions. We live in a relative system. Nothing illustrates this better than the famous "Elephant Chart" by economist Branko Milanovic.



he chart, which tracks global income growth during the peak decades of globalization, looks exactly like the profile of an elephant:

- The Back (The Winners): The massive rise in the middle of the chart represents the emerging middle class in Asia (mainly China and India). Their incomes skyrocketed, lifting hundreds of millions out of poverty.
- The Trunk (The Winners): The tip of the trunk, pointing sharply upward, represents the world's wealthy who leveraged global markets to their advantage.
- The Dip (The Losers): But right between the back and the trunk, at the base of the trunk, lies a deep valley of stagnation. Who sits in this dip? The Western middle class.

While the world cheered for the "back" and envied the "trunk," the people in the "dip" saw their real wages freeze in place. They are the ones who paid the price. For everyone who climbs, someone else falls. Those who thought their place was guaranteed simply by birthright are now discovering the ground crumbling beneath their feet.

It happened to them; it can happen to you.

Historically, the only ones who could guarantee themselves true personal security were those with the economic means to do so. This means living in an area without air pollution; funding private medical services when the public system collapses; living in a crime-free area so your children aren't hit by stray bullets. People in the periphery scream justly about poor medical services, but the rich in that same periphery can afford the best doctors. Money is power.

I don't think emigration from Israel is the solution for Jews who want to preserve their identity as Israelis in the long run, but if you are rich enough, you will have the option to emigrate to any country you want. The rich have always managed to better evade the horrors of war. Money and resources allow a person to take control of their destiny rather than be a victim of circumstance. An American Jew is an American first. Even if his fellow Americans do not see him that way.

But in general, Stop Blaming the System.

It is easy to say, "My parents didn't teach me." It is easy to say, "The education system didn't educate me." It is easy to say, "My grandparents left me nothing."

But let's be honest: How could your parents teach you something they never knew themselves? How could your grandparents, who had less than nothing, give you capital? And regarding the education system? Its role is to preserve class structures and track you into life as an employee. Whoever doesn't understand this is lying to themselves.

We must admit the truth. We were all born into a different "starter pack." Each of us received a different set of cards at the opening of the game. Innate talents, physical and mental abilities, but also disadvantages, weaknesses, fears, and a specific family and environment that shaped us as children (for better or worse).

Some started the race 50 meters ahead, and some started in the negative. But, and this is the big but, the starting point is not the finish line. Our sole responsibility, as adults, is to map out these deficiencies and fill the void ourselves. If you didn't get financial education at home, go learn it. If you grew up in a slumped and ambitionless environment, find a new environment that pushes you up. No one is coming to close these gaps for you. It is your job to upgrade the version of yourself, day after day, despite (and perhaps precisely because of) where you came from.

"The world ain't all sunshine and rainbows. It's a very mean and nasty place, and it will beat you to your knees and keep you there permanently if you let it." Sylvester Stallone
(*Rocky Balboa*)

The system, and those who control it or are close to it, want the situation to remain as it is. What person wants their children to grow up into a lower socio-economic class than themselves? What parent accepts with equanimity the fact that their children might not manage to buy an apartment? Almost every parent is willing to sacrifice themselves for their children. They want them to get the education they didn't receive, to travel the world, to enjoy life. Therefore, those classmates you grew up with, whose parents are of a higher class than yours, want (even if subconsciously) this gap to be preserved for the benefit of their children. And that's okay. It's human nature.

And in the US, just as globalization hurt working-class factory workers, it also hurt the middle class. When elite universities in the US decided to set quotas for student admission based on race to increase the acceptance of "Black" students, the number of Black students indeed surged, but most of them did not come from the US, but from wealthy families abroad who could pay full tuition.

Thus, members of a higher socio-economic class (who weren't rich enough to make a special financial donation to the university) found themselves pushed aside in the name of globalization and inclusion. But they too blame the other side, never their own institutions, because of shared political affiliation.

You can fantasize that the entire public will improve its standard of living together, and that the state will tax the rich and distribute to the poor. But reality doesn't work that way. While you wait for distributive justice, someone else born into your class, or lower than you, is working hard and improving their situation.

While you "go with the flow," the world changes. The profession you went to study at university because you were "guided" there might go extinct tomorrow morning. If you "go with the flow," you let life manage you instead of managing it. This passive conduct

will be your end. It's all well and good as long as luck is on your side, but sooner or later luck turns. In the Israeli reality, this is tangible to the point of being life-threatening.

- If you are poor, you will live in an old, crumbling building without a safe room (*Mamad*). When there is a siren, all you have left is to pray.
- If you have a little more money, you will have a safe room.
- If you are rich, you will build a house with a reinforced, fully equipped underground shelter.

Being richer statistically increases your chances of survival, physically and economically. You can acquire better tools, higher quality advice, better protection. Fate might be foretold, but the permission is given to you to choose which of the possible fates will be yours.

I promise you, if it hasn't happened already, a day will come when you will regret it. You will regret not investing more, not being awake enough, waking up too late. You will be angry at yourself that you didn't have the strength and resources to change something or help someone dear to you. The world waits for no one. Whoever doesn't wake up in time is left behind.

The Writing is Always on the Wall

Usually, the mistakes that kill us are not total surprises, but things where the writing was smeared on the wall and we simply chose not to look. We trusted "experts," "the State," "the System," and we didn't check them. We didn't verify that they were worthy of our blind trust.

"People hate to think about bad things happening so they always underestimate their likelihood." (A quote I love from the film The Big Short)

The most destructive things for a person (and for a nation) are the things we are sure are true, and they simply aren't.

- "Hitler doesn't really intend to start a total war."
- " Hamas is deterred and wants economic quiet."
- "Banks are responsible, so real estate prices must be reasonable" (USA, 2006).

When you stick your head in the sand and believe stories that are comfortable for you to hear, your life is not under your control at all. It is in someone else's hands, and that is the most dangerous position to be in.

Therefore, belonging to a certain party is problematic. Defining yourself as a "Value Investor" or a "Technical Analysis Trader" is problematic. Because psychologically, you will struggle to speak out against people in "your group," or alternatively, you will find excuses by simply saying the other side is worse. Or in the worst case, you won't truly delve into what "people of your group or party" are saying, doing, and believing, even if most of their essence completely contradicts your principles.

This is a phenomenon that happens to us daily, and every time we arrive with this answer, we deepen the pit of our opinion which has long ceased to be objective. People

I trust change their minds according to circumstances. People I don't trust stay with their opinion no matter what. And that is most people, they get into a box and don't come out unless something terrible happens that shatters their worldview. The main reason is the unwillingness to admit a mistake. Because if I am wrong about something I have such a strong opinion on, then what else am I wrong about?

When someone tries to understand how the LGBTQ community supports Hamas, who if they only could, would slaughter all their LGBTQ supporters, this is the explanation. And there is a reasonable chance that you too are behaving irrationally due to identical party affiliation and blind or uncritical support. Intelligent people become stupid when they blindly join a "tribe."

My message here, although I realize it is somewhat shrouded in fog, is as follows: Each of us has a set of values, a worldview, and life goals. Sometimes they contradict one another; sometimes they are unrealistic. We need to ask ourselves at any given moment: Are our expectations excessive? Is my worldview realistic? Do my values align with my aspirations? (For example, a young person studying Political Science with the goal of working with at-risk youth, but at the same time dreaming of buying a private house with a pool?)

Personal Risk

In the world of investing, there are no two subjects harder to discuss (or implement) than the question of when to sell, and the question of what is risk?

Nassim Nicholas Taleb dedicated two masterpieces to the subject of risk. The first, *Fooled by Randomness*, deals with the hidden role luck plays in our success or that of others—a role we tend to repress. Taleb warns there against the hubris that follows past successes, and against envy of others who have succeeded, which causes us to blindly copy their "methods."

In one of the most memorable chapters in the book, he tells the story of a conservative trader who envied his neighbor, also a trader, who took enormous risks, made mountains of money for a short period, and lived a flamboyant lifestyle. Toward the end of the book, the bubble bursts, and we discover that the successful neighbor lost almost everything.

Taleb's second book, *The Black Swan*, completes the picture and discusses the risk of the absolute unknown, events that no model predicted.

But Taleb is not alone. Every investment giant has attacked the word "risk" from a different angle (here are a few examples, and each of them did more than just what I have written here):

- Benjamin Graham spoke about Pricing Risk (paying too much or believing the market).
- Jesse Livermore spoke about the risk of being on the wrong side of the market (a lesson written in the blood of many short sellers).
- David Swensen (the legendary manager of the Yale endowment) focused on the risk of choosing the wrong fund manager.
- Robert Shiller and John Kenneth Galbraith spoke about bubbles, volatility, and crowd psychology.

The problem is that most of them treat risk as a specific or technical event.

Warren Buffett indeed touched on many risks in his letters, but as far as I know, only one tends to dive deep into the philosophy of risk consistently: Howard Marks.

There is no better teacher than him on the subject, mainly because of his occupation: Distressed Debt (Junk Bonds). His job is, by definition, granting high-risk loans. In this world, he must think almost exclusively about the Downside, because he will not enjoy the upside (in bonds, the maximum profit is capped at the set interest rate).

Bond management is a "Negative Art" (a concept Graham and Dodd coined in *Security Analysis*). If out of 100 companies, only 10 go bankrupt, the manager's role is not to find the big winners, but simply not to invest in those that will collapse.

The Missing Piece: "What About Me?"

The big gap I identify is that all these investment giants do not deal with the question that troubles the average person: "What does this mean for *me*?"

They talk about risk management at the portfolio level, pricing level, or market psychology level, but they miss the unique personal situation of each investor. Howard Marks touched on this once in an interview, presenting a scale of 0 to 100 (where 100 is maximum risk). He explained that the decision of where to place yourself on the scale depends on variables such as age, wealth, income, the ratio of capital to current needs, the number of dependents (children/parents), proximity to retirement, and the mental ability to absorb volatility. He added honestly that it is impossible to set a uniform formula, that it is impossible to know which portfolio composition fits every risk level, and that in the end, this number is a matter of mindset.

All the parameters Marks listed are critical, but one must understand that to different people, the word "risk" means completely different things. It is not just a matter of mathematics (return vs. chance of loss). A person's character is much more relevant than their Excel spreadsheet:

- If a person has a tendency to gamble, they might overestimate their ability to handle risk.
- If a person is highly influenced by their social environment (FOMO), the chance they will stick to an investment portfolio that suits them personally is nil the moment they feel they are "being left behind" while their friends get rich.

My intention is that it is not enough to measure the *amount* of risk, but the *nature* of the risk. Two people can hold the exact same portfolio, but for one the risk is tolerable, and for the other, it is destructive.

Furthermore, asset classes change their character depending on location and situation:

- For a person in the USA, investing in real estate is considered (usually) safe and stable.
- For a person living in Ukraine on the Russian border, real estate is the most dangerous asset there is. For them, gold or Bitcoin, which are considered "speculative" in the West, were the safest anchors of salvation.

No classic investment book discusses these nuances, which I believe are critical.

A Final Word Before We Dive Deep

While writing this book, I realized that translating these ideas into the practice of building a personal portfolio (Asset Allocation) requires a book of its own.

The current book is designed for a specific purpose: To explain what I am looking at when I choose not to join the euphoria surrounding the Israeli housing market, and why I do not agree with the market that is pricing in a rosy future and a rapid recovery.

I will touch on painful points, and I suggest you take a moment to have an honest and full conversation with yourself, not just about the money, but about who you are.

Everyone Takes It for Granted: The First Goal Is to Survive, and the First Risk Is Not Surviving

Everyone takes it for granted, but in the financial world (just like in nature), the first law is survival.

“The first rule of investing is don’t lose money. The second rule? Don’t forget the first, that’s all the rules.” - Warren Buffett

“Live to fight another day.” - Old English Proverb

In other words: The goal is to stay in the game long enough.

I don't know why people don't understand this enough. It sounds trivial, but applying it is far from simple. We use these phrases in investing to explain why one must not take a risk one cannot withstand (the risk of bankruptcy). But as a people whose survival is in doubt at any given moment, we tend to frequently ignore this in our daily economic lives.

There is a rule in combat: Whoever stays in place, dies.

This is just as true in the economic world.

- If Inflation arrives, the real value of your money will erode.
- If Deflation arrives, your assets will lose their value; and if you don't have assets in deflation, you will probably lose your job.

Either way, standing still is a recipe for disaster.

Money is power, and power is security, just as getting rich is a relative matter. The amount of resources in the world is limited, and money at any given moment is distributed differently (a zero-sum game in some cases). Other people want to climb the socio-economic ladder, and that sometimes means they are climbing over you.

The only solution is to constantly learn, constantly train, and constantly improve.

Therefore, the first risk is Neglect. When you neglect something, it rots.

It Is Clear: The Primary Risk Is You

Each of us carries genetic baggage, cultural baggage, and our own biological state. How we feel and the hormones coursing through our bodies will influence our decisions. We also need to study the sociology of the society around us and the psychological influence of our environment and culture (something Jordan Peterson expresses well in his lecture series on the Book of Genesis). Andrew Huberman, a renowned biologist, constantly talks about the influence of various factors on our brain function.

I am not going to tell you to stop watching porn or to stop drinking alcohol. But I do suggest learning how the things we do affect us personally. We are all different; we react differently to different substances and different routines. Over the years, our bodies also change.

A huge risk lies in failing to take these things into account when making decisions.

The Unique Psychology of Israeli Real Estate

We must remember that real estate has a psychological aspect unique to it.

The fact that real estate prices have risen is psychological. The feeling that "settling down" and "staking a claim" in the ground is safe is a primal human instinct (dating back to the days of nomadic tribes). Add to that the Jewish thought that "we have no other land" (if you are going to buy a home, Jews will always want to live in the Land of Israel), and the Arab and Druze citizens, etc., who have been here since before the state's establishment and truly have no family memory of any other place.

There is also a difference in the nature of the purchase. When we look for a home to live in versus a place to rent, we usually look at "What is the maximum I can pay?" which is a completely different pattern than buying flight tickets, where people usually look for "What is the minimum I can pay?"

Here are a few points that fit the Israeli mindset:

- **Social Pressure:** Parents pressure you to buy ("When are you buying an apartment?"). All your friends bought, the whole family asks when you will buy. People feel they are in a higher social class when they say, "I own an apartment."
- **Biology Intervenes:** You reach an age where you physically feel the need to settle down (Nesting Instinct). Life pressure increases, and when you are stressed,

your body produces Cortisol. This affects decision-making abilities. People under financial stress make worse decisions.

- The Psychological Trap: The moment you bought, you must believe it was a good decision. Otherwise, you would have to admit that you committed yourself for 25–30 years to something that is losing you money.
- Rationalization: Therefore, people invent justifications instead of examining reality.

And the reality is that most Israelis who bought an apartment in recent years did so for psychological and social reasons, not economic ones. And then they convince themselves it was economic.

I will be the first to shut my mouth if presented with even a semi-professional/serious work of decision-making and investment analysis regarding a home purchase. I am sure the majority did not do this. And I am talking about the majority. Not those who actually sat down and did the work properly (and finding one apartment among other apartments without comparing it to other *types* of investments is **not** enough).

It is perfectly fine to buy an apartment for emotional reasons. But let's not lie to ourselves that it is a good investment if it isn't, or if a serious inspection wasn't done.

I always suggest here that everyone sit with themselves and understand who they are, what they are, and what their desires are. As a thought exercise, I suggest looking at the famous verse:

"Go forth from your land, and from your birthplace, and from your father's house, to the land that I will show you." (Genesis 12:1)

The idea in the verse is dealing with what is easiest to give up versus what is hardest.

- Your Land: (Broad environment)
- Your Birthplace: (Community/Culture)
- Your Father's House: (Family/Deepest roots)

Everyone has their own chain of what they want. Some people don't want to die before traveling to as many countries as possible; others want to help their children as much as possible.

The ultimate metric is: How much are you willing to suffer for it?

The Survival Principle – The Foundation for Everything Else

The most fundamental aspect of humanity is survival. Beyond the principle of survival, the first mistake I cannot afford is the inability to provide for myself at all.

That is why the first recommendation Warren Buffett and Charlie Munger gave to any investor starting out is: Invest in your own profession first.

I take this chain of principles with me everywhere. The mindset here is unequivocally to survive, and therefore one must always verify that they can survive another day. I work again and again on my ability to make a living. From physical labor, to keeping a finger on the pulse of various professions, acquiring tools, and even getting a degree "along the way."

Livelihood is a cornerstone that serves my ability to survive and care for my people. I always say this: Take everything away from a person, just not their ability to make a living. Livelihood is a person's hope, and it is the basis of their sanity.

Excessive Arrogance and Heavy Pessimism

I touched on this before, but I encounter it again and again. I will probably touch on it someday in my personal experiences (perhaps not in this book), but I will mention it here for a moment. In my conversations with people, I mostly encounter dismissiveness (which, of course, if you are reading this book, you no longer or never did dismiss me). People always ignored what I had to say because I didn't have the CV, diploma or all the other shiny things to make them think I was smart or successful. I always tried to speak in an educated and rational manner, and people, instead of judging me by the things I had to say, judged me based on other things.

We tend to think naturally that we are better than others, that we are smarter than them. We are willing to accept another person's superiority only when it is absolutely obvious (in sports, this is immediately apparent), or when other people we respect hint to us or tell us that we should listen. Otherwise, we tend to dismiss the other side; we simply don't listen to them, and while they are speaking, we are thinking about what we want to say.

Therefore, the subject of getting rich is another thing that is completely clear to us when we see it, like in sports. Even though we know that more money does not necessarily mean the other person has a higher skill set, but is simply a proxy for it. Therefore, we tend to overestimate our own abilities, or think that getting rich is easy, or that "because someone else succeeded, obviously I can too." We then act too aggressively, which ultimately leads to ruin.

Subsequently, people despair and sink into excessive pessimism, doing nothing because they believe the game is rigged, that they were "screwed," and they look for

someone to blame. Until, once again, another person, the “right person” who knows how to appeal to us, arrives promising them that he cracked the system and that “this is how the rich do it and no one told you,” and the cycle repeats.

On the flip side, proponents of “indexing” without understanding what you are indexing into encourages the opposite approach: “You can’t beat the index; whoever you saw getting rich just got lucky. You are smarter, so you won’t even try, and when they lose all their money, you will be rich”. To someone who lives in the Bay Area, is not working in tech, indexing into S&P500 while his neighbors are investing in Tech, guarantees that if tech does well over the next decade, he will get crushed. On the other hand if there is a Tech “winter” he might lose less than his neighbors. One should choose what risk they prefer?

Here is a quick mental test:

Option A: odds are 50-50. Either you are the only one who passes a test in your class, or you get a C/B when everyone else gets an A.

Option B: odds are 50-50. Either you fail with everyone or get an A with everyone.

The Natural Mistake – The Fear of Being Left Behind

A massive mistake that people decide they cannot afford, and it is completely natural, is being left behind. They prefer to be wrong together with everyone else than to take the risk of being stuck behind. They are afraid of making the mistake of losing purchasing power. This is one of the main reasons why people decide to buy an apartment: because prices are rising, and they feel the train is about to leave the station.

Case Study – My Friend from Tel Aviv

A friend came to me this week and we talked about investments. I am not an investment advisor, so I always remind him and my friends of this: I am not a professional, and they need to consult with a certified professional licensed by the state. I do, however, share how I think about the matter.

He, like everyone else, comes to me with the expectation or hope of getting an answer (which I am forbidden to give, and I never give because it is so subjective and personal that I don’t think it’s possible to give). Instead, he gets even more questions. Human nature is to shut down in that moment (because it makes him realize that even if he knew very little, only now does he understand how little he actually knew. And I’ll tell you the truth, we haven’t even started licking the tip of the iceberg even in this book).

He wants to live in Tel Aviv, no matter what. Meaning, unlike me, living elsewhere in Israel is not an option for him. On the other hand, although he has the option to move

abroad, his basis for such a move is shaky. (For those for whom moving abroad is out of the question entirely, this example is even more important). He is not a software engineer, nor does he work in those professions.

Therefore, the main mistake he cannot afford is not keeping up with the pace of Tel Aviv. In terms of purchasing power, he has double the pressure: both to raise his salary at the pace of Tel Avivians, and to get rich at their pace. This is a hard thing to do when all around you there are exits and huge corporate salaries, especially if you are not a software\electric engineer or a businessman.

Therefore, for a person living in Tel Aviv, where there is a disproportionately high concentration of cyber and high-tech people, there is great logic in investing in a basket of cyber companies. In the worst-case scenario, where the cyber sector experiences a "winter," the people around him will be damaged too (and his *relative* purchasing power will be preserved). On the other hand, if cyber continues to soar, he will be able to peg his capital and purchasing power more accurately to the population surrounding him. Conversely, for a person who *is* an engineer in a cyber company, who already has a significant portion of their purchasing power pegged to cyber through their salary and options, it might be wise to avoid being invested *even more* in cyber (unless they know from professional acquaintance that there is an exceptional opportunity that will increase their rate of wealth accumulation).

A person who sees difficulties in their industry, and furthermore fears for their livelihood, needs to think very carefully if they should be invested even more in this sector in their investment portfolio.

“One of the lessons your management has learned—and, unfortunately, sometimes re-learned—is the importance of being in businesses where tailwinds prevail rather than headwinds.” - Warren Buffett, in a Letters to Shareholders

A way to try and identify if you might suffer from **FOMO** that will lead to ruin is if you always dress according to the latest fashion, or tend to do things similarly to everyone else.

On the other hand, if you are a person who likes to do everything differently from others even if it is a bit less productive, or alternatively, when you do something and then others copy you it bothers you, you might suffer from "**Excessive Contrarianism.**" Meaning, you will find yourself going against the herd (or the market) even when it is right.

The Myth of Passive Investing

Here is something to consider precisely because so many people *don't* think about it, and I think it is very important to mention.

A trend of "Passive Investing" has emerged, recommending people to "stick your money in the S&P 500... and that's a passive investment because no one beats the market over time... blah, blah, blah."

The array of active decisions the "Passive Investor" makes without noticing they are active:

- Asset Allocation: Even if we assume it is true that investing in an index-tracking portfolio is passive, a very important component is how many percent each asset takes up in the capital portfolio. That is already an active decision.
- Pegging Purchasing Power: Another active decision is tying your purchasing power to a specific market—all the more so when it is not your local market. Because Tel Aviv is joined at the hip with Silicon Valley, a Tel Avivan must take this into account in their investments. Buying an apartment slated for urban renewal (*Pinui Binui*) in Haifa might not keep up with the pace of the Nasdaq 100.
 - A rise in technology stocks is much more relevant to Tel Avivan inflation than it is to real estate prices in Haifa.
 - The Ripple Effect in this case works like this: Silicon Valley -> Tel Aviv -> Haifa Real Estate Prices (this is very, very rough), but unequivocally not the other way around.

If an investor chooses to invest in real estate in Haifa, their profit must at least match the pace of the rest of the wealth creation in Tel Aviv; they must generate Alpha (excess return).

Choosing the S&P 500 is also not that helpful to them

Tel Aviv is not affected by Altria (a traditional tobacco company in the S&P) to the same level it would be affected by small cyber companies that might be trading in the private market. More than anything:

Let's assume tomorrow the American economy collapses, and Israel makes a Pivot to China, or the Israeli economy grows at a much higher rate. The money they invested is pegged to purchasing power in the USA, and their purchasing power will erode relative to the purchasing power of people who invested in Israel.

For me, someone who is ready at any moment to board a one-way flight to the US if I absolutely had to because I couldn't survive here economically, it is a much easier thing to tie my fate to the American economy and invest in the S&P 500.

But don't think the Tel Avivan is protected if they put money in the Nasdaq 100 and invest a fixed amount every month.

1. If Tel Aviv becomes the global cyber capital and the rate of getting rich in Tel Aviv exceeds the Nasdaq 100, he is in trouble.
2. If the Nasdaq 100 crashes and somehow Tel Aviv makes a Pivot to be influenced somehow by a booming China, he is in the same trouble again.
3. The decision to tie ourselves to a specific place, and to say that "no matter what, I cannot afford *not* to keep up with the local pace," requires keeping a finger on the pulse of the character of local wealth creation.

The Israeli Myth About American Index Trackers (And Why It's Real for Americans)

Where does this whole concept of "Passive Investing" and "Invest in the S&P 500" come from?

It comes from recommendations by Warren Buffett or Jack Bogle to an American audience of investors, who depend on the American economy. Therefore, for them, it is a true passive investment. Meaning, if an Israeli takes the active decision to tie their future to the American economy, they are taking the **probabilistic decision** that the Israeli economy will continue to be an **offshoot** of the American economy, and that Israel will not suddenly switch to being a vassal state (yes, I am using that term) of the Chinese economy, for example.

In short, there is no such thing as truly passive investing. Every decision is an active decision:

- Investing in the S&P 500 = An active decision to tie your fate to the US economy.
- Buying an apartment in Israel = An active decision to tie your fate to the Israeli economy.
- Doing nothing = An active decision to lose purchasing power to inflation.

Examples of questions everyone needs to ask themselves:

- Where do I want to live in the next 20 years?
- To which economy do I need to peg my purchasing power?
- Which mistakes can I afford, and which can I not?
- What is most important to me, Security or Growth? Or in other words what is more important to me, the possibility of being richer than my neighbor at the risk of being poorer? Or do I prefer to make sure I just do not fall behind?

"For about a year, I've been sharing my realization that there are two main risks in the investment world: the risk of losing money and the risk of missing an opportunity. You can completely avoid one or the other, or you can compromise between the two, but you can't eliminate both."

- Howard Marks

Before deciding where to put the money, you need to decide where to **"put your life,"** or at least what you want from it, and derive your decisions from that.

A Few Final Thoughts On General Risk

There are several primary risks:

1. Us – The Greatest Risk

We do not know what we do not know. The most dangerous punch is the one we don't see coming. This is the meaning of the Black Swan. Knowing that at any moment we *expect* such a punch to arrive makes dealing with it easier, and this is essential for our ability to recover from it. That is why it is critical to understand that we don't know.

Deep self-knowledge of our psychological makeup is required, knowing how we will encounter things when they happen. Meaning, we need to do two things: learn psychology, and expose ourselves again and again to completely different situations to learn how we deal with them.

I am not necessarily talking about things related to investing. For example, we need to repeatedly do things that scare us, and see that after it happens, everything is okay. Whether it's roller coasters, riding a motorcycle, getting into a fistfight (which is less recommended for adults, but as a child, it was a toughening experience for the future), or sparring with people bigger, stronger, and better trained than us, taking a punch to the face and seeing that everything is fine. Get used to leaving your comfort zone, because when things get bad, it *will* be scary, no matter how rich you are.

The second thing is to understand that we are not educated enough and not experienced enough. So **learn, learn, learn**. Ask questions constantly. Remember every day that we are idiots, but if we conduct ourselves well today, we will learn at least one thing.

“Gentlemen, we will chase perfection, and we will chase it relentlessly, knowing all the while we can never attain it. But along the way, we shall catch excellence.” – Vince Lombardi

Regarding the business we intend to invest in, we must ask ourselves: What else can I learn about it? About its industry? About its employees and managers? About its competitors? And about ourselves, how will we react to different things happening in it or its industry?

2. The Culture of the Society Around Us

The behavioral culture of everyone is what brings these unexpected punches upon us as a society. Meaning: complacency, mediocrity, corruption, etc. In the end, in economics, the shit floats. What happened in the US in the real estate market, the mortgage market, the mortgage derivatives market, the credit market, and the insurance markets was a chain of events that does happen often throughout history: A good idea offered to a limited number of sophisticated investors with very deep pockets develops and eventually moves to funds investing capital that isn't their own. Because the new investment turns out to be excellent, due diligence gradually decreases, and on the

other hand, people are willing to invest in less and less responsible things. The quality of the investments themselves (of the same type) drops, and rolls over to a larger and larger public of less and less sophisticated investors until it explodes and goes up in flames when asset holders suddenly discover they were sold junk and there is no one left to sell to.

Within this entire chain, there is a lot of mediocrity (people not checking what they are buying even if they have the abilities and tools to do so) and also corruption (because people knowingly sell junk and manipulate assets).

Our Personal Culture is part of the matter. What are my habits? Do I strive for excellence? Do I challenge myself and those around me? The question is, if I went to a professional to do what I am about to do now, what would be my expectation of him, and do I meet those standards myself?

"Winning is not a sometime thing; it's an all the time thing. You don't win once in a while... you don't do things right once in a while... you do them right all the time. Winning is a habit." - Vince Lombardi

Even in the business we invest in, we need to ask whether excellence is the professional culture in the business. Because if not, eventually someone excellent will arrive and defeat the business in the market.

3. The Numbers

People are usually too lazy to go over the numbers properly. And for every business and every investment, there are numbers with different meanings. What distinguishes a businessman from an accountant is Context. The businessman is supposed to understand the meaning of the numbers better than the accountant.

Some examples:

- Young Companies: What needs to be asked is: Do they have debts? Are they on the way to being profitable? Or do they have the *option* to become profitable if they slow down the rate of investment in a situation where their potential market experiences a "winter"? What is the current growth rate? What is the size of the potential market? And do they have the ability to expand into additional markets (products, services, and regions)?
- Banks: It is the quality of the loans they gave (found in their Balance Sheet), the Credit Spread (the ratio between the interest at which they borrow money vs. the interest at which they lend money), how fast a Bank Run can occur, and their ability to deal with it (Cash Reserves).
- Real Estate: The rate of population growth is a critical thing, and even more so among the population that generates most of the growth. Notice that the countries in Europe where real estate is cheap are countries that many young people are leaving (for example, Greece).

There are, of course, other numbers, but ultimately, investing is a question of DCF (Discounted Cash Flow) brought in the classic form:

"A bird in the hand is worth two in the bush." - Aesop

A good investment is an investment where the numbers jump off the page at you. That when running different models of different scenarios that might happen and how they will affect the numbers, the page says one thing:

"Heads I win big, tails I do not lose much." - Mohnish Pabrai

And in investing, the most important question is: Will I get my Equity (principal) back?

And the second question is: What is the Return on my Equity?

The moment leverage is introduced into the picture even a little, there is a fundamental difference between the profit on the asset (after expenses, after profits from price appreciation at sale plus cash flow return during holding) and the Return on Equity.

Therefore, when someone talks to me about the yield of a leveraged apartment, and he does not refer to the return on *his equity* but simply to how much rent is relative to the price of the apartment, I know immediately that he does not understand his investment, because he does not understand his real return.

Remember, the market is efficient on average. And excellent investors exploit the points where the market loses its efficiency. They buy when everyone is sure it is a bad asset (and sometimes the crowd is right, but there are cases where they are wrong) and sell when everyone is sure it is the best investment there is.

An Important Note Regarding Bubbles (Or When People Think There Is One)

Excellent investors tend not to participate toward the end of a bubble. They stop deploying new capital, or even sell off some assets. During the Dot-Com bubble, some of the best investors lagged the market from 1998 to 2001.

It is mentally very difficult when people around you are getting rich very quickly. The best cure for seeing everyone around you getting rich is to simply be happy for them. If you decided a certain investment isn't right for you, stick to it. But don't wage war against it. Sit with yourself and try to decide, for yourself, which investment avenue is right for *you*.

If you do this well, you will avoid losing during bubbles, or conversely, you will be invested when *others* think it's a bubble and it turns out you were right, buying when prices are low.

The name of the game is Buying Well. This is only possible when you stop looking at your neighbor's grass. And a little 'love thy neighbor' helps. There are many ways to make a lot of money; the fact that someone found a way that didn't suit you is perfectly fine. And let's face it, sometimes you also need a little luck in life.

The Unique Risk of Investing in an Israeli Real Estate - Mortgage

Now that we understand risk in principle, it is time to step into the minefield called "Investing in Israeli Real Estate". The ability to analyze these risks is our only weapon

against the herd. It is what allows us to identify danger when everyone sees a "once-in-a-lifetime opportunity" (during a bubble), or to spot opportunity when everyone is sure the sky is falling (during a crisis).

For the sake of this discussion, I want us to set aside subjective and emotional factors. Let's ignore for a moment the price premium of a Safe Room (*Mamad*) vs. no Safe Room. Every person prices their family's personal security and the comfort of not running down to a shelter in pajamas differently, and that is legitimate. Let's also ignore the geographical analysis of security zones.

We are here to talk about money, and the speculative nature that has gripped the country. We will dive into the triangle of risk between the Buyer, the Contractor, and the Bank, and analyze the Spread, the financial gap between "real estate on paper" to be delivered in years, a ready-made new apartment, and a second-hand apartment.

The style of this section will be slightly different: I will present the classic arguments I hear again and again from salespeople, developers, and "advisors." These arguments sound logical, but in reality, they are the ones hiding the speculative gamble. Why? Because the people selling you these arguments are in an inherent conflict of interest. Their goal is to earn a commission or move inventory, and their aim is to justify the deal to you (and to themselves).

But just before measuring the risk, we must ask: What is this investment supposed to solve? The short answer is: Inflation Hedge. We invest capital so our savings won't erode, hoping the asset's value will rise above the "Risk-Free Rate" (Government Bonds).

The massive problem begins with the fact that the Israeli public does not know how to price risk. Most buyers do not understand the magnitude of the gamble they are taking. They are led by professionals who are supposed to "help" them, but whose actual interest is to close the deal as quickly as possible. The client is left alone on the battlefield, not understanding if the risks suit him, and without any contingency plan in case the gamble goes wrong. Understanding these take some time, even more when you do it for someone else.

The Israeli Mortgage

The mortgage in Israel is a unique financial product, vastly different from the standard in the US. In the US, the standard is a 30-year fixed interest rate. This rate is correlated, above all, with the 10-Year US Treasury Yield. The American real estate buyer takes a sharp and clear bet: The real estate purchase is supposed to yield a higher return, after expenses, than the yield (compounded) on US bonds over those same 30 years. Even this calculation can only be done at an abstract level, because no one really knows where interest rates will go.

"There's nobody whose predictions on interest rates I would pay attention to, even myself, even Charlie." — Warren Buffett

The Fed Chair himself doesn't know what will happen next year. However, one can use common sense and historical patterns. In 2020–2021, a person had to ask themselves: "Are interest rates today at a historic low?" If so, the likely probability is that they will rise in the future. The same logic applies to inflation. Alternatively, in a very high-interest environment (where we see a true slowdown in inflation), that same "logic" aids us again, but in reverse. The bets concern two variables that follow a clear theoretical line:

- Inflation Rising => Invest in Real Assets (Real Estate/Commodities).
- Asset Deflation / Recession => Invest in Bonds (locking in yield + capital appreciation).
- Interest Rates Expected to Rise => Buy Assets Today (to lock in cheap financing before it disappears).
- Interest Rates Expected to Fall => Buy Bonds Today (when rates drop, bond prices rise, allowing you to sell at a premium and buy assets later).

The cycle historically is this: rates fall => inflation rises => rates rise => inflation will fall => rates fall => inflation rises, and the cycle continues. This cycle is a major source of criticism of central banks and why there are economists who claim that central banks (such as the Fed) exacerbate these cycles since they may overreact or act late, or both. It is an important note, that this logic also led many investors to believe that rising interest rates would lead to a recession and to falling stock prices in the period of 2022-2024, however they were mistaken (it is important to understand the meaning of the numbers and the environment and not follow these as a rule of the universe). The problem in the US was this: interest rates were so low for so long that today, a rise to a level that is historically reasonable disrupts classic economic patterns. This is why so many economists and investors were swindled by the last rate rise part of the cycle. Many companies used the low rates to lock very low interest rates for their debt. Interest rates merely returned to historically "reasonable" levels, and the most dominant companies in the U.S and its stock market are excellent companies with high profit margins, which made it relatively easy to deal with these historically "reasonable" levels of interest rates. That is what was different that time (now you can say that everyone is smart in hindsight, but I did in fact get that right).

Back to business, In simple terms, buying assets versus bonds is a bet against interest rates and for inflation. It implies an expectation that interest rates will rise (causing bond prices to crash). Meanwhile, you need protection from inflation, so you buy assets. (This is why central banks raise interest rates when inflation is high: to suppress it. Consequently, asset values usually drop because people sell them, or stop buying, and redirect capital to bonds).

The "Mark to Market" Accounting Issue – and the relation to real estate

Short-term bonds (1-2 years) are less of an issue because they mature quickly; banks can hold them to maturity without marking them to market. The major crisis arises when holding long-term bonds (10+ years) purchased at very low interest rates.

The bondholder is stuck receiving a tiny yield for a decade, while today they could buy a similar bond paying much higher interest. This devalues the old bond. In such periods, investors prefer to shun bonds and buy assets such as real estate. Conversely, when interest rates are high, the demand for bonds rises, and the hunger for assets like real estate cools.

The Israeli Mortgage Structure

In Israel, the mortgage is essentially a Portfolio of Debt, composed of different "tracks." Each track is exposed to a different economic risk. I am still in complete shock that this is the situation here. The most common debt instrument contains risks that require deep economic analysis regarding unknown variables, yet these are marketed to the general public. I am now going to explain to you the complexity of the Israeli mortgage, and the predicament into which Israeli households are inserting themselves. This subject is complicated in theory, and even more so in reality.

The structure of this portfolio reflects a hedging strategy. Choosing the "weight" of one track relative to the others is an active decision regarding which macroeconomic bets to expose yourself to. When a person takes a mortgage, they are effectively betting on Israel's macro-economics for the next 30 years. Let's start with the Fixed component. Assume the mortgage is taken in a low-interest environment (as was the case in Israel for the last 15 years).

"Kalatz" (Fixed Non-Indexed Interest):

- Mechanism: You lock in a specific interest rate. The monthly payment is fixed, and the loan is fully amortized by the end date.
- The Risk: That you paid too expensive a "premium" (a high fixed rate) and lost the opportunity to save money if market rates drop later. Furthermore, you face Prepayment Penalties (fines) if you want to refinance when rates fall.

Because interest rates in Israel were historically low, it was in the buyer's interest to maximize this track and for the bank to minimize it (in theory, we will jump to reality in the end). The deceptive part is that rates remained low for so long that it fooled everyone. Warren Buffett himself, in meetings around 2014, said he couldn't believe interest rates remained that low for that long without triggering inflation.

Variable Tracks: Managing Risks That Are Hard to See

Now, let's discuss the tracks where risks are less visible to the naked eye, and therefore harder to manage. Here, we enter the heart of the Israeli banking system and understand the interests driving it. These risks can be divided into two categories: The Risk of the Price of Money (Interest Rate), and The Risk of the Value of Money (Inflation).

A. The Prime Track (Variable Interest)

The Mechanism: The interest rate is composed of the Bank of Israel Interest Rate + a fixed spread of 1.5%.

The Risk: Immediate Cash Flow Risk. The change is rapid and sharp. If the Central Bank raises the interest rate tonight, your monthly repayment increases next month.

The Bank's Interest (And why they push this when rates are low): When we take a mortgage, we are essentially selling a "Bond" to the bank. The bank buys a future stream of payments from us.

- In a Fixed Rate Track: The risk lies with the bank.
 - If market rates rise: The "Bond" the bank holds (your mortgage) loses value (Marked to Market). Why? Because the bank is stuck with a loan yielding a low return, while the price of money outside is expensive.
 - If market rates fall: The client has a huge economic incentive to "refinance" the mortgage (take a cheap loan to pay off the expensive one). For the bank, this is a disaster; they counted on high profits for years ahead, and suddenly the client "escapes." To prevent this, the bank imposes a Prepayment Penalty (Exit Fine). This fine is calculated to compensate the bank for the profit it loses due to the interest rate drop.
- In the Prime Track: The bank rolls the interest rate risk entirely onto the client. Therefore, in a low-interest environment, the bank has a distinct interest in clients taking the Variable Rate Track. This is how it protects itself from the devaluation of its assets if rates rise.
- Conversely: When rates are already very high and expected to fall (or inflation is expected to cool), the bank is less enthusiastic about marketing the variable (Prime) track. They would prefer to lock the client into high fixed rates to enjoy high yields.

B. Index-Linked Tracks (CPI Linked)

The Mechanism: The loan principal (the debt itself) is pegged to the Consumer Price Index (CPI). The Risk: Erosion of Equity. If the Index rises, the nominal debt grows. An absurd situation can arise where you pay the mortgage for 5 years, but due to inflation, you owe the bank *more* money today than you borrowed initially.

The Bank's Interest: Inflation is the enemy of lenders. If the bank gives you a million shekels, and inflation runs wild, the million shekels you return in the future are worth

much less in terms of purchasing power. To avoid absorbing this value erosion, the bank offers the Index Linkage. By doing so, it rolls the Inflation Risk entirely onto the borrower. The bank ensures its *real* money value is preserved, no matter what happens in the economy. In this track, we, the borrowers, serve as the bank's "Insurance " against inflation.

The Bank Is Not the Enemy (It Is the Borrower's Most Concerned Partner)

Before diving into sales techniques and conflicts of interest, it is important to shatter a myth and clarify a critical point: The bank has no interest in the client's failure. In fact, aside from the client themselves, there is no entity in the world more interested than the bank in the borrower meeting their payments. For the bank, a client reaching insolvency is an expensive and complicated failure. Collection proceedings, lawyers, and asset liquidation via receivership, all these cost the bank a fortune and consume valuable management time. Therefore, the first rule in managing personal crises is simple: If the borrower identifies a cash flow difficulty, it is in their distinct interest to contact the bank proactively. There is no point in waiting. The bank has a supreme interest, identical to that of the borrower, to prevent bankruptcy. Bankers have an entire toolbox (grace periods, payment deferrals, mortgage refinancing, rescheduling) designed for one purpose: to keep the borrower's head above water, so they can continue paying interest for many more years. The bank will bend over backwards to avoid foreclosing on the asset. Good banks and bankers aim for the client to grow and thrive economically so that they can enjoy continued business with the client over the years.

How Does the Dynamic Between the Bank and the Client Lead to the Choice of Risky Tracks?

The question arises: If the bank and the client share a mutual interest in success, why are high-risk mortgage mixes ultimately chosen? The answer lies in the intersection between the client's desire to maximize their purchasing power in the present, and the solutions the banking system can offer within its limitations.

Additionally, a certain conflict of interest exists. Ultimately, the bank wishes to hedge itself against risks while simultaneously maximizing profits. Therefore, the bank has a distinct interest in rolling risks onto the client (such as interest rate hikes and inflation) to maximize long-term profits. Clients, however, have opposing interests: their goal is to avoid assuming risks on behalf of the bank and to minimize the bank's "profits" at their expense. Clients have additional interests in mind as well. For most households, the determining factor is the immediate monthly repayment. The gap between a repayment of 6,000 NIS in a safe track and 4,500 NIS in a variable track is sometimes the difference between a feeling of suffocation and a feeling of financial well-being in the short term. The *seemingly rational* client chooses the option that leaves more

disposable income at the end of the month. This is a legitimate decision regarding cash flow management, but its price is delaying the confrontation with the true cost of money in the future, often manifesting as a principal balance that does not decrease at the desired pace. Consequently, banks sometimes offer a lower monthly payment, and in return, clients take on more risks.

Often, combining variable tracks is the only way to bridge the gap between the apartment price and the borrowers' income. Bank of Israel guidelines limit the permitted monthly repayment (Debt-to-Income Ratio). For example: A couple earning 20,000 NIS net who wants to purchase an apartment might discover that in a safe, fixed track, the monthly repayment is higher than permitted, preventing the bank from approving the loan. In such a situation, the banker offers a solution: combining a "Variable Index-Linked" track. The low initial interest rate in this track lowers the average monthly repayment, allowing the couple to meet the criteria and receive the mortgage. For the client, this track is the tool that makes the transaction possible.

The Double Meaning: "Flexibility" vs. "Interest Rate Exposure"

In many cases, when the bank presents a variable interest rate track, it highlights its major advantage: flexibility. These tracks feature "exit points" that allow the borrower to repay the mortgage or refinance it without exit penalties (prepayment fees). For the client, knowing they are not "married" to the interest rate and can exit without a fine is a significant advantage. However, it is important to remember that this is a double-edged sword: the very point that allows the client to exit also allows the bank to update the interest rate upward according to market conditions. What is perceived as the benefit of flexibility is also the mechanism that exposes the borrower to interest rate risks.

A very common scenario in building a mortgage mix is reliance on future funds. I know of several cases where clients and the mortgage advisor built a plan in which the linked and risky track was taken for the short term, with the intention of closing it within 3 years upon the release of savings instruments that locked the funds for a time period. This is a legitimate plan "on paper." The strongest evidence that this is common is that banks have created a dedicated off-the-shelf product for this scenario. Every mortgage bank has a structured track called a "Bridge Loan" (or Bullet/Balloon) for a period of 3 years or more in certain cases. If this were not common, banks would not invest in building the product, the systems, and the marketing for it. In practice, reality teaches us that plans often change. At the time of release, many households may designate the money for other uses (events, renovations, a car), and the mortgage remains as it is. Human nature tends to believe the future will be better. Clients tend to assume that their income will rise faster than inflation, or that interest rates will remain low as they were in the past. The bank, as a business entity, presents the existing options on the table. When the client faces these options, they almost always tend to choose the path that allows

for the best deal in the immediate term (the low repayment), believing they will be able to cope with changes in the future.

The banking system does not force risky tracks on the client; rather, it offers products that answer the public's primary demand: the ability to purchase an apartment here and now, with a feasible monthly cash flow. The risk is a byproduct of the desire to bridge the gap between high housing prices and current income levels. For reasons we have discussed extensively in the book so far, humans are very bad at thinking about the distant future and tend to focus excessively on the short term.

Historically: What Happens in Which Environment, and the Risk Israeli Buyers Ignored The Cycle

Historically, a high-inflation environment leads to a high-interest-rate environment. This, in turn, leads to a low-inflation environment (and often asset deflation), which eventually brings us back to a low-interest-rate environment. And so the cycle repeats.

Because the public's memory is short and they do not fully grasp the risks, they tend to make the exact opposite decision of what would be ideal to handle the next cycle.

The Israeli "Cocktail" (The Mix) Unlike in the US, where a borrower typically takes a single loan product (usually a 30-Year Fixed), in Israel, almost no one takes just one track. The absolute majority takes a "Mix", a combination of the tracks we mentioned earlier (e.g., 1/3 Variable, 1/3 Fixed, 1/3 Variable CPI-Linked), this way they think they are "balancing the risks". They are unaware that rising inflation leads the central banks to raise rates, therefore instead of diversifying risks, they are exposed to the "two different risks" that are likely to occur together.

The theoretical idea is "risk diversification" (like a stock portfolio). But in practice, the Mix became a marketing tool designed to create an illusion of cheapness while simultaneously rolling the risk onto the client. For years, the Israeli public got used to interest rates that never rose. Consequently, they didn't recognize the risk that rates *could* rise, or that inflation could cause the loan principal to swell.

In that reality, a new generation of real estate investors and mortgage advisors emerged a generation unscarred by hardship. This generation sought to take as much risk as possible (because risk seemed "free"), minimizing the safe Fixed Rate component and maximizing the risky Variable and Index-Linked components.

The bigger problem arose following a regulatory change by the Bank of Israel that sought to "assist households" in a time of need. Previously, the Prime component (the variable rate track most sensitive to central bank hikes) was limited to 1/3 of the mortgage. When this restriction was lifted (allowing up to 2/3 in Prime) during a period of zero interest rates, many people built a Mix leaning heavily on Prime (because it was

the cheapest at that moment) and on CPI-Linked tracks (because their initial payment is artificially low).

The Result The consequences were not long in coming. They created a Mix where the initial monthly payment was low and tempting. This allowed them to buy apartments more expensive than they could truly afford (driven by the psychological mechanism: *"What is the max monthly payment I can handle right now?"*).

They ignored the fact that this Mix was a ticking time bomb:

1. Interest Rates Rose: The Prime component (which was the majority) caused the monthly payment to jump immediately.
2. Inflation Reared its Head: The CPI-Linked component inflated the total debt balance.

Thus, people found themselves in the worst-case scenario: paying a mortgage for years while the debt didn't decrease, or paying a significantly higher monthly payment, and often both. Yes, this actually happened. People got fucked by both directions.

"Nowhere to Run, Nowhere to Hide" - Martha and the Vandellas

Those who took an "aggressive Mix" failed in Risk Management. They sacrificed future stability for momentary comfort in the present. Ironically, during the years when everyone was being aggressive, that was precisely the time to take a Fixed Non-Linked Rate (the Israeli equivalent of the standard American mortgage).

Let's Review the Risk Scenarios one more time, what Happens When the Index and Interest Rates Change?

To understand the volatility of the Israeli mortgage, we need to look at the two distinct "pain points." One hits the checking account (cash flow), and the other hits the net worth (balance sheet).

Scenario A: The Central Bank Rate Rises ("Prime" Risk)

Impact: Direct hit to monthly Cash Flow.

- The Affected Track: The "Prime" track (and other variable tracks at their adjustment points).
- The Effect: Let's assume you took a 1 million NIS loan in the Prime track. For every 1% rise in the Bank of Israel interest rate, your monthly payment will jump by approximately 500–600 NIS (depending on the loan term).

- The Danger: Inability to meet monthly payments. This is exactly what happened in 2023–2024 when rates skyrocketed. People who started with a comfortable payment of 4,000 NIS suddenly found themselves paying 6,000 NIS.
 - *Note:* The total debt balance does not grow unexpectedly in this scenario, but the monthly burden becomes suffocating.

Scenario B: The Consumer Price Index (CPI) Rises (Inflation Risk)

Impact: Direct hit to Total Debt (Principal). This is much more dangerous because people don't feel it in their pockets immediately, but rather in the long term. It is essentially Negative Amortization.

- The Affected Track: All Index-Linked tracks (Fixed-Linked, Variable-Linked).
- The Effect: Assume you have a debt of 1 million NIS in a linked track, and the CPI rises by 3% in a year (a reasonable, slightly high inflation rate). The bank adds 30,000 NIS to your loan principal *before* it even calculates the interest.
- The Danger: You pay every single month, but the debt does not shrink. You are eroding your equity.
 - *The Nightmare Scenario:* If the value of the apartment drops simultaneously (which often happens when interest rates rise), you can reach a situation where your debt is larger than the value of the home (Negative Equity or being "Underwater").

Strategic Management, is exactly what the Public Lacks, Leading Them to Buy "Yesterday's Insurance"

At a strategic level, the goal of a sophisticated borrower is to fix the interest rate (switch to a Fixed Rate / "Kalatz" track) exactly at the moment *before* rates begin to climb. If the borrower does not trust their ability to time the market, the correct move is to pay the "premium" of the fixed track (while rates are still low) for peace of mind and future protection. The rule is simple: You buy insurance when the sea is calm, not when the storm is already raging.

However, human psychology works in reverse, and the banks are well aware of this. In a high-interest environment (like that of 2023–2024), when the bank estimates that rates are likely to fall in the medium term, it has a distinct interest in locking clients into high fixed rates. From the bank's perspective, it is far better for a client to pay 5% fixed for 20 years than to take a Prime track that might drop to 3% in two years.

Here, the "Double Whammy" is created for the average borrower. People who got "burned" by the spike in monthly payments in variable tracks arrive at the bank traumatized. Naturally, they seek stability at any cost. It is very easy to sell a frightened person a stable, fixed track, even if it is terribly expensive. Thus, the unsophisticated borrower gets "screwed" twice:

1. The First Time: When interest rates rose while they were exposed to the variable Prime rate.
2. The Second Time: When they locked in a high fixed rate at the peak, precisely before it was supposed to drop.

Those who fell into this trap in a high-interest environment included people refinancing mortgages, consolidating debt, or new borrowers who heard horror stories from others. Bank of Israel statistics tell this story perfectly. The moment the central bank rate spiked and the Prime rate reached the 6%–6.25% range, the track that used to be the "cheapest" and most popular became the "most expensive" and burdensome overnight. The public response was immediate and sharp:

- Abandoning Prime: We saw a collapse in demand for the Prime track. If at its peak it constituted about 40%–50% of the average mix, its weight in new portfolios plunged toward 30% and even less.
- The Herd Rush to Fixed Rates: Simultaneously, there was a dramatic rise in taking Fixed Non-Linked tracks. The public chose to buy the mortgage that *would have* protected them from the risk they *already* experienced, thereby preventing themselves from utilizing the opportunity for future rate reductions.

How did the public manage to keep buying apartments at rising prices with such high interest rates? This is exactly what I asked myself when we saw real estate prices surging after the first year of the war. The answer is Financial Stretching.

To cope with the higher interest rates and still meet a reasonable monthly payment, Israelis didn't stop taking mortgages; they simply extended them to the maximum possible (30 years). Spreading the payments over a longer period lowered the monthly burden but inflated the total interest paid to the bank by the end of the road. This is the reason we saw real estate prices continue to rise, even in a macro-economic environment that should have pushed them down.

The Second Risk

The Israeli Developer vs. The Resale Market

The Base Price Valuation must always start with Second-Hand (Resale) properties. With them, "What you see is what you get."

In my view, the ideal house is one that has been standing for a few single years.

- Defects: If there were construction defects, some would likely have already been discovered.
- Maintenance: One hopes the previous tenants maintained the property well.

A person buying a second-hand apartment/house should absolutely bring a professional to inspect the property's condition. One should not be ashamed when making the biggest financial move of their life. You need to check every faucet, every switch, and every corner where mold might be hiding. The chance of significant wear and tear in an

apartment that is only a few years old is low, and the price gap (compared to new) should be significant enough to offset that wear.

From my personal acquaintance, many times people who bought "on paper" from a contractor found themselves in various lawsuits after residents populated the building and defects were discovered. When you buy second-hand, you benefit from a situation where another tenant ran the "pilot" test for you. Additionally, if they performed upgrades to the property, they likely aimed to recoup that investment through "betterment" (value appreciation). This is actually an opportunity to purchase an upgraded asset for "less," simply because they created some wear and tear on it.

In Israel, the opposite happened. The "Base Prices" that took hold of the market were pegged to the highest price of the property next door, which is usually a new apartment from a contractor. (This creates a distortion: if the contractor is currently selling at a subsidized price e.g., via financing deals that becomes the *real* market price, or subsidies by the government. When those apartments are eventually released to the market after the freeze/construction period, they will likely drag down the value of the second-hand apartments next to them).

In a new apartment from a contractor, we don't always know what we will receive, and what negative surprises await around the corner. By pegging resale prices to new construction prices, the market ignored the inherent risks of construction and the value of certainty.

Here Begins "The Warranty Game"

In the case of buying a new apartment from the developer, chasing after professionals who have already received their money, and as far as they are concerned have already finished the job, is tough. In Israel, there is a sweeping cultural tendency to wage a "war of attrition" against the client, in the hope that they will simply give up.

Usually, in cases where the numbers justify the trouble for the client, the matter rolls into court. Time and mental toll are costs that people rarely stop to calculate for themselves. A buyer sees the word "Warranty" and assumes that if needed, the other party will honor the agreement *as the buyer understands it*. In reality, the collective experience of every Israeli is that it simply doesn't work that way. Even if there is a warranty, the entity on the other side often finds a way to still charge for something. Like we said before, people default back to optimism.

But when everyone has already decided to buy the apartment before they even looked at the warranty clause, the chance they will stop to think about its meaning is low.

People tend to sell themselves the idea that "these cases are rare," or "that's why you should buy from a big, well-known developer."

I have an excellent example of a building that was embroiled in lawsuits with one of the largest developers in the market for nearly a decade. There are contractors who are late

in delivery. Israel has an optimistic culture: "What are the chances this will happen to me?"

Contrast this with the perspective of a true investor: "If it happened to them, it can happen to me." Therefore, the investor will tell the developer: "Here is my risk. Lower the price of the apartment to match the risk I am taking".

Inflation Risk & The "Construction Input Index": How an Entire Public Assumes the Very Risk They Tried to Hedge Against

We previously discussed that a primary reason to invest capital is to preserve purchasing power, or alternatively, to hedge against inflation. In Israel, an absurd situation occurred (and still occurs) for many years. When a person purchased an apartment "on paper" (pre-construction), the developer rolled the inflation risks onto the buyer.

Unlike the Consumer Price Index (CPI), which measures the cost of an average basket of goods like tomatoes, fuel, and rent, the Construction Input Index measures how much it costs the developer to build the apartment. It is composed of:

- Iron and Concrete prices.
- Workers' wages (which rise dramatically when there are no Palestinian workers and foreign workers must be brought in).
- Logistics, fuel, and equipment.

Historically, this index tends to be more volatile than the CPI. In certain years, it spiked by 5%–6% annually (of course, lower rates shouldn't scare us).

The Absurdity: In the past, the developer would peg the entire unpaid sum to this index. This was absurd because the apartment price is comprised of the land (the price of which is fixed after the contract is signed) and the entrepreneurial profit. Why should you pay for the price hike of concrete on the value of the land, and cover the developer's inflation risk? (Note: A new law eventually determined that a developer is allowed to link only 40% of the apartment price to the index, but let's look at the logic that prevailed before, which was insane).

People buy a shield against inflation (real estate), but during the construction period, they become the developer's "inflation absorbers". The buyers financed the protection against risk for everyone except themselves.

The Investor's Premise: "There is inflation, cash in the bank is eroding. I'll buy an apartment because real estate prices rise with inflation."

The Reality During Construction: People are not holding an asset (because the asset generates no cash flow at all); they are holding debt. Therefore, the buyer loses immediate positive cash flow (Opportunity Cost) for the hope of "capital appreciation" to compensate for it. Meanwhile, the developer rolls that same inflationary risk onto the buyer through the price linkage.

The buyer sees rising apartment prices and thinks they "profited." What they don't understand is that a significant part of that price rise is being funded by them through their mortgage payments.

- This is less significant in a low-inflation, low-interest environment.
- It is crucially significant when inflation rises. The guaranteed yield they could receive in government bonds is much higher, while they are in negative cash flow due to mortgage payments.

Simultaneously, the total cost of the asset increases, leading to higher mortgage costs over the life of the loan because they need to borrow more. In an environment where prices always rose, people could ignore this because they felt good about themselves. They looked at the fact that the price of the apartment they bought two years ago went up, so they feel they "made money" and expect prices to continue rising at the same pace. However, in an environment where the Input Index rises and apartment prices fall, this becomes impossible to ignore.

If the buyer took a CPI-Linked Mortgage to finance the payment to the developer (which is linked to the Construction Input Index), they are taking on a double risk:

1. Vis-à-vis the Developer: The debt on the apartment grows because the Input Index rose.
2. Vis-à-vis the Bank: The debt on the money borrowed to pay the developer grows because the CPI rose.

The Bottom Line: The investor becomes the "Insurance Company" of the entire deal.

- They insure the Developer against rising raw material costs.
- They insure the Bank against currency erosion.
- And who insures the investor? No one. They are left only with the hope that "apartment prices always rise" at a rate faster than all these costs combined.

When buying an apartment "on paper" with index linkage, it is not classic real estate investing. It is a Futures Contract where the buyer commits to purchasing an asset at an unknown final price, while being exposed to the risk of production costs. They hope that, in the worst case, they will sell the asset at a higher price, or at the same price, without realizing the asset value might be lower. Instead of real estate being a "Safe Haven" from the economic storm, those who bought on paper during such a transition period find themselves in the leakiest boat in the sea: Debt larger than expected, and an asset worth less than what they paid for it.

Many buyers who purchased on paper never looked back to calculate whether the "value appreciation" was truly as they expected, after factoring in all the costs that should have been considered in retrospect.

Final Thoughts on a People Who Do Not Know How to Assess Risk: Between a "Rational World" and the Israeli Reality

In a rational investment world, an apartment\house purchased "on paper" should sell at a significant discount compared to an excellent second-hand apartment or a ready-to-occupy new apartment in the same area. Why? Because the buyer assumes a series of heavy risks:

- Execution Risk: That the developer will go bankrupt, flee, or simply be two years late in delivery.
- Financing Risk: Exposure to interest rate changes and inflation during the construction period.
- Uncertainty: Inability to see and touch the final product (construction defects, poor planning).

Therefore, the rational investor should have told the developer: "You want me to buy on paper? Give me a discount that reflects all these risks." In Israel, the tables have turned. People were dazzled by terms like "Pre-Sale" and "discounts" of 10%–20% (on paper), convinced they had made the deal of a lifetime. They failed to realize that this discount was often an accounting fiction:

1. In a real calculation, financing costs (mortgage interest + index linkage during construction) ate up most of the "discount," if not all of it.
2. In many cases, in the end, they paid a higher price for an apartment "on paper" than for a ready-made apartment across the street, simply because of convenient payment terms.

The Banker-Buyer Paradox The most painful point is that buyers not only failed to receive a risk premium, but they also became the providers of cheap credit to the developers. When a person buys an apartment in a Pre-Sale, they are essentially providing the developer with capital to build. Instead of the developer taking a loan from the bank at a high business interest rate (Prime + risk margin), they get money from the buyers. The buyers effectively paid the developer for the *privilege* of financing the construction for him.

True, there were people who bought during this cycle (real estate prices rose for a very long time) and profited handsomely. But it is important to distinguish between wisdom and luck. Those who profited did so mainly because the entire market rose (a rising tide lifts all boats), not because the deal was priced correctly in terms of risk. Just as easily, they could have stumbled upon a developer who went bankrupt or faced a 5-year delay, and the profit would have been wiped out as if it never existed.

In Israel, many attempt to debate me on this point in an effort to justify the local market distortion. The prevailing argument is: "Without pre-sales, the developer wouldn't be able to secure financing or build at all."

My response is sharp and clear: Look at the astronomical profits recorded by construction companies and banks over the last decade. These massive profits did not

appear out of thin air; they were amassed because the Israeli public did not know how to demand the appropriate compensation for the risk they assumed. Alternatively, perhaps it is simply the business culture in Israel that forces the customer to fight for the obvious. Either way, the bottom line remains: This entire party was made possible solely because the Israeli public volunteered to fund it out of their own pockets.

Chapter 7 – The Israeli Public’s Balance Sheet – A Reality Check

Don't worry, I didn't forget to discuss taxes

One of the main reasons to invest in real estate, beyond appreciation and rent, is the tax advantage. The state, and not just in Israel, overwhelmingly prioritizes real estate investors through tax laws. There are deep political reasons for this. In the U.S., for example, the construction lobby and trade unions hold immense political power that directly influences members of Congress and the Senate. Any attempt to change legislation to the detriment of the construction industry is quickly torpedoed (we saw this recently in discussions around Trump's tax reforms).

But there is also a social reason: The Western world has sanctified the idea of property ownership as a positive value for citizen stability. Therefore, the tax system is built to push people to invest in "blocks and concrete," sometimes over more productive avenues.

Before we dive into the specific benefits, it is important to understand a basic principle in financial statement analysis that directly impacts our pockets as private investors.

"I think that, every time you see the word EBITDA, you should substitute the words 'bullshit earnings'." – Charlie Munger

EBITDA = Earnings Before Interest, Taxes, Depreciation, and Amortization

CEOs on Wall Street, and commentators like Scott Galloway (who tends to praise companies based on metrics that don't always hold water), love using this figure because it makes a company look more profitable than it actually is.

Why is it called "Bullshit"? Because it ignores real expenses:

- Interest: Money costs money. Ignoring interest is like ignoring gravity.
- Taxes: The silent partner (the State) always takes its cut.
- Depreciation: The decline in value of tangible assets like machinery.

"Does management think the tooth fairy pays for capital expenditures?" – Warren Buffett

Why am I telling you this in a chapter on real estate? Because most amateur real estate investors calculate their return exactly like EBITDA. For example, they ignore Depreciation (repairs, renovations, wear and tear of the apartment). As wise investors, we must look at the true bottom line, both when investing in real estate (and our residential home is still an investment) and when investing in stocks. The bottom line is what should interest us.

Man as a Business Every person is a business unto themselves, managing two main resources: Their Time (Human Capital) and their Financial Capital. We manage them in our lives, and our role is to manage the revenue section (from a profession) and the capital management section. Just as what interests us as investors is the bottom line of a business, what its profits truly are, so we must treat our own affairs.

There are massive advantages in real estate, and it is important to know them to utilize them. I am not here to give a full lecture on them, but from my familiarity with Israel, there are insane tax benefits for real estate that do not exist in other Asset Classes. *(Please consult a tax expert; what is presented here is not a recommendation or advice).*

1. Exemption on Rental Income: (Up to a ceiling of approx. 5,600 NIS as of 2024). This is one of the last shelters for tax-free income in Israel.
2. The 10% Track: The option to pay a reduced tax of only 10% on rental income above the ceiling (without recognizing expenses)—a rate dramatically lower than the marginal income tax on labor.
3. Betterment Tax Exemption: On the sale of a single apartment (subject to conditions, such as only house\apartment owned), the capital gain is tax-exempt. In the capital market, for comparison, you pay 25%.
4. Expense Offsetting: In certain tracks, one can recognize renovation, depreciation, and maintenance expenses to reduce tax liability.
5. Keren Hishtalmut: (And other options the state provides). One must look at all of them closely.

Just as good businesses can manage excellent Financial Engineering to bring about excellent results, so can a private individual.

A Crucial Warning: It is very important to consult with licensed CPAs and tax experts. Many people rely on things they hear and end up with debts to the Tax Authority. The government can also change the rules. What is true today can change tomorrow. The political "protection" is strong, but not hermetic. Tax planning is an art that requires professionals (accountants and tax consultants) with licenses.

What Sets the Israeli Real Estate Market Apart?

On the massive differences compared to the US market, and why most people comparing Israel to the US of 2008 are making the wrong comparison—and likely don't know how to think correctly about economies.

A Few Words on Short Selling, the "Big Short" Obsession, and the Difference Between Movies and Reality

One of the most common mistakes in the Israeli economic discourse is the automatic comparison between the local real estate market and the Great Financial Crisis of 2008. Most people making this comparison often lack the correct cognitive tools for macro-economic analysis, or they halt their thought process exactly where it might become painful or inconvenient for them.

But beyond the dry analysis, there is a deeper psychological-cultural issue here: Everyone wants to be Michael Burry. (I've even seen Israeli journalists refer to him by the nickname "The Big Short", a nickname no one outside of Israel uses for him, which I find a bit pathetic. It means they do not understand what a Short is).

The Big Short¹³, the book, and even more so the movie, became very, very mainstream. They simplified, exceptionally well, a specific macro trade executed by a few investment managers. The most important element in that story is gaining insight into the framework of how a decision to take a specific trade is crystallized, and what it feels like to be inside that decision-making process, especially when you see the world going mad around you in a euphoric way, and you are the only one holding your head, saying, "This doesn't make sense".

However, the movie created a certain distortion of reality. Because it is a cinematic work compressed into two hours, viewers forget that this process took long, agonizing years in reality. Irrational market conditions can persist far longer than common sense can grasp.

Additionally, there is an old Wall Street adage that Howard Marks shares in his book *The Most Important Thing* (and he is far from the first to say it):

"Being too far ahead of your time is indistinguishable from being wrong."

Peter Lynch also notes that it took some of his investments 5 to 7 years to prove successful. Things can take time. But sometimes, taking "too much time" is equivalent to being wrong. It all depends on whether the return at the end was large relative to the market. Those who short the market do not have this privilege.

"The market can remain irrational longer than you can remain solvent." – John Maynard Keynes

¹³ Screenplay By Charles Randolph and Adam McKay Based Upon the Book by Michael Lewis

"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in the corrections themselves" – Peter Lynch

First, I wish good luck to anyone who wants to short the market. For those who don't know, it is a type of bet against a specific asset. In this bet, the problem is that the upside (how much you can earn) is finite (the maximum profit per share is the share price, limited by the trader's ability to leverage the position), while the downside (potential loss) is infinite.

"But being short something where your loss is unlimited is quite different than being long something that you've already paid for." – Warren Buffett

This is the main reason I avoid shorting. I prefer to be an owner of businesses, not to bet on their failure. I also try to avoid idle arguments about "Will the market crash?" If I don't put money on my opinion ("Skin in the game"), my opinion is meaningless. I operate in a simple binary world: I understand, or I don't understand. When I examine a company, I first ask: Do I understand the business? If the answer is no, I move on. If I do understand, I check the physical reality of the company, then the numbers, and only finally the price. I look for one rare thing: A deep contradiction between Value and Price, which grants me a Margin of Safety.

The difference between me and the "Short Seller":

- He seeks places where the price is illogically high (to bet against).
- I seek places where the price is exceptionally low (to buy).

In my view, when the market is expensive and there are no opportunities ("downward anomalies"), it is a sign to sit on the fence, not a sign to bet on a crash. Volatility and macro trend shifts are background noise. I look for individual companies. The ideal situation is a crisis that creates opportunities, where I can purchase the best companies at ridiculous prices.

Since 2008, an entire generation of investors and commentators has emerged (like Nouriel Roubini, known as "Dr. Doom," or Jeremy Grantham, etc.) who try to predict the next crisis. They are looking for the apocalypse. For me? It is much more fun and profitable to be on the optimistic side, to invest in businesses I love and understand, and to grow along with them, rather than hoping the world burns.

Part of my portfolio management includes continuing to purchase shares of companies I own at reasonable prices, based on the understanding that an excellent business will surprise to the upside more often than to the downside.

Jim Chanos and MicroStrategy - An Example of a Short

To understand the complexity of the world of short selling, let's analyze a live example unfolding before our eyes, bringing together two giants with opposing worldviews.

Classically, "Short Sellers" (especially the famous ones like Jim Chanos, the man who exposed the Enron fraud) look for one of two things: accounting fraud, or a complete disconnect between the stock price and the actual assets it holds. Peter Lynch once explained (and I am paraphrasing here) that smart investors usually don't short a stock when it is at its peak (\$100), but rather join the celebration ("Pile on") when it has already crashed to \$8 on its way to \$0. Why? Because at \$8, it is clear the company is dying. Whereas at \$100, it can fly to \$200 and wipe you out due to lack of liquidity. Michael Saylor executed one of the boldest moves in the history of the modern capital market. His method works like this: The company issues Convertible Notes at zero interest. The lenders give him money, and in return, receive an option: either get the money back in the future or convert the debt into company shares. Saylor takes this money and buys Bitcoin. When the price of Bitcoin rises, MSTR stock rises; he issues more bonds, more money comes in; [if] the price of Bitcoin drops, they buy more Bitcoin. The use of the stock goes beyond simple leveraged Bitcoin acquisition; it is a trade relying on Bitcoin's volatility.

Jim Chanos enters the picture from the other side. His claim is not necessarily that Bitcoin will go to zero. His claim is mathematical: MicroStrategy stock trades at an illogical Premium relative to the value of the Bitcoin it holds. Furthermore, the volatility combined with the cash in the company's coffers will not suffice to compensate for this in the future. In other words, if the company holds \$100 worth of Bitcoin per share, the stock is trading at \$200. Chanos asks: Why would an investor pay \$2 for every \$1 of Bitcoin, when they can buy a Bitcoin ETF directly today without this premium? Investors currently believe that a dollar in Saylor's hands is worth two in anyone else's. Chanos's short is a bet on Convergence. He is betting that the premium will disappear, and the stock price will return to reflect the true value of the assets. On one side, you have a man betting on the future value of Bitcoin, its volatility along the way, and crowd psychology. On the other side, a value investor looking at the paper and seeing numbers that don't add up.

A Short is Not Just a Bet Against a Company Sometimes a short seller finds themselves playing against other powerful investors. The most famous example is the "Herbalife War." Bill Ackman, a hedge fund manager, shorted \$1 billion on Herbalife, claiming it was a pyramid scheme exploiting immigrants and vulnerable populations, and that the stock would go to zero. Facing him was Carl Icahn, a famous activist investor (who famously hated Ackman). Icahn decided to buy the stock *after* Ackman executed the short, solely to "squeeze" Ackman out (a Short Squeeze). The result? Icahn won, the stock rose, and Ackman was forced to close the position at a massive loss.

In my view, shorts are tools for professionals who know how to manage risk at a surgical level. The fact that trading platforms (like Robinhood or various apps in Israel) make options and shorts accessible to the general public within an interface that looks like a video game is problematic and even dangerous.

The case of Alex Kearns, a young American (20 years old) who traded options during COVID, is an example that will become a classic cautionary tale. He opened the app and, to his horror, saw a negative balance of \$730,000. In reality, this was a temporary technical recording of a complex option trade (a Spread), and he did not actually owe that amount. But the pressure, the shame, and the lack of understanding of the financial instrument led him to commit suicide.

A short is not just a "bet that drops are coming." It is a financial instrument where:

1. The Profit is limited (maximum 100%).
2. The Potential Theoretical Loss is infinite.
3. You pay interest on borrowing the stock as long as the position is open.

Although the movie *The Big Short* is a masterpiece that I love very much, people focus too much on the "Short" itself, the sexy, betting act, and miss the gray, Sisyphean, and dangerous work behind it. Don't try to be Michael Burry at home.

Another way to short a specific event while limiting loss is simply to buy insurance for that event (like Put options). This way, the loss is limited to the premium paid (the cost of the insurance) over the insurance period. This is what Bill Ackman did at the beginning of the COVID pandemic.

The Most Important Scene in the Big Short

In my opinion, the most crucial scene in *The Big Short* isn't the one where the banks collapse, but rather a short scene right at the beginning. It is the scene that encapsulates the phenomenon that led to the crisis. This is the point where Michael Burry (who has proven himself as a macro investor several times, a very rare feat; he doesn't have to be right all the time) first identifies that something fundamental has lost its logic.

MICHAEL BURRY

Did you find it odd that when the tech bubble burst in 2001 the housing market in San Jose, the tech center of the world, went up?

YOUNG ANALYST

Huh. I guess. I mean, no. It's housing. It's always AAA rated, low risk.

MICHAEL BURRY

Yes.... That's the idea..."

Why is this moment so important? Because Michael Burry identifies an anomaly here (a deviation from the norm). Simple economic logic dictates: If the High-Tech industry crashes (the Dot-Com bubble in 2001), then housing prices in the very heart of that industry (San Jose, Silicon Valley) should crash along with it, because people have no money or jobs to pay their mortgages. The fact that they went up was the first warning sign that the market was disconnected from economic Fundamentals and was being driven by something else entirely: a credit bubble and erroneous assumptions about "absolute safety" in the housing market. To understand the connection to Israel, one must understand a basic economic concept: Geographic Comparative Advantage. Every local economy relies on a central area of specialization (its "Locomotive"):

- New York, London, Hong Kong: Global Financial Centers.
- Australia: Mining and Natural Resources.
- Silicon Valley & Israel: Technology, Engineering, and Innovation.

When we analyze the 2008 crisis in the US, many miss the central point. It wasn't just a crisis of "bad mortgages," but the result of a deep structural change in the American economy. As stated in the movie:

"And America barely noticed as its number one industry became boring old banking."

We discussed that real estate is primarily a game of the local economy. For the State of Israel, much like Silicon Valley, the area of specialization is Engineering, whereas New York and London are financial hubs.

The Australian Example Australia is a distinct example where two industries essentially hold up an entire country: Construction and Mining. This is evident because Australian workers tend to flock to these sectors. You will see that engineering and medical positions are often filled by immigrants, as the locals prefer the industries mentioned above. The construction and real estate sectors, perhaps more than any others, are built on debt. Any country where real estate constitutes such a significant component enjoys/suffers from very, very strong banks. Hong Kong and Singapore were significant as financial hubs for the East. London was the banking gateway to Europe and the rest of the British Commonwealth tax havens.

Why does Australia rely so heavily on real estate? When Americans returned from WWII, they rebuilt the "American Dream" in the form of a large house in the suburbs, systematically instilling the idea that everyone must own their own home. There is only one other country with enough land to allow for that same dream, and which culturally relies on the same values: Australia. Sounds simple? Yes. Drive around the Australian suburbs, and it looks like the US. I've said it many times: The driver is cultural, just as the rush for real estate in Israel is cultural.

In the previous century, Americans relied on factories, infrastructure construction, and energy. As we reached the end of the 20th century, these fields were replaced by one main industry (Real Estate and Banking, which usually come together), which was

fueled heavily by the industry that would one day take the reins of the US completely (Technology).

Because interest rates were very high in the US throughout the 80s, Americans didn't want to invest in real estate; they invested more and more in the Stock Market. The wealth generated by technological developments, the decline in security tensions (collapse of the USSR), increased globalization, etc. (all deflationary engines), allowed the Americans to lower interest rates and inject more money into their economy, representing growth and demand (both for consumption and investment).

In the late 80s, through the 90s, and until perhaps the mid-2000s, there was a wave of M&A in US banks (you are invited to read about Jamie Dimon's career and his mentor Sandy Weill, who eventually stabbed Jamie in the back). The transformation of the US into the global financial hub, the ability of American banks to provide loans, diversify risks, and the trading/investing mania of the 90s (with all the fees they earned from every IPO and trade during the Dot-Com bubble) allowed them to occupy an ever-growing space in the American economy, until they became perhaps the largest American industry by the early 2000s. This phenomenon that happened for over a decade, allowed the U.S to expand further into housing.

"Irrational Exuberance"

In the early 90s, US interest rates were low, and the stock market was rising until 1996, when Alan Greenspan coined the term "Irrational Exuberance" regarding the markets, and this was when we were only at the start of the Dot-Com bubble. Although there were slight rate hikes, the growth factors of globalization and the internet were massive enough to genuinely generate growth. Then came two crises: The Asian Financial Crisis in 1998 (there is a great movie called *Default*) and the LTCM crisis (a must-read book called *When Genius Failed*). These created a chain of rate cuts that were quickly replaced by rate hikes leading into the Dot-Com burst. There, aggressive rate cuts took place.

The way this connects to Israel for me is simply a combination of several factors:

1. A tough job market in High-Tech for "juniors" (new entrants into the workforce such as fresh college graduates) during a boom, imagine what will happen if there is a bust.
2. Damage to future growth due to the war.
3. Erosion of the purchasing power of Israelis.

And yet, in early 2024, housing prices hit an all-time high.

Moreover, when we saw a slowdown in the housing market (which was still at a peak, amidst all those "sales campaigns"), and when it looked for a moment like the state might stop pumping money into the system via reservist salaries (a move that would lower the artificial inflation rate) and potentially create a deflationary situation (manifesting primarily in product and asset deflation), the stock prices of banks and insurance companies (which are tightly linked to each other, to the real estate sector,

and the Israeli stock exchange) surged to new highs “forecasting” return to growth in the housing sector.

At the very moment when I personally thought one needed to be cautious for the next year or two, the Israeli financial system broadcasted optimism and, following this optimism, priced assets in the Israeli stock market at new peaks.

Meanwhile, Behind the Scenes

The immense wealth and prosperity that Americans accumulated in the late 20th century was looking for a home. Capital always seeks yield, and when one door closes, it bursts through another. To understand this dynamic, one must understand the cultural-financial history of the U.S., particularly the generational and geographic gap.

In my grandparents' generation (those born in the 30s–50s), there was a massive difference in investment character between the East Coast and the West Coast:

- The East Coast (New York, Boston): Due to the physical and cultural proximity to Wall Street. There, money traditionally went to the stock market.
- The West Coast (California): Due to the distance from the financial center, but mainly because of the dizzying population growth and vast open spaces, the culture was tilted toward Real Estate.

This distinction held true until the 90s. The crazy gains of the Dot-Com bubble blurred the lines and caused everyone, from New York to Los Angeles, to buy technology stocks. Everyone wanted to be part of the future.

The Trauma of 2000–2002: When "The Future" Crashes

Then came the sobering reality. The collapse of the Dot-Com bubble sent the NASDAQ, from March 2000 to October 2002, into a 78% decline over 3 years. People tend to forget the most difficult dimension of this crisis: Time. It wasn't a sharp, quick drop (like COVID in 2020), but a slow bleed that lasted over two years. Imagine the feeling: The market drops 10%, you invest more money ("Buy the Dip"), and then it drops another 20%, and then another 10%. For two and a half years, every time you thought you hit the bottom, you discovered there was another floor further down.

This trauma created a deep scar. The American public, having lost faith in the stock market, sought a "Safe Haven." They wanted an asset they could see, touch, and that "always goes up." They rotated to Real Estate. This was the fertile ground upon which the Subprime bubble grew.

The Psychology of the "Falling Knife" (Personal Experience: Meta)

Here we arrive at the character test of the individual investor. The moment an investor is truly measured is not when the portfolio is rising, but when a business you are invested in and believe in is brutally slashed, and you are required to act against your survival instincts.

I'll take a personal example (this is not a recommendation, but my personal psychological analysis of a past event). In 2021, I was invested in Meta (Facebook). I watched it get cut from \$320 to \$200. After a purchase, it continued to get cut down to the \$100 range. Continuing to buy into these drops, an act known on Wall Street as "Catching a falling knife", is something most investors simply cannot handle mentally. I was able to build the majority of my position at \$100 per share, and I slept perfectly well at night. Why? Because I had deep Conviction in the business and saw a clear gap between Price and Value.

There is another approach, popularized by Peter Lynch, who argues (to paraphrase): "Don't buy the dip, buy the out of the dip." Meaning, don't try to guess the bottom; let the dust settle, wait for the trend to change, and only then enter. This is a legitimate and safer approach. After all, the great danger in "catching knives" is that you might get caught in a Value Trap, a stock that looks "cheap" for a good reason, and will remain "cheap" (in our opinion) forever (or go bankrupt).

Jesse Livermore (who was a legendary trend trader) would, if he could, preach to wait until the market confirms your thoughts with gains, and only then buy. I personally operate differently: I simply ask myself, "Do I love this price relative to the company's value?" If the answer is yes, I buy, even if everyone else is fleeing. But everyone must do what is right for their own personality structure.

Here there is a massive question surrounding myself, do I have skill? Or was it sheer dumb luck? Did I know enough about the company, was my analysis sound? And if so, will I, or you, be able to replicate in a similar situation, or will it just lead to further losses? We will never truly know.

Israeli Bank Stocks: The 80s Show and Its American Parallel

My Israeli friends always like to mention that their parents' generation lost faith in the stock market due to the trauma of the "Bank Stock Manipulation" crisis in the 1980s. Throughout the 1970s and early 80s, Israel suffered from hyperinflation (reaching 400% at its peak). Israelis needed a way to protect their money. The major Israeli banks (Hapoalim, Leumi, Discount, Mizrahi) wanted to raise capital easily. To do this, they created a mechanism of artificial price support, the banks implicitly promised that their stock price would *only* go up, beating inflation. The banks used their own capital (and the capital of the mutual funds and pension funds they managed) to buy their own stock every morning. If there were more sellers than buyers, the bank stepped in and bought the excess supply. Beyond the manipulation of the price itself, the banks used aggressive and often illegal coercion to fuel the demand for their shares. If a business owner or an individual came to the bank to ask for a loan, whether to expand a factory, buy a car, or cover an overdraft, the bank managers would make the loan conditional. The banker would effectively say: *"We will approve a loan of 100,000 Shekels, but only*

if you use 20,000 Shekels of that money to purchase the bank's stock". This practice turned the general public and the business sector into forced accomplices in the bank's manipulation scheme, deepening the crisis when the house of cards finally collapsed. In 1983, the public began to fear a massive devaluation of the Israeli Shekel. People rushed to sell their bank stocks to buy US Dollars. This led to a bank run (also known as Panic) and to a collapse in the Israeli Stock market and to further Shekel devaluation. As a result, major reforms were made. The government agreed to buy the bank shares from the public. Essentially, the State of Israel nationalized the major banks to save the public's money (the government de-nationalized the banks a decade later). Investors didn't lose everything, but they lost significant value (around 17-35% immediately), and their money was locked up for years in government bonds. The Shekel was cancelled and the government created the New Israeli Shekel (NIS). Major reforms were initiated with the Bank Of Israel (Israel's Central Bank). For further reading I recommend a book called "The Bank Of Israel" – by Daniel Maman and Zeev Roznek as a gateway into this historical event.

During that same period of inflation, people saw their rent prices skyrocket (and real estate prices rose as well). Thus, the public perception was cemented that "Real estate is safe, and stocks are dangerous".

Because of that blow, an entire generation turned exclusively to investing in real estate ("Blocks and concrete don't evaporate"). This is logical and natural. But what isn't always understood is that the exact same process, albeit for different but similar reasons, happened to Americans, just 20 years later.

When the Dot-Com bubble burst in the US (2000–2002) and stock markets crashed, trillions of dollars of "paper wealth" were wiped out. But the remaining capital didn't disappear; it simply migrated. Money moved from one Asset Class (Stocks) to another (Real Estate). The interest rates, which were lowered to save the economy, only accelerated this transition. Americans, having been burned by the NASDAQ, bought walls and concrete.

Here we return to Michael Burry's insight. There is logic to Silicon Valley real estate rising during the 90s, amidst crazy exits and massive salaries. But two or three years *after* the bubble burst? That no longer makes sense. When engineers are fired and companies are closing, it is unlikely that people are "upgrading" their housing. If anything, the opposite should happen—they should be selling homes or, in the worst case, moving into their parents' basement. The fact that prices continued to rise while incomes were slashed was the Great Anomaly.

Real Estate is First and Foremost a Cash Flow Game

To understand the risk, one must understand how real estate works. Because of the high leverage (mortgage), real estate is a Cash Flow game. The bank grants us a mortgage not only based on the equity we bring (whose main role is to act as a "safety

cushion" for the bank) but primarily based on our ability to service the debt month after month.

An asset under construction, or a property standing empty and unrented, is a Liability. While it generates no economic benefit (incoming rent or saving on living rent), it generates a heavy economic cost (interest and mortgage payments). For this to be worthwhile, the expectation is that the future benefit will cover the current hole. However, when investors are in a situation where their cash flow is in danger (recession, tech layoffs, war), the ability to hold onto this asset collapses. This is why real estate investment is considered "safer" for tenured government employees, because their cash flow is essentially guaranteed, and the risk of income cuts is nearly zero.

The American Trap: The House of Cards Built on Variable Rates

The movie *The Big Short* reveals that the boom in American real estate was built on the shaky foundations of "Teaser Rates." People took mortgages with very low monthly payments for the first two years, fully knowing that the interest rate would skyrocket afterward. What were they banking on? On the assumption that real estate prices always go up. The plan was simple:

1. Take a cheap mortgage.
2. In two years, when the rate is about to jump, the house value will have risen.
3. Refinance based on the new, higher value, and spread the debt again under favorable terms.

This worked perfectly as long as prices rose and interest rates fell. But the moment housing prices stalled (or dropped slightly), refinancing became impossible. Borrowers were stuck with monthly payments that tripled, and they couldn't sell the house because it was worth less than the debt. Like a snowball, the problem rolled from homeowners to realtors, mortgage brokers, and banks, whose entire livelihood depended on this wheel keeping on turning.

And in Israel Currently? Similar but Different

In Israel, the situation is complex. On one hand, a significant part of the Israeli mortgage mix (like the Prime track) is variable, and mortgage payments indeed spiked dramatically with recent interest rate hikes. On the other hand, there is a fundamental difference in the borrower profile: In the US of 2008, loans were given to NINJAs (No Income, No Job, No Assets). In Israel, the public taking mortgages consists mostly of working people with stronger purchasing power, subject to regulation that limits financing percentages. However, even a strong borrower can collapse if stretched beyond their cash flow capacity for too long.

The Banking Dilemma: The Pendulum Between Fear and Greed

As Howard Marks often describes, the financial world always swings like a pendulum between two emotional poles, Fear and Greed. This oscillation is particularly dangerous when it occurs within the banking system, the beating heart that pumps oxygen (money) into the entire economy.

The Greed Phase

When "Assets" Are Detached from Reality On the greedy side of the pendulum, banks tend to manage their balance sheets based on an overvaluation of their assets. It is important to remember: The bank's primary asset is the debt of the public and businesses (mortgages and loans), many of which are backed by collateral (homes). When bankers are captive to the misconception that "Real Estate Only Goes Up," they misprice risk (meaning, they underestimate it). Here, the "Principal-Agent Problem" enters the picture. Everyone is getting rich, so bankers want to get rich too. Managers want the fat bonus *this year* (based on short-term performance), and to hell with next year's shareholders. This is over-optimism combined with short-term incentives, leading to over-leverage.

The Contagion Effect

A term Mohamed El-Erian discussed extensively when the SVB (Silicon Valley Bank) story broke. The great danger is that banks are the plumbing of the economy. A clog in this piping doesn't stay within the bank; it leads to a blockage in the entire system. When banks run into trouble, they stop providing liquidity. Ordinary businesses (needing operating credit for suppliers and salaries), pension funds, and insurance companies, all get hit. In such a situation, "black holes" form in balance sheets, usually requiring (eventually) a government Bailout and the injection of taxpayer money to prevent a systemic collapse. Meanwhile, a "credit crunch" emerges, and there is a genuine loss of liquidity from the system.

The Fear Phase: Credit Crunch

When the pendulum swings back, it flies with force to the other side. Banking fear is the Mirror Image of greed. In a state of panic, banks "close the taps." They are afraid, or are unable, to grant loans even to *good* borrowers. The result is a Credit Crunch; the economy suffocates from a lack of liquidity. Healthy economic activity stops not because the businesses are bad, but because they lack cash-flow "oxygen." This is a cycle that exacerbates the crisis.

The Principle of Reflexivity in Action

We encounter George Soros's principle once again: Expectations change reality, which in turn changes expectations.

- In the Greed Phase: The expectation that "everything will be fine" and rates will remain low causes banks to issue *more* credit -> which inflates asset prices -> which justifies issuing *even more* credit.

- In the Fear Phase: The fear that interest rates won't fall fast enough, or that the public won't have the money to pay even at low rates (and that their collateral value will drop), causes banks to halt credit -> which crashes asset prices -> and justifies the fear.

This is precisely the historical lesson Ben Bernanke (who was Fed Chair in 2008) learned from investigating The Great Depression of the 1930s. His conclusion was that the critical mistake in 1929 wasn't the crisis itself, but the Central Bank's reaction. They did not provide enough liquidity when fear took over. They allowed banks to collapse and the money supply to contract. In 2008, Bernanke applied this lesson in reverse: The moment fear arrived, he lowered interest rates aggressively and injected trillions into the system (QE), understanding that the Central Bank's role is to act as the "Lender of Last Resort" and to break the cycle of fear before it destroys the real economy.

Why Liquidity is Oxygen, and Why Money is a Genius Invention

Since the dawn of history, even before the invention of currency, some form of credit market existed in humanity. In fact, debt preceded money. Unfortunately, this is also an ancient source of slavery; people who couldn't pay their debts became slaves. Later (like in 19th-century England), there were debtors' prisons. For those who want to dive deeper into this fascinating history, *Debt: The First 5000 Years* by David Graeber is a good starting point, followed by Niall Ferguson (*The Ascent of Money*) or *The Price of Time* by Edward Chancellor, which I mentioned earlier.

History teaches us a consistent lesson: There is a direct link between the state of credit and the health of the economy. A credit market that is too tight chokes growth, and one that is too loose leads to bubbles (this is also true for the 1920s) and inflation.

The Magic of Mild Inflation (2-3%)

"Money" is a very easy mechanism for central banks to add "liquidity" to the system. In a barter economy, the process of generating additional liquidity is extremely lengthy (whether it involves breeding sheep or mining gold). Money is a mechanism that can be used to implement quicker change. When there is liquidity in the market, the wheels of the economy turn faster. Most central banks in the world, including the Fed and the Bank of Israel, have set an inflation target of about 2%. Where did this number come from? From an almost random decision by the Central Bank of New Zealand a few decades ago. The Finance Minister there threw out a number, the Governor adopted it, and it worked so well that the entire Western world flocked after them. Such a level of inflation creates a positive illusion, which creates a positive reality. The money supply rises gradually, nominal wages rise, people feel richer (Money Illusion), and therefore consume more. It also provides a safety buffer against deflation; it gives the Central Bank a "cushion" against a huge danger: falling asset prices.

Milton Friedman

"Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output."

– Milton Friedman

Milton Friedman explained that inflation isn't created just because "oil prices" rose or because the grocer is greedy, but because the quantity of money in circulation grew faster than the quantity of goods. When there is excess money in the system, everyone feels they have more, and they are willing to pay more. Businesses recognize this power and raise prices, some out of necessity (because raw materials got expensive) and some out of opportunity (because the customer is willing to pay).

When inflation crosses the 3-4% threshold, the magic fades and becomes a burden.

The price hikes are felt at the supermarket and the gas station, hitting the weaker layers first who do not own assets (like real estate or stocks) to hedge against inflation.

This is why I am skeptical that simply raising prices due to taxes (like tariffs in Trump's case) will create inflation. Higher prices in certain places will simply depress demand in other areas, and thus they will balance each other out. My fear is this: If the volume of cash rises *simultaneously* with tax hikes like VAT, then rising prices combined with "non-declining" demand might hint to business owners that they have the ability to raise prices further. In such a case, if the supply of money or available credit rises (via rate cuts or QE), the inflation genie might pop out of the bottle again before the central bank notices and readjusts in time, or they may think it is "Transitory".

Deflation

Deflation (falling prices) sounds great to the consumer ("Prices are dropping!"), but it is devastating to the economy. When people expect prices to drop tomorrow, they defer today's purchase. Why buy a fridge for 5,000 NIS if next month it will cost 4,500? This expectation halts business activity, businesses fire employees, people have less money, and prices drop even further. It is an economic death spiral.

The Central Bank's role is like being in charge of a coal BBQ with a fan to control the flames. Its goal is to keep the coals at the perfect temperature, not letting the fire die out, but not letting it burn the food.

From Real Estate Ruins to Tech Growth

The 2008 crisis crushed American real estate, and with it the absolute dominance of the traditional banking system ("The Old Economy"). But out of these ruins, a new opportunity grew. The Fed injected trillions of dollars (QE) to save the system. This huge liquidity, combined with zero interest rates, desperately sought growth. Where was growth to be found when the rest of the world stalled? In Technology.

This allowed Silicon Valley and the MAG 7, FAANG, or any other nickname (a friend accidentally dropped the term BIG 5 a week ago, but let's go with whatever nickname exists because we can invent endlessly, like Dan Nathan tried to coin the phrase, that

never caught on, The Fateful Eight) to break forward and take center stage, which I think they truly deserve. A massive amount of the liquidity the Fed provided to rehabilitate the banks flowed to these tech companies. They enjoyed access to cheap money that allowed them to invest in R&D, acquire competitors, and build global empires. In fact, one could say that the liquidity injected to save Wall Street banks became the jet fuel that launched Silicon Valley to the top of the global market cap table. Additionally, talent that previously turned to the banking sector now turned to tech companies and startups.

The "One Egg" Paradox: The Critical Difference Between Israel and the U.S.

There is a great similarity between Israel and the Western world regarding interest rates and globalization, but there is one profound difference: The Source of Wealth. Current Israeli wealth relies almost entirely on one "faucet", High-Tech profits. This faucet streams money not only into the pockets of engineers but trickles down and sustains the entire economy: real estate, restaurants, service providers, and private consumption. If this flow weakens, we could see a domino effect that collapses an entire tower, one whose foundations are more fragile than many realize.

Americans, for example, have multiple industries. Perhaps not all are as large as banking or technology, but they have additional sectors like Energy (where they are a massive superpower) or giant Pharmaceutical companies.

A Question of Probability, Not a Doomsday Prophecy

It is important for me to be precise: I am not claiming that the Israeli housing market is about to collapse tomorrow morning. I am not a prophet. Investing is a matter of probabilities. There is where the ratio between the risk and the chance for profit (as well as the size of the potential profit), a spectrum between turns a deal into either a golden opportunity or financial suicide. Excessive optimism ("It will be okay," "Real estate always goes up") is exactly the poison that increases this risk.

"One of our most painful problems has a name, a first name and a last name—it is the combination of the two words 'Yihiye Beseder' (It will be okay). This phrase, which many of us hear in the daily life of the State of Israel, is intolerable. Behind these two words usually lies everything that is not 'okay': arrogance and a sense of excessive self-confidence, power and authority that have no place. The 'Yihiye Beseder'(It will be okay) has accompanied us for a long time, for years, and it is a symptom of an atmosphere bordering on irresponsibility in many areas of our lives. The 'Yihiye Beseder,' (It will be okay) that buddy-like slap on the back, that wink of the eye, that 'trust me,' is a symbol of a lack of order and discipline, of professionalism that is absent, and of idleness that is present. The atmosphere of 'Hafif' (slapdash/cutting corners) is, to my great sorrow, the

heritage of many publics in Israel, not necessarily just in the IDF. It eats away at us with a full mouth. And we have already learned in the hard and painful way that 'Yihiye Beseder'(It will be okay) means that a great deal is not 'beseder'. (not OK)"
- Yitzhak Rabin, Graduation Ceremony of the Command and Staff College, August 2, 1992

Sam Zell argued that real estate always takes the hits with a delay relative to the economy. My addition to this is that the public's "Wealth Effect", and their ability to maneuver their cash flow—, is critical. When there is a feeling of wealth, it fuels Asset Inflation (prices rise). But when there is Asset Deflation (prices fall), it immediately hurts everyone's balance sheets. Suddenly, you can't refinance a mortgage, you can't raise debt, and liquidity in the economy vanishes. This exacerbates the recession. The effect of the "feeling of wealth" is also seen with a delay (my addition). When a person looks at their personal net worth, they should, at any given moment, price it at 15%-20% less. When they think the market is excessively expensive or in a bubble, they should increase that number.

The Four Key Questions for Israel's Future

To understand where Israel is going, we must ask ourselves four hard and honest questions. These are not philosophical questions, but Risk Management questions:

1. The Investor Test: Do I trust that the average Israeli real estate investor acted rationally and priced the risks correctly? (Or did they buy "blindly" because everyone else was buying?)
2. The Professional System Test: Do I trust the banks and contractors to have managed their risks wisely, without being blinded by short-term incentives?
3. The Government Test: Do I trust the politicians and bureaucrats to create a quality of life here (security, infrastructure, education, health) that will convince the strong population to stay? Are they investing in the growth engines of tomorrow (research, education) so that we can survive even if High-Tech weakens?
4. The People Test: Does Israeli society meet standards of excellence? Are Israelis capable of doing what is required to survive in the global economic jungle?

We will start specifically with the fourth and most painful question. The Israeli economy is totally based on a bottleneck of one industry that generates excess wealth for the entire population. This industry depends on one main country (the US), and specifically on its largest companies which hold up the Israeli industry. Meaning, Israel's industry is not only dependent on a foreign country but on the largest companies within that field. Those same companies are currently focused mainly on their ability to replace their workforce (which includes our High-Tech workers) with Automation. That is, there is a real risk to the jobs of our engineers and programmers; some of them will not make the

cut. The main problem is that this might happen during a very sensitive period, a time when cash flow is most needed, and it might be compromised.

In conclusion, the massive difference between the US and Israel of 2008: The cornerstone of the American crisis was the American real estate sector. A sector whose workers could not get on a plane and move to another country, and a sector that was not dependent on another country.

The Crucial Difference from the U.S.

The foundation of the Israeli real estate market (which is not currently in crisis, and potentially might not face one if managed with sufficient excellence) lies in a completely different industry. Its workers (tech professionals) can simply get up and leave for another country, since their livelihood is already based on a foreign nation. Therefore, the Israeli economy is vulnerable, because all its eggs are in one basket that is controlled by others.

Analysis of Israel's Unique Risk Profile

This is the most important distinction in this entire discussion. In the U.S. in 2008, the problem was that the collapsing sector (real estate) was also the sector supporting itself. It was like a snake eating its own tail. They had other alternatives to lean on. In Israel, the situation is far more dangerous:

1. Total Dependence on High-Tech Approximately 25% of Israel's GDP comes from High-Tech. It is not just a sector—it is the basis for all wealth in the country. Engineers and programmers are the ones buying the expensive apartments; they are the tenants everyone wants to rent to; they are the ones holding up the entire market. They also purchase investment properties in the periphery. They spend money on luxuries (restaurants, bars, cafes, electronics stores, etc.), and through this, wealth trickles down to the rest of the economy, which then also invests in real estate or uses income derived from tech workers to pay rent or mortgages.
2. High Mobility An American construction contractor cannot simply go work in Mexico. However, an Israeli programmer can move to work for Google in San Francisco next month.
3. Threat to Jobs Whether due to an overly strong Shekel or, alternatively, Artificial Intelligence, there is a tangible threat to some of these jobs. They could either move to engineers/programmers in other countries or face total elimination, where the role performed by that programmer/engineer is divided among others made more efficient by AI.
4. Dependence on External Factors The economy depends on foreign elements:
 - Career timing depends on American companies.
 - Investments depend on foreign investors.

- Markets depend on the global economy.
- And everything can change overnight.

5. Double Weakness The weakness is twofold because a very dominant sector in Israel, Real Estate, depends on these exact same people. If a Google engineer decides to move to Palo Alto, they not only cease buying an apartment in Israel, they also sell the one they currently own.

The Frightening Question

What happens if a portion of high-tech workers decide to move abroad? What happens if AI truly replaces high percentages of programmers? What happens if American companies decide Israel is too risky? This does not mean it will necessarily happen. But it means that when people say "In Israel it's different" , they are right. It is much more dangerous. Instead of one egg in many baskets, the economy has many eggs in one basket. And that basket can fall.

One Scary Similarity

When Israeli High-Tech loses steam (layoffs, company closures, declining investments), it makes logical sense for real estate prices to drop, especially in Tel Aviv, which depends on High-Tech. But instead, prices continue to rise or remain stagnant. A 5% drop in prices, or mere stagnation after such massive increases in apartment prices, is not even a scratch on the surface.

The Elephant in the Room – Assets Are Nice, But Cash Flow Is King

At the end of the day, a building doesn't pay for groceries, and stocks don't pay the rent. What determines economic survival is Cash Flow. Therefore, when I analyze the current market, I put aside the stories of "wealth" and focus on four critical data points:

1. Median Wage Trend: (More important than the average) – Is the ordinary Israeli earning more, or are the gaps widening?
2. Average Wage Trend: To understand general purchasing power and the influence of High-Tech.
3. High-Tech Job Growth Rate: The leading indicator for future growth and the entry of new money into the economy.
4. The "Real" Unemployment Rate: The most deceptive figure right now.

The Hidden Bubble: "The Reservist Economy"

One of the most troubling questions is what will happen on the day after the war. Currently, tens of thousands of people are defined as "employed" or receive compensation from the state because they are in reserve duty. The state is effectively

subsidizing their cash flow. But what happens when the uniforms come off? Are their civilian jobs still waiting for them? Did their independent businesses survive? We might discover, all at once, a broad stratum of people who have lost their earning ability, exactly at the moment government support stops.

The Dangerous Reflexive Cycle: Pension Leverage

This is perhaps the greatest systemic risk, and it works like a self-feeding cycle (for better or worse):

1. Israelis want to buy an apartment but lack sufficient equity.
2. They take a loan against their Study Fund (Keren Hishtalmut) or Pension (until recently, at zero interest).
3. This money flows into the housing market and inflates the profits of real estate companies and banks.
4. Real estate and bank stocks rise on the stock exchange.
5. Pension funds (which are heavily invested in the Israeli stock exchange) increase in value.
6. The Result: The public feels richer and can take a larger loan against the grown fund.

But what happens when the wheel spins backward? A drop in real estate will hurt the stock market, which will hurt pensions, which will trigger a Margin Call on the loans taken, forcing people to sell assets.

What is Hiding Under the Rug?

The mountain of Israeli cash is an important safety cushion, but I don't know how the market will react to a scenario of long stagnation or price drops of 10-15%. Intellectually, I am curious (and also afraid) to know what sits in the books of construction companies, contractors, and banks. Are there valuations that are too optimistic? Are there "cash flow holes" currently covered by cheap credit or regulatory leniency during wartime?

"Only when the tide goes out do you discover who's been swimming naked." - Warren Buffett

The Sword and the Shield: The Concentration of the Israeli Market

The Israeli market has a unique feature: it is small, centralized, and interconnected.

- The Disadvantage: High Contagion risk. Insurance companies, banks, and real estate companies are intertwined. The fall of one real estate tycoon shakes the bank's balance sheet, which hurts the public's pension.
- The Advantage: Ability to control and manage a crisis. Because the market is small, regulators (Bank of Israel, Ministry of Finance) can identify problems quickly and perform targeted "root canal treatment." We have a very professional Central Bank, with massive foreign exchange reserves (over \$200 billion), which can provide liquidity in times of trouble.

The Bottom Line: Concern for the Middle Class

I am not concerned about the rich. Wealthy Israelis have enough liquidity to exploit opportunities in a crisis. My real worry is for the middle class and below. This is the public whose majority of capital is "trapped" in their single apartment (four walls that don't produce cash flow), and whose income depends 100% on a monthly salary. If this demographic takes a double hit, from layoffs (hit to cash flow) and a drop in pension/apartment value (hit to assets), they will be in a very difficult situation, because they have no "fat" to burn. This is all the more true if they are dependent, through their pension and study funds, on an Israeli market where a very, very high percentage is tied to real estate, directly or indirectly.

Part III – Where We Stand Today, and a Glimpse into the Future

"A people that does not know its past, its present is poor and its future is shrouded in fog." – Yigal Allon

So, what have we covered so far? My central thesis is that the State of Israel is in a race against time. I examine the situation through the lens of an investor. If I were wearing the hat of the "Passive Investor" (Silent Investor) who merely seeks a quiet place to park capital, the State of Israel would immediately go into the "Too Hard Pile" (Warren Buffett's "too complicated" basket). I would simply move on.

I want to take a moment to clear up a common misconception among Israeli investors. When people in Israel say "Passive Investment," most imagine blindly buying an index (like the S&P 500) and falling asleep for thirty years. But the precise definition is different; a passive investor is simply an investor who is not an Activist; they could be someone holding a concentrated portfolio of only ten stocks, yet they conduct themselves as a "Silent Investor" who does not attempt to manage the company. The term Israelis are actually looking for is "Defensive Investor." This confusion between concepts is a known phenomenon here; Israelis tend to adopt English terms and give them a local interpretation that sometimes creates inaccuracies. As an advocate of

conceptual clarity, I am very careful about using words or phrases that might generate a flawed mode of thinking regarding a specific subject.

But, let's assume we are viewing the country wearing the hat of an Activist Investor, or a Private Equity investor—one willing to get their hands dirty to understand the mechanism, identify where the clock is broken, and figure out what is needed to fix it. In the first stage (The Narrative), we examined the historical events and the backstory leading to the country's current situation. This provided us with the context. In the second stage, The Balance Sheet, we looked at the assets held by the Israeli public. We know that the public's portfolio is dramatically skewed toward residential real estate, whether for personal use or investment. Correspondingly, we discussed the largest source of liabilities (debts): mortgages. We pointed out the danger inherent in assets priced very high relative to the cash flow they are capable of generating. This gap reveals the critical dependence of the entire system on another external cash flow source: Israeli High-Tech. We also touched upon market psychology and the dangers lurking in excessive optimism.

Chapter 8 – The New World: Israel as a Small Cog in a Great Game

The End of an Era and the Beginning of a New One

The world is transitioning from a phase of low volatility and high predictability to a chaotic world of high volatility and low predictability. This is not merely a "change in weather," but a complete climate change. One can observe the collapse of the global consensus shaped after the fall of the Soviet Union, and the end of the Western "World Order" meticulously built after World War II.

The comfortable assumptions that guided investors for decades, that globalization is an irreversible process, that central banks can solve any crisis by lowering interest rates, and that the U.S. will always be there to back its allies, are all standing trial today, and many are failing.

In 1991, when the Soviet Union collapsed, it seemed America had won. The idea that liberal democracy and free-market economics won, and American hegemony became "absolute". The narrative was that the whole world would eventually converge into one model: Western-American. For investors, this was paradise. Rules were stable, trade routes were open and safe (courtesy of the U.S. Navy), and geopolitical risk was pushed to the margins.

For Europeans, American hegemony was a dream arrangement that allowed them to live inside a bubble. They enjoyed what is called the "Peace Dividend": the ability to stop investing in the military and security (because NATO exists and the U.S. funds it), and divert all resources to building a pampering welfare state. For decades, the "European Project" was built, a utopia of a 35-hour workweek, early pensions, and enveloping social security.

In retrospect, there is something ironic about the nostalgia of politicians and commentators on the left, who just a decade ago hailed the European social-democratic model as a role model. What they missed, or chose to ignore, is that this model relied on shaky foundations:

- Shrinking Demographics: High quality of life was funded partly by reduced birth rates (saving on family expenses), creating a future demographic hole.
- Immigration as a Magic Solution: Relying on cheap immigrants to drive growth and perform jobs locals didn't want.
- Free American Protection: The ability to neglect national security.

Today, the bill is due. The social crisis in Europe is exploding. Immigrants have changed the "calm European way of life," and the social-democratic economy is running aground. The population, accustomed to a certain standard of living, refuses to give up the welfare state, even though it is on the path to bankruptcy. The painful conclusion begins to sink in: a free and competitive capitalist market is not the problem, but currently the only ticket out of the decline.

Simultaneously with the European decline, the rise of China undermined the global order. To understand the pace of change: in 1990, the Chinese economy was the size of Italy's. Today, it breathes down the neck of the U.S. This is an unprecedented leap in human history in just 30 years. The 2008 Beijing Olympics was the turning point. It wasn't just a sporting event; it was China's "Coming Out Party" and a national statement: "We are back at center stage, and we are here to stay." That was the moment the U.S. realized China was no longer just a "cheap factory," but a dangerous strategic rival. From that moment, the world entered a new Cold War.

But then came the real test: COVID-19. The pandemic exposed the cracks in the centralized Chinese model. The "Zero COVID" policy, which initially looked like the success of a strong regime, turned into an economic death trap. One cannot shut down completely for two years and expect the economy to keep functioning. The result was devastating: growth slowed dramatically, youth unemployment skyrocketed, and most importantly, the Chinese real estate market, which accounted for about 30% of GDP and was the basis for the middle class's feeling of wealth, collapsed.

The world today is fragmented. There is no longer one harmonious "global market." There are competing blocs, rising tariff walls, and supply chains being dismantled and rebuilt based on political interests rather than purely economic ones.

The Situation Today – The Good, The Bad, and The Ugly

In my view, Larry Summers and Mohamed El-Erian are the only two economists, who are not professional investors, that have truly proven themselves over the last five years. All the others have demonstrated time and again that they are like blind pilots, driven more by ideology than by coherent thought. Since Donald Trump's election, and even during his campaign, Larry Summers has focused intensely on politics and its implications. Therefore, for the purpose of this conversation, we will set him aside, though he deserves to be mentioned out of respect, as many of his key insights guided the WhatsApp group I opened at the start of COVID to share information sources with friends rather than having them invest based on hype. Mohamed El-Erian, on the other hand, is doing excellent work when speaking about global markets today. He describes the current global situation as one oscillating between "The Good, The Bad, and The Ugly." It is crucial to understand that this state is temporary and subject to change.

The Good: The United States

The United States still leads in every metric that truly counts: strong economic fundamentals, technological leadership, dollar hegemony, deep capital markets, the rule of law, and the ability to attract global talent and capital.

It is the only nation in the world capable of running trillion-dollar budget deficits and massive trade deficits while remaining the strongest global power. The US Treasury market is the largest market in the world; we are talking about \$26 trillion of government debt traded daily, making it several times larger than any stock market on earth. This isn't just paper—it is the bedrock of everything else. Every interest rate in the world starts from the US Treasury yield; every risky investment is measured against it; and every central bank holds the majority of its reserves in US Treasuries.

This is precisely why global trade is conducted in dollars, meaning the US can effectively create money out of thin air to purchase real goods. When the Fed prints dollars, the entire world essentially subsidizes it. If you are a country selling oil, you must accept dollars. If you are a company engaging in international trade, you need dollars. If you are a nation wanting to buy American technology, you pay in dollars. Consequently, the demand for dollars will always remain high, allowing America to sustain deficits that no other country could survive. As Treasury Secretary John Connally famously told his European counterparts in 1971:

"Our currency, but your problem," - Treasury Secretary John Connally (1971)

It is akin to being the world's central bank, you set the rules. Kenneth Rogoff even released a new book this year on this very topic, titled *Our Dollar, Your Problem*. This dominance extends to technology. Artificial Intelligence, the cloud, autonomous vehicles, and private space exploration are all American-led fields. This isn't because Americans are innately smarter—though there is plenty of talent—but because the US possesses the world's superior system for generating innovation. It has universities that

attract the best minds globally, investment funds with billions of dollars seeking the next big idea, and a culture that embraces failure as a necessary part of learning.

The US capital markets are the deepest and most liquid in the world, making them the central hub for raising funds and financing ideas. A company that wants a valuation in the billions must enter the American market because only there can one find money that is sufficiently large, experienced, and sophisticated to value and fund grand visions. An American investment fund can pour a billion dollars into a startup that hasn't earned a single dime, simply out of the belief that it will be the "next big thing." No other place offers the trust, capital, and experience to execute this on such a scale. The biggest and most famous Venture Capital funds such as Sequoia, Andreessen Horowitz, Kleiner Perkins, Founders Fund, are the ones that attract the best ideas, and every startup dreams of being backed by them.

Furthermore, the rule of law makes people trust the US despite its political turmoil.

When a private company sues the US government, it can actually win, as Palantir did in federal court. When a foreign investor buys an American stock, they know no politician will steal their money in the dead of night. The courts function, laws are generally respected, and the constitutional system withstands pressure. It is not perfect, but it is predictable, and in a world of uncertainty, certainty is worth a fortune.

Finally, the US has an unmatched ability to attract global talent and capital. The most talented individuals want to study, work, and build businesses in America to live the American Dream. The wealthiest individuals want to invest in American markets. They come not because they are forced to, but because it offers the best returns. It is where talent is most rewarded, where ideas become reality, and where one can achieve things impossible anywhere else. The promise remains the American Dream: if you work hard, dare greatly, and strive for excellence, you can live a life of the highest quality, a big house with a yard, quality cars, excellent infrastructure for children, and entertainment. It is important to note the political weakness here: this dream is becoming harder for more people to achieve as education and housing costs soar, but the dream itself still exists.

Above all, the US sustains this position because the world needs it. The US military protects global trade routes, and its technology powers the internet. The looming problem for the US, however, still one that is taking up more space in political discourse, is that interest payments on the national debt are beginning to eclipse defense spending.

The Bad – China: The Challenge of the Awakening Giant's Transition

Categorizing China as "The Bad" in El-Erian's model does not stem from moral judgment, but from a cold analysis of the complex economic situation in which it finds itself. China is not a "bad country," but a superpower at the most challenging turning point in its development. This is the story of a nation that orchestrated the greatest economic miracle in human history, lifting hundreds of millions out of poverty and

becoming the world's factory within a single generation, and is now hitting the "glass ceiling" of transitioning into a developed nation.

The Chinese paradox lies in the fact that the centralized and wonderfully planned model, which allowed it to build cities, bridges, and infrastructure at a speed the West could only dream of, is now facing friction as it attempts to move to the next stage: the innovation economy. While a manufacturing economy requires discipline and exemplary order, an innovation economy thrives on creative freedom, risk-taking, and the willingness to accept failure. Within this tension, the administration executed moves that created significant turmoil.

A prominent example is the shifting attitude toward the technology sector. Precisely during a period when the real estate crisis began to cloud traditional growth, and economic logic relied on new growth engines like technology to rescue the economy, the government chose to tighten its regulatory grip around internet giants out of a desire to promote "Common Prosperity." The famous case of Jack Ma, the founder of Alibaba, who "disappeared" from the public eye for a long period after criticizing the government, sent a chilling message to the markets and wiped-out immense value from Chinese flagship companies. However, it appears that today, after the economic damage has become clear, the pendulum is beginning to swing back. Beijing has recently signaled renewed support for the tech sector and an end to the "crackdown," out of a pragmatic understanding that without the "Alibabas" and "Tencents," it will be extremely difficult to extract the economy from the slowdown. This is a real-time process of trial and error by a superpower trying to rebalance itself.

Amidst this shifting reality, China is also facing a significant demographic challenge. The population is aging rapidly, and the government is investing massive efforts to re-incentivize childbirth. Simultaneously, the younger generation is undergoing a shift. Much like their counterparts in the West, young Chinese are asking tough questions about the endless economic race. Phenomena such as "Lying Flat" (*Tang Ping*) and "Professional Children"-young adults who prefer to rely on parental support and manage the household rather than enslaving themselves to the corporate rat race, testify to a deep psychological change in an economy accustomed to growth based on hard work and ambition.

In the real estate sector, the situation is no less complex, and perhaps even much more so. While the current crisis in the sector is painful, credit must be given to the Chinese government for its courageous willingness to pop dangerous bubbles ("The Three Red Lines") before they turned into a greater disaster. The leadership in Beijing understands that growth based solely on skyscrapers and leverage is unsustainable, and they are attempting to steer this giant ship toward higher-quality growth, even at the cost of short-term pain. The massive problem with popping the bubble is that it created deep distrust in investments; the public is saving rather than investing as they did in the past. This has led to a deflationary spiral from which the government is struggling to recover.

Despite the difficulties, one cannot speak of China without admiring its technological capabilities. The old stigma that "China only copies" has passed from the world. Chinese engineers are among the best and most industrious globally. Ultimately, the reason China is classified as "The Bad" in investment terms right now is the uncertainty and deflation surrounding it. It is a superpower with immense potential and fine human capital, but the combination of structural slowdown, frequent regulatory changes, and attempts to fix things on the fly makes it an enigma. The risk is not that China will collapse, but that the rules change while the game is being played. In the investment world, the inability to predict the next move is often the most deterring factor.

The Ugly – Europe

Structural stagnation, demographic decline, excessive regulation, energy dependence, political fragmentation, and an inability to adapt or compete efficiently with the US or China. These are the themes that plague Europe.

Instead of investing in the future, Europeans invested in comfort. Instead of inventing the next generation of technologies, they invented hundreds of regulations on how to produce them. Instead of building technology companies, they decided to fine American ones. Instead of encouraging entrepreneurship, they built bureaucratic systems that turn every innovation into a headache. The result: out of the 50 most valuable companies in the world, only 6 (as of this moment) are European. Two are luxury brands, two are pharmaceutical companies (whose drugs receive prioritization within Europe), one is in asset management, and only one is a technology company, whose entire client base is outside of Europe. All the technological giants are either American or Chinese. Europe is left with old banks, an automotive industry struggling to cope with the transition to electricity, and energy companies that relied on Russian gas.

This bothers them less. What is worse from their perspective is that they have lost the ability to defend themselves. When Russia invaded Ukraine, Europe discovered it could not help its neighbor without American assistance. They do not have enough ammunition, they do not have enough equipment, and they lack logistical capabilities. Germany, the largest economy in Europe, lived for decades relying on cheap Russian energy and American protection. Suddenly, it discovers it is dependent on the very people it wants to fight, and that the Americans will not jump to help with everything as they previously thought. In a recent poll in Italy, the absolute majority of young people indicated they would refuse to enlist if a war broke out.

The result: Europe has become a beautiful museum of what used to be. It has stunning cities, rich culture, and developed democratic institutions. But it lacks the power to shape its own future. While America and China are competing over who will set the rules for technology, Artificial Intelligence, and the digital economy, Europe sits on the

sidelines, concerning itself solely with regulating them and figuring out how to tax and fine them.

The European Dream – The Welfare State and Inclusion without Accountability

The European welfare model has blown up in their faces. I remember over 13 years ago, politicians preached to me about how amazing the European social-democratic structure was. But in a country where you have nothing to worry about because the state takes care of you, no one worries about anything. In such a case, no one can be at fault because everyone is at fault, so no one is blamed. A situation arises where no one takes responsibility, not for their own future and not for anyone else's.

Quality of life, cultural acceptance where the culture of politeness rules, and a policy of "let's help the weak" even if they arrive with impure intentions, all these brought a Europe that took afternoon naps (*siestas*) at the expense of work time to wake up to a reality where public coffers cannot fund the states. They face numerous migrants who, instead of trying to integrate, attempt to change the countries themselves and take ownership of them. They woke up to discover they are in a dire economic situation while totally dependent on superpowers that are beginning a process of decoupling. Rights without obligations are a source of disaster anywhere. Look at how a spoiled child develops when they get everything they want without discipline or responsibility. It will not end well.

Amidst all this global fragmentation, Europe remains without a clear strategy. It cannot compete with America in technology, it cannot compete with China in manufacturing, and it cannot compete with anyone in defense. The only thing it does well is pass laws that prevent its citizens from using innovations. This is not exactly a recipe for success in a rapidly changing world. Furthermore, the structure of the EU does not allow them to progress because every country can veto anything. The result is that they all start legislating for themselves and looking out for themselves.

The Cleanest Dirty Shirt

This is why Mohamed El-Erian calls the US "The Cleanest Dirty Shirt." Assuming you are on a trip, and after a week where you have worn all the clothes you have, you need to go back and wear a dirty garment. You will choose the cleanest shirt out of all the dirty ones available. You do not choose it because it is the best choice you could imagine (it is dirty), but it is relatively cleaner than all the others.

The US is today the lesser of evils, or the only apple that isn't rotten (though not fresh) in a basket of rotten apples. Therefore, the world continues, for lack of a better choice, to choose the US, even though there are several trends weakening that choice.

The Heartland Theory: The Sea vs. The Land

The massive global enrichment of recent decades brought with it a paradox. The same "Keynesian Law" we discussed at the very beginning returned with full force:

Globalization dramatically increased the pie, but the distribution of the slices was uneven. While the world as a whole got richer on average, specific groups got much, much richer, creating unfathomable gaps that cracked the social consensus. These cracks are the economic background leading us to the great geopolitical shift: the transition from integration (globalization) to fragmentation (because of internal politics). Halford Mackinder spoke over 100 years ago about two types of empires: Land Empires (China, Russia) and Maritime Empires (the USA). A maritime empire controls sea trade routes and coastlines. Note that the Russia-China-Iran axis is a land axis. We won't get into the geopolitical war implications of a clash between two such empires or what might result from it. What we do see is a decoupling between the world of maritime trade and the world of land trade.

With China's return to global trade (after the Vietnam War in the 70s) and even more so with the collapse of the Soviet Union, we saw a form of global hegemony. The US controlled and still controls maritime trade routes, and land empires shifted down a gear, whether in their aggressiveness in exporting the communist revolution or in their aggressiveness in clashing with the maritime empire. The US, which from its inception replaced the Crusade with "Manifest Destiny," entered with full force into the belief of exporting democracy and the American system, even to cultures where this doesn't fit at all. They carried the belief that if Communism failed, their system must be the correct one. This approach failed. Whether in Somalia, Iraq, or Afghanistan, the US witnessed that exporting the Republic doesn't work when the locals aren't interested.

Economic processes that widened gaps in the US, and the import of European ideas by the American intellectual elite, caused fringe populations and their political views to penetrate the American mainstream over time. With the increasing use of the internet, where one can obsess even more over the neighbor's grass, hostile actors exploited these technological means to spread divisive ideas within the US. The cracks in the American Dream, which went from being possible for everyone to possible only for those born into the right class, brought weakness to the American political system. The two main American parties slowly entered an internal war: the "Woke" on the left and the Isolationists on the right. This trend accelerated the coalescence of the axis whose members have "nothing in common except opposition to the US" to operate both openly and in the cyber realm to undermine the US. This axis began putting pressure specifically on the US monopoly over trade route control, whether through the New Silk Road or the renewed race for control of the Arctic Ocean, while fueling messages aimed at creating internal unrest in the US.

In my opinion, Trump has an excellent person advising him, since his first term, who operates behind the scenes and shares Mackinder's worldview. I have no idea who he

is. Trump has been obsessed with maritime trade routes since his first term. The world views this humorously and doesn't understand the significance. The reason I described is the source of the tweets about annexing Canada and Greenland, capturing the Panama Canal, and the reason for the attempts to bring Putin and Russia closer to the US and distance them from China. This is done out of respect to the capabilities of Russia and China.

This is essentially a "Reverse Kissinger" maneuver. Just as Henry Kissinger drove a wedge between the Soviet Union and China in the 1970s by siding with China, the logic now is to peel Russia away to isolate China.

This is also another reason why he is particularly hostile to the Iranians. The axis between Russia, Iran, and China is essentially Genghis Khan's Mongol Empire, which the world likes to forget was the largest empire in the world for centuries, disappearing only due to its own disintegration. Pay attention to the special relationship between all these countries, and how culturally they are accustomed to being under the influence of those nearby empires, and unequivocally avoiding confrontation with them.

The "Saudi Pipeline" Conspiracy and the Egyptian Wall

I want to pause for a moment to address one of the most popular conspiracy theories that emerged after October 7th: the claim that Hamas attacked to torpedo the normalization agreement with Saudi Arabia, the entire purpose of which was allegedly to create an alternative to the Suez Canal—oil pipelines to Ashdod and cargo trains to Haifa's ports on the way to Europe.

I do not know how to calculate right now if such transport would be faster or cheaper, but the idea that the entire essence of the agreement and regional geopolitics boils down to "oil and commodities" is, in my view, a very shallow interpretation of reality. Anyone who thinks this ignores the biggest elephant in the room: Egypt. If there were ever a real reason for Egypt to go to war against Israel (and Saudi Arabia), it is the creation of a "Suez Bypass."

We must understand: Egypt is a poor country with a strong army that is expanding at a dizzying pace. This military buildup does not happen in a vacuum; it stems from the fact that, from Cairo's perspective, there are two existential threats to the state's very survival:

- Blocking the Nile: The threat from the south, in the form of the Grand Ethiopian Renaissance Dam (or potential moves in Sudan), which could dry up Egypt's only source of water.
- Drying up the Suez Canal: The economic-strategic threat. The canal is not just a source of billions of dollars in revenue; it is Egypt's insurance policy and the reason superpowers are interested in it at all.

I have heard naive theories suggesting that, as part of the Saudi-Israeli-American agreement, they would "pay Egypt a bribe" or fixed compensation as a substitute for the

canal's revenues. I do not see such a scenario happening in reality. Sovereign states, certainly those with national pride like Egypt, do not sell strategic assets in exchange for a welfare check. For Egypt, it is too dangerous to rely on a fixed payment from superpowers that could stop the moment a diplomatic crisis arises.

Furthermore, such a move turns Israel into an enemy that stole Egypt's livelihood. The first time there is a threat to the payment transfer, or if Israel feels too secure, Egypt would attack, not to conquer Tel Aviv, but to destroy the alternative infrastructure and force the world to return to passing through the canal. Creating a route that bypasses Egypt necessarily entails a dramatic deterioration, and perhaps even war, in our relations with our southern neighbor.

Egypt is currently the "gatekeeper" of the maritime trade route between Europe and Asia, and therefore it is umbilically linked to the US and Europe (the Maritime Empires). However, the greater threat to Egypt is not just an Israeli pipeline, but the strengthening of the "Land Axis" we discussed, China, Russia, and Iran. If this axis succeeds in establishing efficient land trade routes (the "Belt and Road Initiative") that transfer commodities and oil from the East to Europe via Asia and Russia (and let's assume via Turkey as well), the Suez Canal would become irrelevant. Therefore, the Egyptian interest is actually to preserve Western maritime hegemony, as long as it passes through them.

Israel, in a reckless move to establish a bypass route, could find itself backing Egypt into a very dangerous corner. Geopolitics is a delicate game, and the thought that one can simply "lay a pipeline" without shaking the regional balance is simplistic at best and dangerous at worst.

The Failure of Manifest Destiny, American Fatigue with the Role of Global Policeman, and the Infiltration of Anti-American Messages

"Manifest Destiny" was a movement born in the 19th century to justify American expansion from coast to coast, but its remnants are what led to the increasingly growing US interventionism. *In the Shadows of the American Century* (by Alfred McCoy) and *The Assault on American Excellence* (by Anthony Kronman) are two of many books and testimonies describing the trend where the expansion of influence, as well as the US pursuit of excellence and dominance, actually created some of the trends gnawing at the most American ideas from within.

The two books I mentioned come from opposing angles. One criticizes the failed American attempts at influence, and the other criticizes the spread of the Woke movement in universities. McCoy's book describes how the relentless American ambition for global dominance created a boomerang effect. On one hand, the "Left" views American attempts to export liberal values (like freedom and equality) as imperial expansion, and the pursuit of excellence as an attempt to oppress others. Precisely the

ideological ideas that were once a source of pride have created counter-trends that are eroding American society.

The Woke movement, for example, shifts responsibility from the individual regarding their fate (which is a cornerstone of the American myth) to the environment surrounding them. The Woke movement accuses the US of trying to be the "Global Policeman" in global suffering (which goes hand in hand with messages against the police and the system, which are allegedly guilty of oppressing the weak). In other words, the Progressive Woke movement performs a deconstruction of the most important foundation of the American myth: Personal Responsibility.

The new narrative posits that man is not the master of his fate. If you fail, it is not because of you—it is because of "The System," "The Social Structure," or someone else's "Privilege." This movement accuses the US of being the source of global suffering; therefore, any attempt by it to impose order is fundamentally invalid (Imperialism). This connects directly to anti-police messaging within the US ("Defund the Police"), which views the police as an instrument of oppression in Chicago or Minneapolis, making it obvious to them that the US military is an instrument of oppression in Iraq or Ukraine. This is an ideology that denies the right of the US to project power, inwardly or outwardly.

The most ironic part is that the faction of the Democratic Party that leans toward the center keeps its mouth shut and does not raise criticism against that body because of the "coalition of votes." Those who are radical about any theme of the party, become radical for all themes of the party. This is exactly how promoters of "equal rights" for everyone, fight for the causes of figures who lean toward Islam—which opposes LGBTQ rights.

The Democratic Party, more than anyone, looks at the issue of "groups" and does not cast criticism on members of its own group. A very complex situation arises: The Democratic Party is willing to give massive funds and great support to non-American elements, organizations, and countries, while simultaneously claiming that the US has no right to advance its interests on the globe, even though undermining America's status as a superpower and creating a vacuum for other nations is exactly what will undermine the US' capabilities to continue supporting these causes in the long run. There is a profound moral dissonance at play. From the perspective of many Americans, the brutal oppression of minorities by regimes like Iran or groups like Hamas is tolerated—or even rationalized—because they are enemies of the American establishment. Meanwhile, Israel, a US ally, is branded an oppressor regardless of the reality on the ground.

Ultimately, the loudest voices waving the banner of 'human rights' are the ones standing silent when their favored groups commit atrocities. There is zero criticism of how Hamas abuses its own people, but infinite outrage over how Israel handles a terrorist. The

moderate majority within the Democratic Party, held hostage by the ballot box, chooses silence over principle. Anyone who dares to point out this hypocrisy is swiftly excommunicated and labeled a 'fascist,' an 'oppressor,' or, worst of all—a 'Republican.'

On the other end of the political map, there are people who were perhaps marginalized in their status in American society as factory workers or miners, but their situation was still better than that of Indians or Chinese overseas. This working class, miners, and their shared demographic is the one that sends its children to the army. They saw with their own eyes how their children paid the physical and mental price, while they paid the economic price (as they see it), for US activity overseas that brought benefits mainly to foreign nations, while for them (as they see it), it only brought suffering. They saw how their children returned in coffins or with PTSD from Iraq and Afghanistan, while the elites in Washington and New York raked in the profits from international trade. From their perspective, the "American Empire" is a scam: it brought benefits to foreigners (protecting Europe, developing China) and brought suffering and neglect to the ordinary American citizen. The result is aggressive Isolationism: *"Let them all burn, we only care about ourselves."*

Paradoxically, these two fringe movements are rapidly leaking into the mainstream and taking over the major parties (Democrats and Republicans). We are witnessing a revival of dynamics that existed in the US 100 years ago, in the 1920s and 30s:

- Then, on the Left, was the American Communist Party, which sought to dismantle the existing order. It created an imagery based on "stolen land," claiming all US territory was stolen from Native Americans. Just as the US Army and white settlers 'stole' land then, the US Army does outside the US now. Thus, those blindly following the Progressive movement for "Human Rights" find themselves supporting terror organizations whose entire essence is anti-human rights, simply because they view them as the modern parallel to the "Native Americans." The Communist worldview evolved from Bourgeoisie vs. Proletariat to White Men vs. Everyone Else.
- Then, on the Right, was the original "America First" isolationist movement, which viewed European wars as "their problem" and refused to intervene. This movement, along with other fringe groups on the Republican side, merges today with a doctrine that partly seeks to fight the Progressive movement (as a defense mechanism of those white men against a movement that marked them as enemies of humanity), and partly stems from religious purism or xenophobia.

In both movements, then and now, there are elements of racism, hatred of the other, and the total cancellation of anyone who does not was the shock of Pearl Harbor and World War II. The frightening question today is: Will America need another global catastrophe to remember who it is, or is the internal disintegration irreversible this time?

The fundamental problem is a contradiction between the interests of these groups and their methods. The group that supposedly wants equality acts against the very system that did the most to advance them (imposing Western values on cultures where they don't fit is indeed problematic, but undermining the system entirely is suicidal). On the other hand, to maintain a high quality of life for Americans, American supremacy is largely required. American superiority relative to other nations is what allows the US to obtain cheap credit (because there is demand for their bonds and attracts foreign capital for investments) and thus invest in infrastructure and conditions at home. Those leading these movements are not stupid. They exploit their ability to inflame their public to advance their personal interests. One look at the enrichment of politicians after they are elected, especially those representing "marginalized populations", is enough to understand that what is good for the politician is often not good for their public.

In Between "America First" and "Virtue Signaling"

The Americans who are not on the radical fringes understand perfectly well that the US benefited immensely from its status as a global empire. They are desperately trying to find a way to optimize the previous situation and fix the failures of the past two decades: the failure of Bush (brute force) and the failure of Obama (the naive belief in the "goodness of people").

However, for each side of the center, there is a party they lean toward. Because of the total inability to work in a bi-partisan manner and ignore the fringes, every centrist is forced to do things to appease the radicals in their own party. On the Democratic side, they engage in Virtue Signaling. This is the primary reason why the political left jumps on every cause that looks like "protecting the weak," regardless of the complex reality. They try to signal that they are moral. A prime example is the Biden administration's decision not to supply Israel with 2,000lb bombs while continuing to send lighter munitions. They did this because it is a "less bad headline." People who know nothing about bombs think heavier equals more deaths. The opposite is true: heavier bombs with delay fuses would have prevented high casualty numbers by penetrating bunkers surgically. But for the Democrats, the main thing is how things *look*.

This is why Israel needs to ban interviews of government ministers and Members of Knesset (MKs). Because of the Israeli political system, each one feels the need to grab headlines, say to cater to their supporters ideology, even if the issue has nothing to do with their role. They are dangerous when they focus on their own self-righteousness rather than on how their words sound. The enemy exploits these interviews to prove that Israel is as evil as they claim. On the other hand, the Israeli government is perceived time and again as an entity that cannot be trusted with secrets. Leaks happen left and right. Ministers and MKs make declarations to the media based on nothing.

While in other countries in the region, nothing is said without the approval of the Head, in Israel the Head is constantly busy putting out fires.

Anyone who makes their country look bad on the global map endangers it—or themselves. I am certain that if Jack Ma had met privately with government officials in China, there would have been no problem. Ultimately, both they and he want the welfare of the Chinese people. Therefore, in Israel, if they want to lead a policy change, they must do so from within. Anyone trying to force a policy change in Israel using external pressure brings greater harm upon it. We see this in ancient Jewish history as well: whenever there was a struggle over who controls Judea, the faction that went to a foreign king or a strong foreign empire brought about deeper subjugation of the people and a bitter end.

On the flip side, for Israel, this means that the days of blindly relying on America are over. Israel must emphasize how it serves American interests to get help from the US.

The West needs to learn to live in a world where America helps when it is convenient, and does not help when it is not. Europe too, cannot expect blind American support with no return. This is a much more dangerous, less predictable, and far more expensive world. Therefore, it demands a higher level of functioning from the citizenry. More excellence, less mediocrity.

For investors, this means the Old World is dead. The rules that worked for 30 years will no longer work. You can no longer count on free trade. You can no longer count on the Dollar being strong. You can no longer count on America keeping the order. You cannot rely on the fact that a company manufacturing in China and selling in America can continue to do so. You cannot rely on a small country being able to rely on a big country. In the New World, it is every man for himself. Those who do not understand this will find themselves on the wrong side of history. And those who do not prepare for this now will find themselves unprepared when the shock arrives. This is the time for all of us to read *The 33 Strategies of War* and *The 48 Laws of Power* (both by Robert Greene) and dive deeper into the rabbit holes he creates (his books are full of other sources worth exploring). Every nation needs to be smarter—especially Israel—and more ready for the new world we are in.

The Israeli Paradox: Why I Keep My Money Overseas

In recent years, a growing tide of Israelis has joined the global stampede to invest in the US markets. I, thought about swimming against this current and invest in individual Israeli companies listed on the Tel Aviv Stock Exchange. However, very quickly, these attempts were relegated to the "Too Hard" pile. Every company that I felt I could truly understand was already trading in the US. I have other reasons for avoiding the local

market, but out of fear that my words might one day come back to haunt me, I will keep those specific details to myself.

The Tel Aviv Stock Exchange is a reflection of the country itself: highly centralized, where power and money are concentrated in very few hands. The Israeli elite all know one another, and there exists a pervasive culture within major corporations where, in my opinion, controlling shareholders legally "milk" the public asset for their own benefit and that of their associates. Alternatively, senior management often exploits their cozy relationships with the heads of the institutional bodies, those who hold the public's stock, to execute moves that I find highly questionable.

We saw this clearly with the conduct of the executives at a major publicly traded supermarket chain, who manipulated financial reports to trigger their own bonuses. On a personal level, they faced no consequences. Eventually, wealthy investors with deep pockets took over the company and "cleaned house," ousting those executives. They likely guessed there was hidden value swept under the rug, and indeed, the company presented higher profitability within a year, sending the stock soaring.

The Nepotism Factor vs. The American Standard

We have seen time and again how in Israeli companies with a controlling core, you might find ten family members on the payroll. Compare this with Walmart. It is the only company with such massive family ownership (the Waltons), yet not a single family member works in the company drawing a huge salary just because of their last name. Jeff Bezos's children do not work at Amazon.

One of the critical decisions in choosing a business to invest in, and US stock indices are businesses in every respect, is selecting excellent management that looks out for its shareholders. In other words, our interests. I believe there is a place for investing in businesses with a powerful controlling shareholder (I am invested in such companies). If you personally trust that individual, it can be a very smart move; you have a partner you trust who is the strongest person in the room. Ultimately, a controlling shareholder is our partner in the business.

The Opportunity I Choose to Miss

The real problem is that this centralization in Israel is an inevitable result of a small country with a concentrated economy. When there are only a few dozen large companies and a few thousand people in management circles, personal connections are unavoidable. The real question is how we deal with this reality.

Warren Buffett and others found opportunities in the US in environments that looked exactly like this: companies trading for less than their assets, businesses the market had thrown in the trash but still had a few "puffs" of value left in them. Buffett would physically go to places, visit factories, talk to managers, and read reports of small companies no one knew. At that time, information wasn't available to everyone, and

American capitalism wasn't as efficient as it is today. Those willing to do the hard work could find "Dollars for 50 cents."

I am certain these opportunities exist here in Israel, and they are even more accessible than in the US. One can physically drive to see the factories, speak with managers, and check the books. The market is small, less efficient, and has fewer analysts covering small-cap companies. It is exactly the kind of environment in which Buffett thrived. But I do not do this myself, and I have my reasons. The most significant reason is simply that I do not understand Israelis. I often feel that the way an Israeli *should* think is different from how they *actually* think; that the average Israeli should act differently than they do. These subjective views bring me, time and again, to a situation where I look at the people around me and fail to understand the logic behind their actions. This disconnect clouds my ability to predict which Israeli business will succeed. My recognition that this lies outside my "Circle of Competence"—outside my ability to decipher the local operating system—is the ultimate reason for you to be wary of my own interpretation of the Israeli economy.

The Weakening Dollar and the American Corporate Advantage

Multinationals and Industrial Dominance

When we analyze American multinational corporations, we see entities that dominate far more industries and geographies than any local player could ever dream of. Take a scenario where the Dollar weakens by 10%. For certain US giants (like Meta or Alphabet), this actually translates into a significant boost in their bottom line, as their international revenue is suddenly worth more Dollars. These companies are far more insulated from foreign exchange (forex) impacts than other companies. Other businesses, particularly those heavily involved in import/export, maintain sophisticated financial departments that trade currencies and derivatives to hedge themselves against sharp fluctuations. They prioritize a stable and consistent cash flow over trying to gamble on currency movements, knowing full well they could get burned.

When investing in individual companies dealing with Commodities or those heavily exposed to a specific foreign currency or market (for example, Australia's Fortescue Metals Group, which is heavily exposed to China), it is critical to analyze this section of their reports and decide: Are they managing this risk responsibly?

Resilience Through Diversification Beyond currency, major US companies are far more diversified geographically and industrially than companies in smaller markets.

- Apple sells in Asia, Europe, Latin America, and Africa.
- Microsoft serves government, business, and consumer clients in dozens of nations.
- Amazon operates data centers, e-commerce, and logistics services on every continent.

The implication is financial resilience. When a crisis hits one region or one industry, these companies don't collapse; they simply adapt and shift resources to places that are working better. You can look at it like a car hitting a bump in the road: there might be minor damage, it might force the driver to slow down until they get back up to speed, but it doesn't crash the car.

The "Single Point of Failure"

If we compare this resilience to that of a typical Israeli company, the average Israeli firm relies heavily on the domestic market, or at best, has a foothold in a few limited markets in Europe or the US. This structure creates a "Single Point of Failure." If something dramatic happens in Israel (war, political instability), or if one of its few export markets enters a recession, the entire business model can destabilize overnight. If a specific regulation changes in Germany or a new tariff is imposed in the US, an Israeli exporter could lose 50% of its revenue in an instant. This doesn't mean Israeli companies can't be phenomenal investments—many are. But it means their risk profile is fundamentally different. It is binary and concentrated, rather than linear and diversified.

The Currency Trap Then there is the currency trap. For a local economy, exchange rate fluctuations are a double-edged sword that cuts deep:

- If the Dollar weakens (and the Shekel strengthens): It is a disaster for Israeli exporters (like high-tech companies). They earn in Dollars but pay salaries and rent in Shekels. Suddenly, their operational costs skyrocket in relative terms, wiping out their profit margins and lowering corporate profitability in Shekels.
- If the Dollar strengthens (and the Shekel weakens): It hurts importers and drives up the local cost of living (inflation), as everything from fuel to cars becomes more expensive to bring into Israel.

The Natural Hedge of the American Giant

This dynamic explains why investing in US multinationals offers a unique advantage for the non-American investor. When you invest in a company like Apple, Coca-Cola, or Procter & Gamble, you are effectively buying a "Natural Hedge" against currency volatility. Why? Because these companies operate everywhere.

- If the Dollar weakens: Their profits in Euros (from Europe) and Yen (from Japan) are suddenly worth *more* when converted back into Dollars for their financial reports. This pushes the stock price up, compensating the foreign investor for the drop in the American currency's value.
- If the Dollar strengthens: Their international profits might look lower accounting-wise, but the value of the stock itself—denominated in the world's reserve currency—increases for the foreign holder.

Investing in true multinationals provides the investor with protection against the violent swings of any single currency, offering a layer of stability that a local company simply cannot offer.

The Scale Advantage

Furthermore, these giants can enter new industries and capitalize on growth opportunities that simply do not exist in smaller markets. Imagine an Israeli company wanting to enter the autonomous vehicle or space agriculture sectors. The local market is simply not big enough to justify the investment. Additionally, contrary to popular belief, US regulation is often less bureaucratically complex than in most countries. Yes, there are many laws, but they are clear, consistent, and have a steady legal interpretation. The US market gives companies the ability to plan for the long term, and it has enough capital and customers to justify multi-billion dollar investments. This is why Israeli startups wanting to operate in these fields almost always build for the US market, often hoping to be acquired by an American company. It is far easier for them to establish the business in the US, even if the development itself is done in Israel.

The Illusion of "Tech" Concentration

In Israel, banks constitute more than 20% of the weight of the leading indices (like the TA-125), and in my estimation, roughly 50% of the index is directly or indirectly tied to the Israeli housing market. You can tell me until you're blue in the face that the US market is concentrated in "Technology companies," but anyone grouping these companies under one umbrella is completely delusional.

- Nvidia, AMD, and the entire chip industry should be treated as Commodities. It is a basic industrial necessity that the entire modern economy runs on.
- Netflix is an entertainment company.
- Amazon is a retailer; it is the owner of the world's largest commercial real estate portfolio (via third-party providers on its store and AWS server farms); it is an infrastructure provider (even entering satellite internet); a logistics company; and is entering the healthcare sector aggressively. It owns an autonomous vehicle company (Zoox) whose technology is best suited to replace buses, shuttles, and industrial vehicles.

In contrast, the Israeli stock market is far more concentrated. And for all those whose wealth is already tied to the housing market (because they own an apartment), the Israeli stock exchange will suffer deeply if the local real estate market takes a significant hit. Meaning, even when Israelis try to "diversify" their portfolio beyond just their apartment by investing in the local index, they are actually exposing themselves to the exact same risk—the Israeli real estate market (since the banks are directly affected by it). If you believe in the local real estate market here more than in the US capital markets *after* giving it serious thought, then investing here is a reasoned move. But if someone invests in Israel purely because "real estate prices went up and the stock market went up," they are completely ignoring the fine print every investment manager repeats constantly: Past performance is not indicative of future results.

The Bet on the American Market and the Expansion of P/E Multiples

We must understand that the massive exposure of Israelis to the US market hurts the pockets of those with vested interests in Israel. There are fewer Shekels chasing their stocks. It is highly likely that we will see significant pressure and public discourse aimed at minimizing this exodus. Therefore, we are already seeing a rush to publish articles about how the strengthening Shekel has deeply hurt those who invested in the US, while completely ignoring the performance gap between the two markets (the S&P 500 has significantly outperformed the Tel Aviv 125 over the last 5 years). This performance gap is far more significant than a currency fluctuation over a month or two. Interestingly, there were no articles praising investors who diversified into the US when the Shekel crashed to 4-something against the Dollar. The Tel Aviv Stock Exchange has performed excellently over the last 5 years, as of this moment. You can decide whether that is justified or not, that's up to you.

The Pension Trap

The decision to invest in pension funds is a decades-long outlook. The choice of *Keren Hishtalmut* (advanced study funds), pension funds etc., often stems from trust issues, meaning, how much one trusts the insurance agent or the institutional body. I think this is a far more interesting topic than just currency matters. Earlier, I explained regarding risks that when someone invests in American companies, they are pegging their purchasing power to the US and taking a risk relative to their purchasing power in Israel. Another thing to take with a grain of salt regarding all pension and *Keren Hishtalmut* products is that most are not 100% invested in stocks even in the "Stock Track." The theme of the portfolio might have a nice name, but in practice, the composition is usually unrelated. What matters is how the portfolio is constructed and the percentages of each asset class. Many Israeli funds are also invested in bonds even though their title suggest 100% stock exposure.

Instead of allowing people to open an IRA (Individual Retirement Account) for personal management and invest the entire fund in a single index, which inherently creates diversification across over 100 businesses, regulators force people to invest in at least 10 different ETFs. And this is only if you have saved enough to qualify for self-management or deposited a large lump sum. On top of that, the company managing the fund can charge management fees for doing absolutely nothing. And God forbid one of those ETFs rises a bit more than the others; if the value of a single investment exceeds 10%, you are forced to sell. Meaning, the Israeli IRA mechanism encourages hyperactivity rather than passivity.

If you don't want to play this game via an IRA and use those companies providing portfolio management, you will find that the portfolio composition is very different from what you thought. (There is this guy, Micha Stocks, who talks about doing a service to the public by exposing this, kudos to him).

"Know what you own" - Peter Lynch

Why America? Quality vs. Valuation.

I believe people decided to invest in the US out of a belief in American businesses—that they are excellent—and because there is far more accessible information on US markets and companies. Beyond the high-quality Rule of Law and the protection of shareholder interests, there is the layer of business quality. Israel is not the only country whose citizens have increasingly invested in the US; this is a global phenomenon. From all over the world, people have allocated a higher percentage to the US. More money chased fewer companies, which pushed the prices of American businesses higher. Naturally, Price-to-Earnings (P/E) multiples expanded in the US. If you believe the businesses there are indeed better, then this expansion is justified. An investor looking for quality will want to invest where the businesses are of the highest quality. The whole world participated in this trade, not just Israelis.

The P/E Fallacy

To look at a bank in Israel and a bank in the US, and simply say "this one has a higher P/E so it's more expensive" demonstrates a lack of understanding. The P/E ratio reflects the market's opinion regarding the company and its future earnings.

- If a company suddenly invests a very high percentage of its profits in something that will significantly increase future earnings (which increases expenses in the short term and lowers current profits), the P/E might skyrocket, but for a reason that could lead to massive future gains. The market might decide that even at such a high multiple, the price is actually cheap, buying more and pushing the stock price up. Meaning, the P/E will grow even further in the short term.
- Another example: During the COVID crash, Berkshire Hathaway had to report drops in their stock portfolio value as if they were losses (even though they didn't lose a single dollar realized). Although Berkshire's stock price was cut, Berkshire's reported earnings were cut much more, causing its P/E ratio to spike relatively. To Warren Buffett (and to me at the time), Berkshire's stock might have reflected a higher P/E, but it was cheap. The stock rose significantly from that point. Someone who didn't know Berkshire and only looked at P/E multiples wouldn't have understood the story.

Numbers without context are just numbers.

The way P/E multiples are "taught" in various investment courses, that you should look at businesses in the same sector and compare multiples to say what is expensive or cheap, is simplistic. Markets aren't stupid, although they sometimes get swept up in delusion. There is a reason why the price is what it is relative to earnings. You need to know the business to decipher whether the price is justified or wrong relative to *future* earnings.

Conviction vs. FOMO

The question for everyone is: Did they invest in the US because they think the businesses there are better, or because of FOMO and "influencer" posts? If it's the first reason, it's a smart decision. If it's the second, it could be problematic when the euphoria ends. If you invest there because "everyone is doing it," you are not investing—you are gambling. And if you don't know *why* you are investing, you won't know when to stop.

A worrying sign is what happened when the Shekel strengthened recently. Suddenly, people started panicking: *"I lost money," "Maybe I should sell," "Maybe the US market is a bubble."* People who invested because they had conviction that American businesses are superior wouldn't be confused by a change in the exchange rate for a few months. They would say, *"Fine, right now it's worth less in Shekels, but I believe in the businesses I hold."* Or alternatively, they took this risk into account when deciding to invest in a different market with a different currency. People who invested out of FOMO immediately start doubting their decision.

The same applies to tariffs. One who invests in excellent companies is confident that the ship they invested in will sail better than the competitors in any ocean, and in a management team that will navigate the ship better through any storm.

Establishing Startups in the US and the Boom in the Gulf: Warning Lights for the "Startup Nation"

There are many excellent reasons why entrepreneurs prefer to establish their businesses in the US. It begins with massive tax benefits (such as tax exemptions on the first profits, up to \$20 million, if I recall correctly, when realizing startup shares under certain conditions), and continues with the fact that the world's largest venture capital funds are based there. In Israel, everyone celebrated the taxes the state would collect from the Wiz and Google deal, only to discover in hindsight that the amount remaining in Israel might be significantly smaller than expected. The state counts on taxing Intellectual Property (IP), something Wiz would likely aim to prove belongs to the US entity. At the end of the day, for investors and entrepreneurs, it is a "headache" to invest in a country with more regulation, fewer resources, and constant geopolitical problems.

The Rise of the Gulf

Simultaneously, a reverse movement is evident in the Persian/Arabian Gulf. Massive resources are being invested specifically in the UAE and Saudi Arabia. These countries are gaining increasing access to the best technology the US has to offer and are becoming destinations with a long-term positive narrative. In contrast, Israel feels like a rollercoaster between good and bad, between euphoria and war. We are also witnessing more and more funds deciding not to invest in Israel at all due to political reasons (the investment fund of Quebec, CDPQ, is just one example).

Meanwhile, the Gulf states are moving in the exact opposite direction. They are investing billions of dollars to import talent. Dubai has become the financial hub of the Middle East. Saudi Arabia is building futuristic cities and inviting the most advanced technology in the world. The Emirates offer insane tax conditions and minimal bureaucracy. Israel, which was supposed to be the "Startup Nation," is losing some of its prestige to countries that 20 years ago had no clue what technology was. Nations that were technologically in the dark are currently attracting a massive amount of global attention. A rational investor may look at this and asks a simple question: *Where will my money be safer? Where is there more stability? Where is there less political risk?* The answer may not be Israel.

The Triple Threat: Why the "Israeli Engineer" is No Longer an Insurance Policy

It is important to qualify: Money continues to flow into Israel, primarily into Cybersecurity, Chips, and Deep Tech. The narrative that Israeli engineers are a "Special Forces unit" still holds water. The Israeli engineer is creative and battle-tested. This story still exists, but it faces three existential threats that could change the picture:

1. **AI Arbitrage and Labor Costs:** The Israeli engineer is among the most expensive in the world (and if the Shekel strengthens further, they will become even more expensive). In the past, this premium was justified by the quality gap. However, the danger today is that in the medium term, an engineer in Eastern Europe or India, equipped with advanced AI tools, will be able to close this cost-benefit gap.
2. **The Junior Time Bomb:** Companies refuse to hire Juniors (inexperienced engineers) and want only ready-made "Talent." This creates a dangerous bottleneck. Since young engineers are not being trained today, in 5-10 years there will be a catastrophic shortage of Seniors and Team Leads. The industry is eating the seeds instead of planting them, which will lead to a severe shortage of quality manpower in the future.
3. **The Trust Crisis ("The Backdoor"):** Perhaps the most dangerous risk is the branding of Israeli Cyber. As Israel is perceived as a controversial or unstable political actor, foreign nations and mega-corporations are beginning to fear installing Israeli cyber products in the core of their infrastructure. The fear is twofold: fear of "backdoors" and espionage, or simply a desire to avoid a political "headache" and potential boycotts. If the "Made in Israel" label transforms from a badge of quality to a warning label, the central growth engine of the Israeli economy could stall.

The great question is what Israel is doing to reverse the trend. How can the state return to being a place with a positive and stable narrative? Without a change in direction, Israel may find itself in a reality where its brightest minds move to other countries, and its most successful companies are listed on foreign exchanges, with their connection to Israel remaining purely sentimental.

Foreign Debt Fundraising and Additional Tax Hikes in Israel

The state needs to raise increasing amounts of capital via debt and taxes to fund its growing expenditures, which were not part of the original plans—primarily defense spending. The entity funding this is the public. When individuals ask "Where is the state?" and why it does not assist them with a specific issue, the missing understanding is often that, by and large, the public is not sufficiently interested in the matter, and therefore the system does not address it. It is not that the topic is unimportant in the public discourse; it is simply not important enough to drive protesters to the streets as occurred regarding the Supreme Court, a subject that interested no one, until three years ago and became the center of attention. Meanwhile, protection racket cases across the country were closed due to "lack of public interest" (as seen in "Kan News" investigations). Consequently, instead of the system becoming efficient as required and tightening its belt even when the economy is excellent, it increases the deficit, with the primary goal of leaving existing expenditures untouched.

Today, the state is forced to manage expenses far larger than usual, and therefore must raise these funds. The first source is higher taxes. When the state raises taxes, it effectively eats from the economic pie instead of growing it. One must understand the mechanism wherein every shekel the state takes today as an additional tax is a shekel removed from private consumption and business sector investment. When the public has less disposable income in their wallets (due to VAT, income tax, etc.), it consumes fewer services and products, and businesses earn less; alternatively, the public reduces its savings rate and investments, which decreases the amount of capital available to financial markets. When businesses earn less money, the first thing they do is halt expansion plans, freeze hiring, and cut investments.

This is the domino effect of excess taxation; in the immediate term, it might close a "hole" in the current year's budget, but it stifles the growth engines of the coming year. Historically, massive tax collection occurs during economically prosperous periods, characterized by high capital gains realization, real estate profit-taking, rising salaries, etc. When this happens during a harder period, and the state actively raises taxes out of necessity, it is akin to a farmer eating his seeds in the winter because he is hungry—he might be full today, but he will have nothing to harvest and sell next summer. The result is an economy that contracts exactly when it needs to grow to repay debts.

Therefore, seemingly positive data in the short term must be viewed with caution. If the government deficit narrows, or grows at a slower pace than forecast, and this does not stem from organic growth of business activity but solely as a result of a heavier tax burden, this may prove to be a temporary illusion. The numbers in state reports will look better for a moment, but the economic foundation upon which they rest is eroding. This is the crucial part: the true effects of increasing the tax burden and eroding growth

engines are only seen in the medium term, after two or three years, not in the immediate term.

Here lies the problematic part: if growth slows (and as mentioned in the context of the tech sector, this is a possible scenario), the Israeli government may find itself in a trap: fewer taxes coming in, and more spending on unemployment and public support. One option would be to further increase the tax rate on the public. The second option is that the state will have to raise more and more debt. These debts are not taken to fund growth, but to fund the status quo or repair problems unrelated to national growth. Instead of investing in infrastructure, the state will need to replenish the IDF's ammunition stocks (a very important matter in itself, and some argue the budget should be increased further while simultaneously demanding much more Accountability, but it is important to understand this will come at the expense of other things). There is a current need to pay salaries for reservists, compensation for people whose homes were destroyed by missiles, and the rehabilitation of entire regions. Massive capital must be invested just to return to the same starting point. Subsequently, every shekel that goes to service government debt is a shekel that does not go to private investment that could generate real growth. It is like moving money from the right pocket to the left, only some of it disappears along the way.

Adding to this the fact that the most talented young people (those expected to bear the future tax burden) can simply leave and move abroad when taxes become unbearable, or when the quality of life in the public sphere declines (due to overcrowding and lack of infrastructure investment), creates a recipe for a potentially severe problem. Ultimately, someone must pay the bill, and the question is whether there will be anyone willing to do so when the time comes.

The massive expenses due to the war with Hamas in Gaza, Hizballah in Lebanon, the short war with Iran, and the fact that it could easily flare up again in the future, alongside Israel's other security dangers (such as Turkey and Egypt), force the state to utilize many resources for these issues, and not necessarily for things felt by the public in day-to-day life. Although the citizen does not feel the missile *not* fired at them due to the new "deterrence," they will unequivocally feel the heavier tax burden and the decline in the quality of life in the public sphere (e.g., traffic jams), because this money was not invested in infrastructure, or worse, was invested in causes that do not generate growth but encourage non-productivity.

The Impact of Tariffs and Supply Chain Shifts on Global Wealth

First, it must be understood that the implication of tariffs for the entire world is inherently anti-growth. There are several additional points that are crucial to understand in this context:

A. After countless economic experiments, the world realized that the capitalist economic system is the only one that works. A sharp, albeit incomplete, transition lifted hundreds of millions of Chinese from absolute poverty to the global upper-middle class. A slight shift in this trend toward an anti-capitalist direction crashed part of their economy and prevents many sectors from taking off. Democracy usually comes hand-in-hand with capitalism because the freedom to choose the head of state goes together with the ability to choose what to purchase.

“No one pretends that democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst form of government except all those other forms that have been tried” - Winston Churchill

B. Higher taxation generally leads to lower growth.

C. As a population becomes wealthier, wealth disparities widen.

D. Historically, once these gaps become too large, political upheavals occur.

E. Therefore, a crucial element in a capitalist economy is the *Redistribution* of that wealth by the government for the public good. When the government goes too far in taking wealth from those who create it... it stifles growth. Conversely, when it prioritizes specific tycoons too much, it leads to problems. The stronger a country is globally, the more forgiving reality tends to be.

Bearing these points in mind, let's look ahead: We are regressing to an old political thesis, returning to a more Mercantilist economy. In this view, exports are examined as a super-important economic factor, and the amount of "gold" in a nation's central banks is seen as something of intrinsic value. (*Milton Friedman Speaks: Free Trade: Producer vs. Consumer* <https://www.youtube.com/watch?v=qJCeoFxrDn0>)

In every country, there is a struggle between the consumer and the producer. This struggle is currently undergoing change in different nations in various aspects. COVID-19, which demonstrated how fragile supply chains are, and the realization that war might arrive, created a reality where every country is auditing what it consumes and modifying its supply chains and production.

We could discuss the pros and cons, but let's jump to what this means for investors and consumers:

1. The Cost of Goods - First, it means products are going to get even more expensive. The modern economy is based more on services than goods, so the impact won't be as massive as it might have been years ago. Generally, this is a tax similar to VAT—meaning, a regressive tax. Relatively speaking, tariffs in the US will hurt the poor more. For companies like American Express (of which I am a shareholder, though I have other concerns about it), which generally address wealthier clients and the service economy, the impact will likely be felt less relatively. This trend will be strongly felt in businesses dealing with raw materials. In the construction world, we will likely see upward pressure on construction prices.

2. Border Closures and Construction - a trend the world is moving toward (US-Mexico, Israel-Palestinians), combined with rising raw material costs, will lead to price increases for renovations and construction in general, but on the other hand, will reduce demand. Before people in Israel say this is another reason real estate prices will rise, I return to a few important points:

There is a limit to purchasing power. The public must be able to pay. If construction costs skyrocket to a level where the final price is impossible for the consumer, the business won't sell, and the project will stop. The market cannot defeat the mathematics of the paycheck. In such cases, either the sector enters stagnation (Stagflation), or the government intervenes with massive subsidies at the taxpayer's expense. The combination of interest rate cuts or QE (Quantitative Easing) at the moment a structural change increases costs often allows businesses to roll costs onto consumers, starting inflation. This is the main reason why, in my opinion, with Trump's tariffs in the US, as long as the Fed doesn't pump excessive money into the system, real inflation won't happen.

3. The Labor Market Crisis - Furthermore, for contractors anywhere, even if there are customers, if there are no workers, there is no product. If a contractor can't find workers to build, the building won't be built. One needs to sit and think about how this global change will affect the businesses and economy in which we are invested.

Another critical point is the labor market. Just as restaurateurs couldn't find staff after COVID, the construction sector in Israel lost its main supply of labor Palestinian workers (who prefer to work for Israelis since pay is higher and conditions are better). We might find ourselves in a paradoxical situation: On one hand, high demand for supply. On the other, a severe shortage of working hands and soaring material costs. The result? Israeli workers entering the sector will demand (rightfully) much higher salaries, making the final product even more expensive. This is a recipe for immense political pressure on the state to subsidize housing because the market's "Invisible Hand" will struggle to find an equilibrium that enough of the public can afford.

The situation before us is a multi-dimensional puzzle. The transition from an efficient global economy to a nationalist and fragmented economy creates friction, inflation, and challenges we are only beginning to understand. It is a world where politics dictates economics, not the other way around.

Chapter 10 – Cash Flow. Returning to Values, and What People Fight For. In every business, the question of culture is the question of *how* it is going to execute what is required of it

The Russian invasion of Ukraine woke the Western world up to the possibilities of hot war. It placed Europeans on the front line with Russia, Israel managing the campaign against Iran, and the US facing China regarding Taiwan. The fact that Trump leads the "America First" agenda and forces Europeans to fend for themselves, combined with the idea nesting in European minds that Russia might invade additional countries after Ukraine, is leading to an armament trend in Europe.

Europeans are forced to start playing a double game, as happens in the US: on one hand, displaying help for the weak, and on the other, taking what they need. This creates a dual situation where countries both condemn Israel and purchase military equipment from it. Notice that a large portion of the countries that are most vocal against Israel, for example, Ireland and Spain, are those geographically furthest from Russia. At the same time, there is a culture of ancient Catholic Christianity there that inherited deep antisemitism (including Slovenia, which of the Balkan states is furthest from Russia and has a rather dark history with Jews, which is why they barely lived there throughout history).

Israel must understand that while the European wallet has indeed opened, and this is certainly an opportunity, these days we see articles almost every week about massive growth in Israeli defense exports, the money being poured out also constitutes a strategic threat in the long term, because Europe wants this directed at self-production as well. In the medium term, this money will sprout new European defense companies and strong competitors that will rise in Germany, France, and even Eastern Europe. Israel has enjoyed a technological advantage and operational experience so far, but if it provides European politicians with too many reasons to hate it, it might discover that they will use this money to develop alternatives and disconnect from dependence on Israeli technology. Israel's challenge is twofold: not to provide excuses for boycotting the country, and simultaneously, to always remain one step ahead of the competitors in terms of capabilities.

The State of Israel: Why Does It Exist? (The Core Value)

The most important thing for any business that wants to be **Built to Last** is defining its "Why." For the State of Israel, the supreme goal is simple, brutal, and sacred: to keep its citizens from dying. If one distills the Israeli essence, the core value is the sanctity of life and survival. With all due respect to the non-Jewish citizens (Muslims, Druze, Christians, etc., who are an inseparable part of the Israeli fabric), the historical motivation for the establishment of the Israeli state was the Jewish tragedy. Jews arrived to Israel out of a painful understanding that they do not have the privilege of relying on any foreign entity to protect them. History taught the Jewish people a lesson written in blood. This creates a crisis of trust with local populations as well. On one hand, Jews are loyal to the state as long as it does not harm them above a certain threshold. On the other hand, the non-Jewish locals ask themselves an important question: *Where does your loyalty lie?* Because if you are willing to get up and leave for another land if things get bad here (especially since you pray for it and speak about it every Friday and Saturday), then how can we trust you to fight for this country at any cost? This is the most common argument against Jews. Therefore, in many cases, to try and belong, some Jews show how they not only do not support the State of Israel and its policies but actually oppose it. They oppose Israel not because they feel they belong to their current place of residence, but the opposite, subconsciously, they do not feel they belong, and in an attempt to integrate, they become extreme in their opinions against Israel and use their Jewish identity as a tool to pretend that they are objective, although no Jew can ever be objective about Israel.

Naturally, it makes sense that a minority that has experienced persecution would be suspicious of its environment, especially if there is a racist history against it. My friend, a Black man of American origin, once told me how he views white people:

"I know what you are thinking, but I will give you the benefit of the doubt." — Naf We shared experiences where we both faced racism. I was attacked several times (with hot and cold weapons) in foreign countries when it was discovered I was Israeli or Jewish. He spoke about his experiences where racism suddenly surfaced in situations. This sentence of his distills the Jewish and Israeli experience. Even when Israel extends a hand for peace, in the back of the mind, the suspicion—the memory of persecution—always exists. Israelis who have been attacked abroad solely because of their origin know this feeling well. Racism and hatred erupt at unexpected moments, and this understanding is fuel for Israeli existence. The minority not being sure about the majority, is why some times African Americans see some American problems as the white peoples' problems. This was a claim against the war in Vietnam.

Jews, wherever they were, understood that the Messiah was not coming, so they decided to return to the Land of Israel alone. And the State of Israel is the global Ghetto for Jews, only for the first time in history, on the walls of the Ghetto, the weapons are

pointed outward (to keep enemies out) rather than inward (to keep Jews in). Therefore, the Zionist idea, before the rebuilding of the land and the existence of Jewish/Hebrew life, is fundamentally the very ability of Jews to survive, and that their survival depends on themselves and not on an external factor. This is what makes Israel sometimes a complicated ally for the USA, because at the end of the day, Israel's security and defense organizations will do what they think is necessary for the security of Israel. Israel too, like any country has racists. The majority of the Jewish racists who might say "Death to Arabs," usually emphasize their Jewishness (because, after all, what distinguishes them from an Israeli Arab is first and foremost religion). These people forget that:

"You were a stranger in a foreign land" (Exodus 2:22)

And the Torah repeats again and again the idea that one must care for:

"The stranger, the orphan, and the widow" (Deuteronomy 24)

While the citizens of the Land of Israel are not "strangers" because they are citizens of the land, the interpretation is to care for immigrants and minorities as well. And that is the reason why murder cases in the Arab sector, in my humble opinion, are a religious problem for Jews (from the Torah), and a severe violation of the supreme value of the State of Israel: The Value of Life.

The difference between the value of life as a supreme value compared to other nations is vast. If you listen to military generals (and not journalists and "intellectuals"), professionals of war, they will always go into detail how the IDF does more than anyone else to minimize unnecessary casualties. Other Nations bring different set of values to their actions. Countries that have a supreme value have a clear direction for what they are aiming for. Americans have a compass noted in the *Star-Spangled Banner*:

"Land of the free, home of the brave"

The supreme value for Americans is Freedom, and they know that fighting for freedom takes courage.

"Freedom isn't free"

The value of freedom is what leads them. Sometimes for better and sometimes for worse. This is a source of criticism sometimes against the USA, for trying to bring democracy everywhere. The reason the American Constitution allows bearing arms is the idea that if a dictator takes over the country using the army, the people can organize against him. The supreme value of religious states, like Iran, is the Islamization of the world. Of North Korea, the preservation of the regime, etc. For us, it is the Value of Life, and therefore the issue of security is above all.

Jews who are religious people can maintain a religious affinity in the Diaspora and claim they are waiting for the Messiah, something that connects with the Christian Evangelical religious narrative. For a religious person, religion is the supreme value. The problem today that the Jewish population in the Diaspora finds is in the secular arena. Jews in the Diaspora today do not know whether they are Jews ethnically or religiously. There is

a distinct difficulty in explaining that they are "indigenous people to an indigenous land that is Israel." In the US, they have a distinct difficulty explaining to their peers on the Left in "woke" language that Eastern Persian and Iraqi colonialists, and Western Roman colonialists, exiled them and some returned to a land stolen from them. And since there is no such thing as illegal immigration (for progressives), the immigration of Jews back to the Land of Israel and settling in it is also legal. They have difficulty explaining to the Right that a large part of Jewish immigrants to Israel view this as the fulfillment of a secular *Manifest Destiny*, aiming to bring democratic values and a distinct American interest to the Land of Israel, while those living in the US view themselves as Americans in every respect and feel no Israeli belonging whatsoever (today, the vast majority of secular Jews have a loose connection to Israel if at all).

A person must decide for themselves what their supreme value is and let that be their compass, all the more so when it comes to a state or any organization. This concept, placing a "Core Value" at the center, is not an abstract philosophical invention I made up, but an iron principle in strategic management researched in depth in the seminal book *Built to Last* by Jim Collins and Jerry Porras. The book, which researched companies that managed to survive and thrive for decades compared to competitors that disappeared, reached a unequivocal conclusion. They coined the term Visionary Companies and claimed that companies that zealously preserve a "Core Ideology" that never changes, while simultaneously encouraging progress and change in all other areas, are the ones that succeed. The supreme value is the roots and trunk of the tree. The most distinct example of applying this principle consciously is Amazon under Jeff Bezos. After the Dot-com bubble burst in the early 2000s, Amazon's stock crashed. Wall Street commentators laughed at the company, calling it "Amazon.bomb." The pressure from investors to change direction to generate quick profits was immense. In those critical days, Bezos invited Jim Collins to the company headquarters for in-depth discussions. The insight extracted from those meetings was clear: instead of being scared by the stock price or trying to please the market in the short term, Amazon must cling to its supreme value with almost fanatical extremism. For Amazon, the value Bezos chose was Customer Obsession, "Earth's most customer-centric company". Bezos decided to ignore the background noise and focus solely on building the mechanism that would serve the customer in the best way (low prices, fast deliveries), knowing clearly that if he is "Built to Last" around this value, the financial results will come. Inspired by the conclusions of *Good to Great* (also by Collins), Bezos illustrated Amazon's famous "Flywheel." In exactly the same way, the State of Israel must treat the value of "Sanctity of Life" and survival as Amazon treats the customer: this is the only compass not subject to negotiation, and every strategic, political, or military decision must be derived solely from it, even when there is background noise and outside pressure. The direct meaning is this: even if the enemy holds a body, if the price of

returning the body is releasing terrorists that could lead to the death of a single additional Israeli, as important as returning the dead for burial is, it is less important than keeping people alive and healthy.

Security and the Israeli Economy

Safety and security are expenses that exist in every business, and their sole role is to maintain the organization's ongoing function and prevent collapse. Just as many businesses have insurance against fire, cybersecurity expenses, security guards, or safes, so does the state. The fundamental difference is that the state has no external insurance company, and therefore is required to prevent threats itself and insure itself. It pays this premium on an ongoing basis through the defense budget, with the money raised from the people who work for it—who are simultaneously its customers, its shareholders, and its source of revenue via taxes (meaning the customers and shareholders are the citizens).

It is crucial to understand the critical distinction between types of expenses: security expenses are not "productivity" expenses and do not generate development out of thin air. Part of the state budget, such as education, culture, sports, and infrastructure, is intended to develop the state and grow the future pie. Welfare and aid for young people and at-risk youth are also investments intended to move populations from a supported sector to a productive sector in the future. In contrast, health, police, and social security are intended to preserve existing productivity through order and peace of mind; a person whose parents are healthy or who has safety in the street is more free to work and create. The general security of the state maintains order from the outside; this is existential preservation work. A state that is not attacked from the outside but collapses from within will not develop, but on the other hand, the most productive state will not exist if its citizens are murdered without response. Therefore, security services are an essential service, but they do not increase the budget. Anyone who claims that defense exports are a growth engine confuses a byproduct with the primary goal. Increasing the share of defense in the budget must come at the expense of other things, just like a business company forced to cut its Research and Development (R&D) budget to fund defense against cyberattacks. When resources are diverted from productivity to defense, growth will necessarily not be maximal. In the current reality, revenues from defense exports do not come close to recouping the money for the state's defense expenditures.

The Israeli economy, similar to the American one, is a consumption-based economy. This is the reason why, even under prolonged war, the economy did not collapse immediately, as people continued to spend money. Paying salaries to reservists serves as a temporary solution to prevent a crisis, as long as consumption continues, but the problem arises when the situation persists over time. Here the Israeli paradox is

revealed: Israel is a state created to survive and its survival is constantly threatened, yet it conducted itself as if it were a normal and stable Western country. The fact that the 2008 financial crisis skipped over Israel, and the prosperity of the tech industry in the last 15 years, strengthened the illusion of normality and caused people to forget the fact that this is a "Villa in the Jungle" requiring expensive maintenance.

To understand the issue of reserves and conscription in depth, one must look at it through the lens of **opportunity cost**. The State of Israel made a historical decision that it is willing to lose the economic output of young people aged 18-21. From a pure economic perspective, drafting an 18-year-old boy to the army is the most profitable move for the state. His cost to the system is low (accommodation, food, pocket money), and the tax the state "loses" from him not working is negligible, since without training or experience he would earn minimum wage. In contrast, calling up reserves is a heavy economic burden. A reservist is usually a working and experienced person, and the state is forced to pay him a high salary and absorb the loss of taxes and product he would have generated for the economy. The economic equation is cruel but clear: drafting a Haredi or a conscientious objector aged 18 for regular service is many times cheaper than drafting 12 reservists for a month a year. Three years of regular service are the rational balance point between the minimal cost to the state and the operational benefit, while over-reliance on reserves erodes the economy's engine.

The State of Israel made a decision that it is willing to lose the output of its army servers and national service volunteers at the taxation level for their years of service in uniform or in whatever roles. For many of these, it takes another year or two to get back on track. They work in odd jobs, travel, sit at home trying to figure out what to do next. For some, it takes time to recalibrate back. The state does something that pays off for it; it takes a labor force that will likely be cheap (because if they worked without education or training, the tax receipt from them would be low anyway) and on the other hand employs them in a business where they can already start working. I always explain to everyone that the thing military service as a combat soldier in regular service gives, is that the fighter will never work harder, and will never receive a lower return for his work. Therefore, taking an 18-year-old to the army is the most economically profitable thing for the state to do. Because the money it "loses" from taxation is a relatively low sum, and his costs are low. This is the reason why drafting a Haredi (ultra orthodox) or a conscientious objector aged 18 compared to 12 reservists (all giving a month) is first and foremost a financially profitable move. Three years of service for a combat soldier is supposed to be (although there are things chosen arbitrarily and they work) the number arrived at rationally as the ideal balance between generating possible taxes from the serving person and the benefit that can be derived from him. The state pays for training, provides housing, food, medical services, and pocket money. The state somehow holds the citizens in that beyond a certain amount of time they might rebel (there are draft dodgers and plenty of people trying to get out of the army anyway).

The Illusion of Defense Exports and the Budget Black Hole

To understand the economic limitations of the defense establishment, one must dive into the bottom line of the financial reports. Personnel costs in defense organizations are among the highest in the economy, and that is before factoring in the astronomical costs of Research and Development (R&D), field testing, and human capital training. The state, in an attempt to recoup some of this massive investment, turns to exporting these capabilities. But here lies an economic trap: most defense products—interceptors, tanks, advanced munitions—are "hardware" solutions requiring expensive physical materials, complex production lines, and heavy logistics. Unlike a software company (SaaS) in the private sector, where the marginal cost of producing an additional copy of the software strives for zero and the Profit Margin is huge, in the defense industry, every additional unit costs a fortune to produce. Profitability, by definition, is lower.

Moreover, the state is very limited in its ability to monetize these developments. It cannot sell to the highest bidder for fear of technology leaking to hostile nations or disrupting geopolitical balances. An unnatural situation is created where the government pours its best money into places that are not its most profitable business model, but rather into places necessary for its existence. Of course, Israel does not live in a vacuum but in one of the toughest and most violent neighborhoods in the world, and this investment is a threshold condition for physical life in the country.

However, the critical point is this: One cannot count on the defense industry to be the locomotive that leads Israel's economic growth or the rise in quality of life, as is expected from civilian sectors like high-tech or advanced manufacturing. The numbers simply do not add up. The defense industry does not have the mathematical ability to return to the state the funds required to maintain the army and other ongoing defense expenditures. If exports covered the expenses, the deficit and the defense budget would not be such a painful topic of public discussion.

As noted, this is a "short blanket" equation. As defense expenditures take up a larger slice of the government pie, they necessarily come at the expense of civilian growth engines: education, infrastructure, academic research, health, and culture. Every shekel that goes to iron is subtracted from the public's mental and social resilience. This situation requires the Israeli public to make a hard decision, one that the political and social system has so far avoided discussing courageously: Is the public willing to pay in the "currency" of a decline in quality of life in exchange for added security? Assuming the economy returns to pre-October 7th output levels, is the citizen willing to pay permanently higher taxes to fund higher-quality security?

The managerial challenge intensifies even more when examining the system's organizational structure. The IDF, alongside government defense companies, often operates as a "Black Box." Unlike a business exposed to shareholder scrutiny and

financial transparency, these bodies enjoy a veil of secrecy that makes efficient management and true control difficult. Inside the IDF specifically, there is tremendous waste of resources, often stemming from a shocking lack of professionalism in logistics and budget management levels, and an organizational culture that does not reward saving. Vast sums are poured in without measuring output vs. return (ROI), projects are managed inefficiently, and valuable manpower is squandered. The inability of the political echelon and the Ministry of Finance to "open the lid" of this box and see where every shekel truly goes makes any attempt at efficiency an almost impossible task. The only alternative to strangling tax hikes is aggressive efficiency and breaking the Black Box. The structural problem in Israel is chronic avoidance of cutting the "fat" and sectors that do not contribute to productivity. A distinct and painful example is the budgets for Yeshiva students, and Yeshivas. There is a certain blindness, even among Right-wing and Likud voters, regarding the deep and long-term macro-economic consequences of funding non-work. When the state funds a lifestyle that does not produce growth, it shrinks the sources available for security and welfare. Beyond cuts, an uncompromising public demand for Accountability and a higher level of professionalism in the public sector and the IDF is required. The public must demand a better return on its tax money and ensure that every shekel invested in defense or civilian needs yields the maximum result, rather than being swallowed up by bloated, wasteful, and opaque bureaucratic mechanisms.

The Unfathomable Cost of Reserve Duty (And Why Everyone Ignores It)

The true economic cost of the reserve array is almost unfathomable in scope, which is exactly why the system prefers to ignore it and focus only on "direct costs." When analyzing defense spending through the lens of the workforce, one discovers that the state is committing a sort of double economic self-inflicted wound. When a software engineer, doctor, entrepreneur, or project manager is plucked from their place and drafted for a prolonged period, the damage is two-way. On one hand, the state dramatically increases its expenses by being required to pay their salary, equip, and sustain them. On the other hand, it inflicts upon itself a massive loss of revenue. It loses not only the direct taxes it would have collected on their current work during those months, but also—and this is the critical part—the future taxes that would have been

derived from the "excess growth" that employee would have generated had their work not been interrupted.

To understand the depth of this hole, one must understand how a business or a creative mind works. A business is not a linear factory that can be switched off and on like a light switch; it is more like a snowball on a slope or a heavy freight train. It is built on momentum. When this momentum is cut off at once, the impact is not limited only to the time of absence but echoes long into the future. Anyone engaged in complex cognitive work—writing code, strategy, or creation—knows the difficulty of getting back into the "Zone" even after a short vacation of a few days. Time is needed to reload the context, understand where we were, and get back into the rhythm. In the case of reserve duty, we are not talking about days, but a disconnect of weeks and months, and the return is not from a vacation in the Caribbean but from a battlefield.

This "hidden cost" consists of three timeframes that do not appear in the Treasury's reports: the time *before*, the time *during*, and the time *after*. Even before the draft, the moment the order arrives, output plummets. The head is no longer at work, but on home logistics, anxiety, parting from children, and uncertainty. During the service itself, the disconnect is absolute. But the heaviest price is paid in the "after"—the recovery period and return to routine. A reservist returning home is a person who needs to mend the tears, both in the business that stalled and in the psyche that cracked. He returns physically, but mentally he is often still torn between the sights he saw and the demands of clients, wife, and children. The abysmal fear of "what will happen next time," and the accumulated burnout, create a systemic "delay." Projects are not just postponed; they lose their relevance. Innovation is suffocated.

This is a point that is hard to discuss coolly, but economic analysis demands it: the mental price is a macroeconomic factor. Trauma, anxiety, and in the most tragic cases, the suicides of heroes who could not bear the burden, are not only a terrible human tragedy but a loss of precious human capital. The economy loses its best sons, literally, both physically and functionally. A person suffering from untreated PTSD is a person whose productivity is damaged for years to come, and sometimes cut off completely—whether through loss of work capacity or, in extreme cases, suicide. Therefore, it is important to clarify sharply: even those who did not wear a uniform, and those who did not experience the war firsthand, will pay this price. The invoice for the loss of momentum, the collapse of businesses, and the treatment of mental health casualties will be submitted to every citizen in Israel. It will meet everyone without exception, in a decline in quality of life, in collapsing public services, and in a shrinking pocket resulting from taxes meant to fund this hole.

“When somebody congratulates Amazon on a good quarter, I say thank you. But what I'm thinking to myself is—Those quarterly results were fully baked three years ago. So today I'm working on a quarter that will happen in 2020, not next quarter. Next quarter is done already and it's probably been done for a couple years.” — Jeff Bezos

This quote by Bezos captures what I feel no one in Israel wants to discuss. When everyone celebrates the exits or capital raises of the past year, they miss that this is, in many cases, the result of actions taken several years prior. What worries me personally is when the future period arrives—where the entrepreneurial moves that were supposed to happen in a parallel reality during these war years did not happen—the results of those actions will be absent from this reality. What will remain is a vacuum. Meaning, a plunge or slowdown in fundraising, exits, and the founding of startups. In other terms, a drop in growth.

How the Government Tries to Fill the Void (And Why It Works, Economically, For Now)

The government has performed an act of no-choice: a massive and ongoing reserve call-up. The immediate economic meaning is a surge in expenses (which are horrifyingly expensive) alongside a plunge in revenues. To understand this dynamic, let's return to two things we mentioned:

1. **Labor Substitution:** The State of Israel has replaced a workforce engaged in *advancement* (development, high-tech, manufacturing) with a workforce engaged in *preservation* (guarding, fighting). A preservation workforce does not generate tax revenue.
2. **Non-Productive Spending:** The state increased spending not in areas yielding growth (like infrastructure or education), but in salary payments, ammunition, and consumable equipment. The money is "burned" in the economic sense.

Solution One: Taxes

The government was forced to deploy the tool most hated by politicians—raising taxes. No elected official wants to reach into the voter's pocket, but the math defeated the politics. To fund the expenses, the state must increase its share of collection from the citizen. This move has two immediate macroeconomic implications:

1. **Erosion of Purchasing Power:** When tax rises, disposable income falls. The public is forced to make a hard decision: cut expenses (which leads to economic slowdown and even deflation, as seen in China), or "eat" into savings to maintain the standard of living. The Israeli public, which is in no rush to lower its quality of life, tends toward the second option. The result is that the percentage of savings and investment—those supposed to generate future growth—drops, while inflation remains sticky because demand does not stop.
2. **The Inflationary Vicious Cycle:** When the government injects money into the economy that it didn't have (through printing or deficit), it increases the money supply.

"Inflation is always and everywhere a monetary phenomenon," — Milton Friedman.
More money chasing the same amount of goods equals inflation.

The combination of these two factors generates inflation in the near term during the war, and the moment the flow of government funds ends with the war's conclusion, deflation will be created. Because a lot of money was injected into a system that produces less more money that is less invested (because it doesn't generate future growth) and goes toward consumption. When the money stream stops, the funds sucked out by higher taxes, and the money is withdrawn from the system at a higher rate during the same time that the growth which wasn't created starts to show evidence, this creates another hole. It will be the role of the government and the Bank of Israel to know how to limit inflation and prevent deflation.

Solution Two: Raising Debt

Since taxes alone cannot cover the hole, the government turns to the capital market to raise debt. Here, interest rates enter the picture. When the state raises enormous sums, it naturally pushes interest rates upward (demand for money raises its price). In a normal situation of slowdown, a central bank lowers interest rates to encourage growth. But right now, due to inflationary pressure, the Bank of Israel is handcuffed. The high interest rate rolls directly onto households: most mortgages in Israel are linked in whole or in part to the Prime rate. When the state pays more on its debt, an Israeli family pays more on its apartment, which further reduces the ability to save and invest.

The Barometer of Credibility: Credit Rating

The government tries to walk between the raindrops: to find the delicate balance point between raising taxes (which strangles growth) and raising debt (which makes interest expensive). The hope is to keep both as low as possible. Here credit rating enters the picture. This is the barometer by which objective external bodies assess the borrower's credibility. A high rating equals low risk and cheap interest. A low rating tells investors: "There is risk here, demand a premium." The rating downgrades Israel is experiencing are not just grades on a report card; they are price tags. Every downgrade means the state will pay billions more just on interest—money thrown into the trash instead of going to security or education. Historically, rating agencies are not good at true credit assessment, but they are considered the accepted standard.

Borrowing against the Future: The Two Big Problems

The current situation creates two structural problems that will meet the State of Israel in the near and distant future:

1. **The Debt Repayment Burden:** Like a family that took a huge loan for a cosmetic renovation that yields no income, the state will have to pay back the money. Future interest payments will bite into the state budget and prevent investments in real growth engines. Instead of investing in technological education (which will produce the next engineers), we will pay interest on bonds sold in 2024. This is similar in concept to a family forced to renovate instead of paying for private tutors for their children. Education is something a state hopes will generate

growth; that is why parents today pay money for children to learn to code, because they hope they will be placed in high-tech companies.

2. The Glass Ceiling of Growth: Raising taxes reduces the incentive to work and create, which slows down the pace of growth. If the economy does not grow at a faster pace than the debt growth rate, the state will require an ever-growing slice of the pie just to service its debts. This is a recipe for Stagnation.

A Note on the American Privilege

It is important to be careful with comparisons to the US. Americans also deal with their infamous Deficit, and politically refuse to take the necessary steps (cutting expenses and raising taxes). But Americans have a privilege no one else has: they are the greatest empire in the world, and the dollar is the global reserve currency. They can afford fiscal irresponsibility for a long period because of their economic and military might. Israel, a small country surrounded by enemies and subject to existential risk, does not have this safety cushion. The market will not forgive Israel as it forgives America.

The Race Against The Clock

Now we arrive at the most critical component in the equation, which many tend to ignore: the time component. As the current security and economic situation continues longer, the Israeli economy not only loses the current output of reservists but erodes its future potential. Time acts here as negative compound interest. We have already analyzed the structural problem of lost workdays, but along the timeline, additional destructive side effects develop:

1. The Illusion of Wealth and the Inflationary Sin. Money is currently flowing into the economy for preservation purposes, not growth. The Israeli government spent huge sums on salaries to reservists and evacuees, and many people—naturally and humanly—used this money to live "as usual" or even increase consumption as emotional compensation ("the urge to escape"). But economically, this is a trap. The public pours oil on the inflation bonfire without realizing they are sawing off the branch they sit on. This money arrives without the backing of real production. When government support ends (and it will end), those people will meet a harsh reality: layoffs (because employers won't be able to survive for long with empty positions or inefficiency), skyrocketed cost of living, and eroded savings. The government, instead of encouraging saving and investment, actually "forces" or incentivizes people to spend through designated grants and funds that replace labor income. The result: upward inflationary pressure, which prevents the Bank of Israel from lowering interest rates and forces the public to pay dearly on its debts. And if we add just one thing about designated grants—in many cases, these grants are limited to crony businesses.

2. The Silent Boycott and the Costs of Isolation As time passes, external pressure will trickle down to the Israeli citizen's pocket. Damage to trade with countries that have turned hostile (Turkey) or silent sanctions from the European Union make imports more expensive and hurt exports. Over time, the equation might shift so that Israel as a collective brings in less foreign currency and spends more on every product. The economy will become poorer over time.

3. The Test of Entrepreneurship and Productivity Israel is on borrowed time, and it depends on two main factors that will determine if the economy climbs out of the mud or sinks in it:

- **Entrepreneurship:** The ability of Israeli entrepreneurs to establish new businesses that fulfill a real need, domestically and abroad, and create new growth engines out of nothing.
- **Productivity:** The ability of the average Israeli worker to be "worth the money," to produce high value that justifies their employment, whether in an Israeli company or as a global freelancer.

The Government Failure: Preferring Cronies over Producers

Here we encounter the toughest structural problem of Israeli governments for generations: the state is built in a way that does not encourage entrepreneurship or reward hard work. The tax system in Israel is very regressive (heavy VAT burden, high taxation on productive labor), and does not reward the productive middle class that bears the burden. The opposite is true: the system is built so that the edges—the wealthy tycoons on one side, and populations that do not participate in the workforce on the other—benefit relatively much more than the middle, productive layer upon whose survival the entire State of Israel depends. If Israel does not change direction and start aggressively rewarding entrepreneurship, investment, and productive labor—at the expense of preserving monopolies and supporting non-work—this race against time is lost in advance.

Israel's High-Tech Problem and the Artificial Intelligence Revolution

The country's primary lifeline is its high-tech industry. Whether it is Israeli companies exporting abroad or optimizing systems within Israel, or the public employed by international tech giants (such as Apple and Nvidia employees in Israel), the sector is vulnerable. Israeli companies face the risk of being boycotted, or alternatively, the risk that employers abroad will simply tire of having engineers who disappear on them. It is true that headlines were made regarding Nvidia's desire to open a research and development center and employ 5,000 workers. However, if this comes to fruition, it will take a long time. In the meantime, a negative turn in the American tech world could torpedo or further delay this. Additionally, if Trump's plan succeeds in the long run—by

making it substantially more economical to employ workers within the U.S. than outside of it, or if Israeli workers become too expensive relative to the benefit they provide—a deeper employment crisis could emerge in the tech industry.

In the meantime, Israel depends on what currently exists, which is under massive pressure because there is one thing AI models are very good at: writing code. In his book *Intellectuals and Society*, Thomas Sowell distinguishes between two types of people in the world: intellectuals (whose work is difficult to measure) versus those whose work is measurable (such as engineers). These AI models are particularly well-suited for those whose output can be measured, and less so for intellectuals (since models tend to hallucinate and invent things). This applies even more strongly to programming, where writing incorrect code can be detected quickly (especially for those working with the Test-Driven Development method; for those who want to understand this better, I recommend reading *Test-Driven Development: By Example* by Kent Beck). Today, this actually slows down those who know how to write code quickly (you have to wait for the model to finish the job), and often the autocomplete text does not guess well, or it takes more time to scroll and select than to simply type. However, if this revolution fully materializes, the models will continue to improve drastically. And as we have discussed, the companies with the deepest pockets in the world have a vested interest in this revolution becoming a reality. Programming could become a profession reserved only for those who are truly exceptional and highly productive, and a worker who disappears for two months a year is simply less productive (not to mention sick days, additional vacation days, and all the breaks workers take).

The State of Israel is extraordinarily dependent on a workforce that is frequently drafted for reserve duty. These are very high-quality people, but the reality is that foreign employers view their absence from work with unease. If there is already a global fear that AI models will replace jobs, in Israel this fear is intensified—not only due to automation but also due to the reduction in productivity associated with reserve duty. The bottom line is that while AI models improve non-stop, the Israeli worker is forced to contend with personal burdens, security uncertainty, and external limitations that lower their output relative to global competition—all while being forced to take significant breaks. The Israeli worker is therefore required to be more productive than they have ever been.

In other words, one must look at the cocktail currently brewing in the Israeli tech industry:

1) The Judicial Reform/Revolution This is an incarnation of the pro- and anti-Netanyahu demonstrations since 2018. The public's obsessive preoccupation with issues that didn't interest them at all a year prior, and the fact that people ran to the U.S. telling everyone that Israel was moments away from becoming North Korea—warning them not to invest here—needs to resonate in the background, because this is one reason people avoid investing in places.

Whether this is true or not, I lack sufficient legal knowledge to discuss the topic, so I refrain from expressing an opinion. Israel's massive problem is that too many people formed an opinion based on a few articles, or allowed their political views to influence their judgment. Israel's "Netanyahu problem" is identical to the "Trump problem" in the U.S.: one side refuses to acknowledge problematic character traits in their elected officials and their methods, while the other side refuses to acknowledge that sometimes Bibi is right, and that it is impossible for everything he or his government does to be driven by personal motives.

This entire story negatively affects how investments in Israel are viewed, because the "Rule of Law" is a recurring motif when investors look at international investments (and a fundamental reason why so many foreign investors invest in the U.S.). This unrest might spill over into the elections and the day after the next elections. Personally, that is what worries me—the day after the next elections.

I want this to resonate: This entire book discusses risks occurring in the background that may materialize after the budget is passed by the government elected in the 2026 elections. So the date we are actually looking at, where some shit may hit the fan, is only in 2027.

2) The Bursting of "The Everything Bubble" of 2021 The COVID era exacerbated the trend of people retraining to become programmers. When people don't choose a profession out of love to begin with, but do so for the "money" or lack of choice, they usually aren't people with a true and deep passion for the field. To reach a level above the average, in many cases, requires hard work plus talent. And it is very difficult to work hard at something you don't love and aren't drawn to in the first place.

Moreover, the simpler the work is, and the more replaceable it is with cheap labor in another country, the higher the probability that these jobs will move to a more economical region. This is one of the reasons why globalization is deflationary in terms of consumption, but exacerbates economic disparities in local communities. The situation during the bubble created a sweeping reality where the workforce in this sector is likely over-saturated. If this field shrinks further, or if the workforce becomes more expensive, it could cause a spike in the number of people losing their jobs. We are already seeing a decline in the number of Computer Science students. It is not certain that this workforce will find jobs with the same alternative income level.

3) The War From startups that don't open because the entrepreneurs are in reserve duty (this happened to me personally; I started working on something with a partner and it was torpedoed because he was plucked out for long months of reserve duty) and are busy surviving (growth that won't happen and its invisible loss), to jobs that will disappear the moment it becomes legal to fire employees, to corporate decisions to move work to another country, or not attempting to fill a vacated position.

All these, along with additional consequences, are going to drag down the scope of employment in this industry in Israel. For a long time now, people have struggled to find work in the industry unless they have significant experience. The main problem is that the experienced engineers and developers of a few years from now are supposed to be today's juniors, but the juniors are unable to find a job to gain that experience.

4) The "Junior Problem" Stemming from Israeli Culture

One could discuss the flaws in Israeli culture at length, but here it is crucial to address them in the specific context of "Juniors." This is the product of a nation that, in my opinion (and historically, long before the state was founded), tends to view the short term rather than the long horizon.

a. Life Pressure, Hedonism, and the Cost of Living – Risk Taking Today, it is harder to work for low wages in order to learn and evolve. The average Israeli enters the job market at a relatively older age and without experience. The race to "start life"—family, apartment, children—is very pronounced. This forces people at early career stages (but perhaps advanced life stages) to make decisions that require immediate income. Young people are at a stage where they feel the need to find partners and start their lives, or seek stability, leading to frequent outings to bars, parties, and restaurants. This is a moment where a real biological need exists, overriding the logical behavior that would actually suit this career stage: "Work extremely hard and save the majority of it."

Generally, the hedonistic culture, combined with the cost of living, adds immense pressure to bring in money *here and now*. Since the start of the war, the age of entry into the workforce has risen (longer service, reserve duty during studies, etc.), and the internal pressure to generate immediate utility is even more massive.

The first problem this creates is preventing "Juniors" from taking lower-paying jobs at "stable" places (to learn from experienced engineers) or working at a startup to gain diverse experience in a demanding environment that doesn't pay well. In the U.S., there is a strong culture of young people starting startups during or right after their bachelor's degree. While this culture exists in Israel, it is very common here for startups to be founded by "Seniors," rather than a young, inexperienced group whose very lack of experience allows them to break consensus, move fast, code all night, and sleep in the office. It isn't the age that hurts, but the surrounding obligations. The older you are, or the fuller your social life, the higher the obligations that eat into work time. Also, the fear of holding options that might be worth nothing, and the lack of transparency from entrepreneurs toward employees regarding stock options and funding rounds, exacerbate suspicions before joining such places. Starting such businesses is scary enough; external constraints make it terrifying.

Because Israelis enter the workforce late and are in a rush (relative to their peers abroad) to start a family, they arrive at this life stage with fewer savings and assets, but with higher expenses relative to their career stage (creating upward pressure on prices). This is especially true for startups requiring commitment, sacrifice, and financial risk.

The adults cannot take the risk because there are bills to pay and mouths to feed. The young enter the market with debts, pressures, and immediate demands. Thus, a situation is created where innovation risks being suffocated.

b. The Junior Barrier – The "Don't Be a Sucker" Culture Problem The pressure discussed above creates a reality where many switch jobs every two or three years, as it is a known fact: the best way to upgrade salary and conditions is to move to another workplace. This behavior scares managers away from hiring and training juniors, lest they flee immediately after the training period. This stems mainly from the desire not to be a "Sucker" (or *Freier* in Hebrew).

Job hopping is common in Silicon Valley too, but Americans and other nations have two massive advantages Israel cannot compete with (aside from Unit 8200 or draft dodging): entering the workforce young (allowing for lower wages), and the willingness to do unpaid internships or take huge risks as a startup with debt. (Worst case: go bankrupt at 24 and find a job with experience; best case: Airbnb. Anyone wanting the reference should learn how Airbnb started—it's common there, even if most fail).

Employers, for their part, fear investing in someone who won't stay. They want "receipts" (proven track record). The result: giving up on dozens of good candidates in advance. The entire economy pays a future price because there aren't enough Seniors to build the next generation. Nir Zuk of Palo Alto Networks warns of exactly this: Israel will simply run out of quality manpower. The focus only on current utility rather than long-term industrial benefit is a fundamental problem in Israeli culture. A culture of building exits, not winners. A culture of building unicorns, not dragons. Today's Juniors are tomorrow's Seniors. The candidate looking best on paper isn't always best in practice—only shoulder-to-shoulder work proves that.

The Israeli culture of "not being a sucker" leads to not training someone just so they can leave. The Israeli employer needs to understand that the last engineer they hired left another place—they are doing it to each other. The labor market "understands" this, but instead of raising the salary of their trained employee to match an external hire, they raise it by less. In my eyes, this is madness; I would reward people extra for loyalty. The workers' culture of playing musical chairs and seeking greener pastures, combined with the unwillingness to reward loyalty... creates a situation where no manager wants to be a sucker, and workers create the fear of hiring, training, and losing. "The fathers have eaten sour grapes, and the children's teeth are set on edge." True, these people created the problems for today's juniors, not those of three years ago, but it will come back to hurt them when they have no one to hire, or no one to sell their apartment to, because the demographic with relevant purchasing power no longer exists.

This is the point I have been trying to reach: Israel's current risk is a cash-flow risk. The balance sheet risk is a debt risk requiring forward cash flow stretched over 30 years, which has lost all connection to income reality. In a classic valuation, this would require a massive growth rate in Israeli purchasing power (even if housing prices stagnated).

The problem beginning to emerge here: The existing market structure, where Juniors don't get a chance without prior experience, creates a negative loop: No experience -> No job -> No experience. Two major problems could arise for the Israeli economy. First, the workforce in terms of quantity of quality, experienced engineers will drop, simply because not enough new inexperienced ones are being hired. This will affect Israeli businesses forced to hire elsewhere. Second, the percentage of people earning above average will drop. Meaning, the median will drop relative to the average.

I am repeating, the second problem is that the percentage of people earning above average will drop. Meaning, the median will drop relative to the average.

a. The Alternative Path: Draft Dodging or Gaining Experience at the Expense of the Army The phenomenon of private tutors and after-school clubs prepping kids for Unit 8200 creates a social crisis beneath the surface and forms cliques within the public. I have several friends who chose the intelligence track over the combat track (more than 15 years ago) because they were more worried about their future careers than about what they thought would be more beneficial to the state. I am not going to enter into people's personal decisions here, but I will address the fact that when recruiters look for people for a role, they will often summon someone from 8200 lacking relevant experience (let's say all he did was translate Arabic), simply because he is from the "clique," over someone perhaps more talented who won't get the opportunity because she decided to enlist in Caracal (combat unit) or was assigned by the IDF to Iron Dome. Ask recruiters if they've ever encountered an interviewee from 8200 who arrived in a T-shirt, convinced the sun shines out of his ass, didn't say what he actually did because it's "classified," and believed that just being in 8200 was enough to get the job. On the face of it, this wasn't a massive problem, at least not until today. The volume of jobs grew so much over time that the more talented and suitable guys would eventually find a role, gain experience, and become the amazing Seniors of tomorrow. Today, on one hand, the pressure for money *now* prevents people from perhaps taking a better, more suitable job because it pays too little. On the other hand, for other jobs, there is very high competition, and there is a fear of giving a person without relevant experience or connections a chance.

The war is shrinking the volume of jobs in the near future anyway, pushing junior salaries down even further, while they don't want to—and can't afford to—be "suckers." I have yet to hear of a case where someone approached a job offer and proposed raising their salary in exchange for a commitment to work at the company for a period of 5 years. The best thing someone can do for themselves is to find *any* job, no matter what it pays at first, just to gain some practical experience. This is essentially upgrading productivity relative to costs.

And to anyone recommending doing "side projects": Don't recommend doing just "a project." Recommend developing a **product**, building something that is needed. Doing something with no practicality for the real world doesn't help. At least if you don't manage to find a job, you might have something substantial in hand that could allow you to become an employer yourself. That is entrepreneurship and innovation.

b. The Employers' Problem Employers do not want to pay someone without experience a normal salary only for them to abandon ship after two years the moment the person becomes valuable. This is understandable, so they lower salaries significantly or give up on the positions entirely. Today, if you want to hire someone, you will need to prove that another worker using an AI model cannot fill the void (as has started happening at Shopify). In doing so, they might be missing out on good candidates and perhaps avoiding developing the Seniors of tomorrow that the economy will need. Nir Zuk (Palo Alto Networks) echoes this warning constantly. I know several people who are amazing human capital who are on the verge of giving up on finding a job right now because they have been looking for a year and are despairing.

Meanwhile, the models are improving. And this is the first time in history that I know of where the greatest beneficiaries of a productivity-improving technological development are its creators. If there is one thing these models are all excellent at, it is writing code. In my humble opinion, the roles that will disappear are specifically those of the **mediocre engineers**, not the bad ones or the best ones. The engineers and programmers in Israel are mostly at the mediocre level; a smaller portion is excellent. You cannot be a bad programmer or engineer in Israel because that person's role is in India or Bangladesh where it is cheaper. The models will allow those cheaper markets to close the gap.

These two points are dangerous regarding the state's workforce in a few years. A state is a business in every respect, and anyone who doesn't look at it that way doesn't understand that all the trees together create a forest, and a forest is made of trees; they are merely blinded by the "green" in their eyes and have no clue what they are looking at.

If the Israeli public does not understand the depth of the problem, and does not produce active policy, smart solutions, and real support for those still trying to enter this cycle—Israel will lose not only its relative economic advantage but also its ability to build a quality future for itself.

Negative migration of engineers and productive elements in Israel is more dangerous than anything. If those who produce economic growth—and also constitute a significant part of the reserve force—leave, Israel is in danger. If this public, which spans the entire political spectrum in terms of voting but constitutes Israel's backbone, decides it needs to look out for its own interests first and emigrates or decides to stop showing up for reserve duty, the problem will be severe.

Why I Won't Shut Up About High-Tech Industry

The reason I obsess over this sector so much is precisely because it is the one under risk, and simultaneously, it is by far the most important sector in the country. Think about all the bars and restaurants that serve this demographic. Office buildings that might lose another 5% or 10% of their occupancy while other office buildings are under construction and about to hit the market. All the jobs of recruiters recruiting for this industry. Real estate agents, lawyers, accountants, and investment managers who provide services to this industry and its people. A problem in this sector will spill over into other sectors of the economy.

A big enough problem will spill over into the economy's credit payments and expenses, and inevitably trickle into the financial system. Saying "it will be fine," "interest rates will improve in a second," or "the war will end in a second" might turn out to be correct. Or, we might discover one clear day that something more serious is happening to us, and we simply ignored the signs.

Jamie Dimon, CEO of JPMorgan, was eating at a Greek restaurant with his parents when he got a call from Alan Schwartz, CEO of Bear Stearns:

"Jamie, I need \$30 billion tonight, otherwise we're going to go bankrupt in Asia in the morning." — Alan Schwartz

Jamie answered him that he didn't know how to get \$30 billion either. Dimon rushed his team to the office. He would later recount:

"We did six months of work in two days, and bought Bear Stearns that night." — Jamie Dimon

The reason JPMorgan was the one receiving the call and not the other way around is this:

"I knew that if the sht had hit the fan early on, we would've had a real problem... Don't over celebrate the rising tide, be prepared for the tide to go out... I don't care if it happens [or not]... I want to know if it happens that we survive to serve our client." — Jamie Dimon

This is again a situation where an excellent manager lives in a reality where **only the paranoid survive**. The question I ask myself right now is: Does Israeli society think about all of this, and is it priced into real estate prices and the Israeli stock market? Or do Israelis refuse to look at the signs?

Chapter 11 – More on Israel

Problems from the House of Artificial Intelligence

Silicon Valley is determined to invest whatever is necessary for us to expand the Frontier of Artificial Intelligence, to continue spreading further into the discovery/invention (which are one and the same in this case) of computing capabilities that can perform actions in place of human thought processes and actions. These businesses have a double motivation, which is an exceedingly rare thing in human history. They have the incentive of efficiency (saving money and being faster), and the incentive of profits. It sounds like the Holy Grail of every innovation for every business: more profits and relatively fewer expenses. In a few words: An increase in the profit margin. We could hold long conversations about why software is such a profitable business compared to others, but here there is a significant factor. The most expensive "factory workers" in the world are programmers and engineers.

The first thing these models are really good at is software, because so much of it is repetitive. These "assistants" have the capabilities to drastically shorten work time, increase the output of an excellent programmer, and drastically close the gap between a bad one and a mediocre one (finding bugs takes much less time now when you have someone "going over your code" at speed). Big Tech companies are the entities with the deepest pockets (aside from nation-states), and they are betting the house. The danger for them isn't spending \$5 billion that they will earn back within a year; rather, the danger for them is that this will be such an exponential technology that if they don't run at the same pace as everyone else, a gap will open up that they won't be able to close. It's like a group of riders in the Tour de France breaking away, and the rest of the peloton failing to close the gap until the end of the race.

There are two ends to the scenario. Let's start with the bad scenario for the tech giants—which is bad in the short term for programmers but very good for programmers

in the long term. In this scenario, we hit a wall in the development of AI capabilities, meaning tech companies are wasting billions today for nothing. They will need to appease their shareholders, and they may cut costs in certain places. These cuts will slow down Acquisitions and IPOs, and reduce fundraising for startups. Basically, we will experience the "Tech Winter" we were supposed to enter in October 2022, which in the end, relatively speaking, was just a rainy week in the middle of summer. In this scenario, it is likely that the job market in the tech sector will worsen for a short-to-medium period and then improve because it will turn out there is no substitute for human manpower. It is important to note that Alphabet's headcount rose in the last year. The question is, was this felt in Israel as well?

In the second extreme scenario, the models will be so good that they can replace most engineers and programmers, and this will happen in a gradual process. Software companies will not hire new employees, and as the models improve, they will remove layer after layer of mass that has become, from their perspective, excess fat.

As we noted, the first audience that needs to fear this story is the audience of programmers. The prodigies in the market know who they are, and they know they are irreplaceable. But there are enough people in Israel earning salaries of 30,000–60,000 NIS gross who are currently shaking in their boots. They joke about it with friends, but the fear is real. Therefore, there is no logic for people who fear they might be without work, and will have to find themselves career-wise, to continue spending money as they did yesterday. (And a decline in standard of living is a hard thing. Not everyone can look their partner in the eye and say we aren't flying this year, or say "I know you're used to 5-star hotels, but we'll have to look for something cheaper.")

Buying an apartment, then, under this situation, is in my eyes absolute madness. Committing for years ahead to a mortgage when you don't know if you can meet the mortgage payment, or if you can rent it out for the same amount, is total insanity. While there is a felt decrease in the amount of people going out and partying, only now are we hearing about a slowdown in the housing market and slight drops in prices of "second-hand" apartments (which I guess are those without a safe room/MAMAD), but meanwhile in Tel Aviv, there is an increase in rent, mainly due to apartments with safe rooms.

The drop in apartment prices in Tel Aviv would have made sense with an increase in rent, within a market where there was an expectation that rent would rise but it didn't rise enough (we talked about pricing future profits; if profits don't grow as shareholders expected, there might be those who want to sell, even at a lower price, because they don't believe in the future of the business). But that's not the story here. There is something here creating cognitive dissonance for me—I simply don't understand what is happening in the Israeli housing market. The safe room issue is clear to me. What is a bit unclear to me is how there are people capable of spending an even higher percentage on housing in monthly expenditure (rent)—which is indeed a short-term

commitment (12 months is short)—within such a state of uncertainty. Let's assume they raised their monthly expenditure from 25% to 30%. That, I can still digest. What I don't understand is how people continued buying apartments and houses in the last year, and how contractors still expect to sell apartments in the current situation.

My bet is that what Israeli businesses think (contractors, banks, etc.) is that even if there is a slight drop in prices, it will be short and will stop. I don't think they are looking at 2027, which is the year that interests me.

But I have confessed several times: I don't understand the Israeli consumer, nor Israeli businesses. Mainly because the Israeli method seems to be this: fool the consumer, and by the time they catch on and get mad at you, they'll get annoyed at someone else and forget about you. "Shitat HaMatzliach" (The "If it works, it works" method) is an Israeli phenomenon.

The Israeli Business Model – Fooling the Israeli Consumer

Israel is a country with a rare talent: the national ability to obsess over the trivial and neglect the essential. Beyond that, a cynical and sophisticated business model has developed here, based on a psychological weakness of the Israeli consumer: the fear of being a "sucker" at the micro-tactical level, which leads to them becoming the biggest sucker at the macro-strategic level.

The Parable of the "Cuckoo": State-Sponsored Greed

The saga of the former national airline (let's call it the "Cuckoo" here) is a perfect case study for this dynamic. It demonstrates how the Israeli public, through its behavior, exacerbates its own suffering with its own hands. As we recall, in the midst of the COVID crisis, the state bailed out the Cuckoo from collapse using all of our tax money. The public was there for the company in its time of need. But two years later, when the wheel turned and the citizens of Israel found themselves under an aerial siege during wartime, the Cuckoo did not return the favor. On the contrary: it exploited the vacuum in the skies and public anxiety to hike prices to astronomical levels.

Instead of the government picking up the phone to management and setting a clear boundary ("Want to profit? No problem, raise it by \$50 a ticket, not \$500"), it let the party continue. For the entire year of 2024, the Cuckoo recorded record profitability, which translated—of course—into massive rewards for executives. The CEO and management's interest was clear: maximize profits here and now, on the public's back, because the annual bonus is derived from it. Only at the end of the year, after the lemon was squeezed dry, did the institutions remember to intervene and restrain the salary celebration. Meanwhile, the Cuckoo tried to minimize reputational damage with a cynical campaign about "rescue flights"—as if returning passengers who paid full price for a ticket is an act of Zionist philanthropy, rather than a basic contractual obligation. The tragedy lies not in the company's greed, but in the people's reaction: rage on

Facebook, and swiping the credit card at the checkout. The Israeli public complains, cries, and pays.

The "Don't Be a Sucker" Culture That Creates Suckers

I was impressed (honestly, favorably, regarding the insight) that on a podcast, managers of a hedge fund investing in Israel noted the "Israeli consumer character" as an investment advantage. In simple words: they are banking on the Israeli consumer swallowing any frog. Past protests (Housing in 2011, Milky, Cottage Cheese) proved a consistent pattern: a momentary outburst of rage, followed by acceptance and surrender. The abysmal difference between the American and Israeli consumer lies in the approach to price:

- **The American:** Determines a **Value** for themselves in advance. If the price in the store matches the value, they buy. If it is too expensive, they simply don't buy. They vote with their feet.
- **The Israeli:** Decides they *must* buy. All their energy is invested in searching for the cheapest deal locally ("Where can I save 5 shekels?"), even if the entire product is 30% more expensive than its real value. They will argue over the shekels and lose the thousands.

The biggest cultural consumer difference between Americans and Israelis is that an American decides in advance how much something is worth to them in terms of price, and if they enter a store and it's in their range, they buy. They won't look for the absolute cheapest store just for that. If it's too expensive, then they look in other stores, and assuming they don't find it, they won't buy. The Israeli habit is to search all stores for the one that is locally cheaper, even if the price is too expensive. They decide in advance that they are going to buy no matter what. The risks for an Israeli are more significant than for a U.S. citizen, and therefore they should be more conservative in their buying habits than an American, but in many cases, the opposite is true.

The best example of Israeli consumption habits and, on the other hand, Israeli society's inability to organize well, is the banking industry. Interest rate hikes took time to roll over to customers, allowing banks to enjoy a very high Spread. Meaning, they could give loans at much higher interest rates than they were required to pay the public. They managed to avoid the problematic profitability situation that Bank of America got themselves into. Bank of America held a lot of U.S. government bonds at very low interest rates, and to avoid short-term losses (by selling the bonds at a loss), they decided to let the loan term expire and get the money back. SVB tried to do the same thing but a Bank Run started, which would have created its bankruptcy (the Fed intervened and the case was handled). In the U.S., when interest rates rose, credit markets froze for at least a year. Businesses took long-term loans during low interest times and avoided taking additional loans until recently (this was one of the feared dangers in the U.S.—that businesses would need to take new loans at higher rates and

wouldn't meet expenses). The real estate market in the U.S. is frozen as of writing these lines on July 9, 2025.

The Real Estate Trap: Disappearing Contractors

The system doesn't stop at the supermarket or the bank; it reaches its peak in the Israeli's biggest purchase—the apartment. In the Israeli real estate market, contractors developed a method of operation. After handing over the apartment, when defects are discovered, the warranty turns into a legal chase. Instead of fixing, many contractors "drag" the tenants through courts, exhaust them bureaucratically, and exploit the power disparity. They know the little citizen will give up long before their legal battery gets tired. This is "Shitat HaMatzliach" (The "If it works, it works" method) in turbo version: sell expensive, deliver a mediocre product, and dodge responsibility. And the public? Continues to buy "on paper" and fund the mechanism that screws them.

The public makes excuses for why buying specifically from a big contractor means the warranty is worth something: "It's traded on the stock exchange," "They are a brand," "They have a name." And when this contractor dodges responsibility, they use the same reason to explain to people why the contractor isn't meeting the warranty: "They are big with lawyers, how will you chase after them?"

The average Israeli needs to be the most conservative and cautious consumer in the world, given the unique security and economic risks. In practice, they conduct themselves with consumer recklessness, led by FOMO (Fear Of Missing Out) and a desire not to be a sucker, thereby allowing monopolies and big companies to celebrate at their expense, time after time. And after digging themselves into a hole, they make excuses not to learn a lesson, but to justify their situation and not feel like an idiot.

Israelis are afraid to be the only sucker who didn't buy real estate, which leads many people in many cases to financially destructive situations.

The Structure of the Israeli Mortgage and Why It Resembles Sub-Prime Loans in the U.S. (Even Though the Borrowers Are Completely Different)

The Israeli mortgage is a unique hybrid creature. Despite fundamental differences in borrower quality, its structure disturbingly resembles the mechanism that led to the Sub-Prime crisis in the U.S. in 2008. As we discussed, the beating heart of the 2008 crisis wasn't just the defaults, but the "shock" borrowers felt when variable interest rates spiked and they couldn't refinance at a higher "value" or sell at a profit. This is exactly what happened in Israel, just in a different guise. In the U.S., the standard is a fixed rate for 30 years. The borrower knows exactly how much they will pay on day one and on the last day, no matter what the Federal Reserve does. In Israel, however, the regulator and the banks pushed the public into "Prime" tracks (variable interest), which were very

cheap when interest rates were near zero. But when rates rose, the trap snapped shut. Many Israelis discovered their mortgage payments jumped by thousands of shekels a month, far beyond what they planned for in their family "stress test."

To survive, many families had to run to the banks and "recycle" (refinance) their mortgage. But unlike refinancing done to save money, here it was done out of distress. To lower the monthly repayment, they spread the loan out anew over 30 years. A family that had 15 or 20 years left to finish their mortgage wiped out their progress and added another decade of interest payments. This is exactly the difference between the U.S. of 2008 and Israel of 2024: In the U.S., mortgages were given to a weakened population (Sub-Prime) that couldn't meet the payment the moment it rose, so they threw the keys and walked away (creating the snowball of market collapse). In Israel, mortgages were given to the general population, including the middle class and upper deciles. These people have higher absorption capacity; they "eat" into savings, cut consumption, and recycle debt—anything not to lose the house.

The Banks: The Big Winners of Interest Rates

Ironically, this situation upgraded the banks' asset portfolios. The rise in interest rates allowed them to replace old, cheap loans with new, expensive ones, or simply enjoy the automatic indexing of Prime tracks. Their profitability soared. At the same time, the Israeli housing market continued to rise (or stability). The rush to apartments with safe rooms (MAMAD) and lack of supply created a floor for "on paper" prices. This allows banks to continue giving loans based on high asset values, and developers to "kick the can down the road" using aggressive financing deals (like "pay 10% now and the rest upon delivery"), hoping the public will continue to buy.

Israel is Between a Bank of America Situation and a Silicon Valley Bank Situation

There is no doubt that various developer promotions are less profitable for developers and constitute a real decline in asset value. The most important thing for them is that it isn't "on paper." As long as the public continues its normal economic activity and allows for a moderate real decline in asset value, these developer companies and banks can cope with slightly lower profits or minor losses. This is the Bank of America situation. This year, as things in the U.S. heated back up in 2024 and credit markets returned to function, Bank of America is less profitable, while other American banks enjoy higher profits (for example, Citi and JPMorgan). *(Full disclosure: I am a shareholder in these two, and I did so after sitting on reports of many banks when I reached the conclusion that interest rate hikes in the U.S. would lead to higher profitability for American banks. I chose these two because they had the lowest debt-to-excess-cash ratio. Meaning, they had the ability to give many loans at higher interest rates, and additionally, they didn't hold relatively many assets yielding very low interest that would reflect losses, as was clear with Bank of America. I am far from the only one who identified this; there were several articles even on Bizportal in recent years—they wrote more about the BOA topic*

and the bad bonds they held and less about the banks I purchased). When I say we are in a Bank of America situation, it means the banks and contractors hope that time will do its thing and the economy here will return to growth. In the worst case, there will be a flow that weakens for a period and then returns to strengthen.

The Dangerous Situation I Don't Hear Enough in the Discourse to Satisfy Me

The true danger to the economy is a transition from the BoA model to the SVB model in the real estate market. What happens if the public not only stops buying apartments from developers but starts selling themselves out of cash flow pressure? This is the wet dream of housing protest leaders, but in practice, it is a macroeconomic nightmare scenario that will lead to Deflation (a broad decline in prices). In such a situation:

1. The Wealth Effect Crashes: People feel poorer because their house is worth less, and therefore stop consuming. The economy freezes.
2. The Debt Trap: The debt to the bank (the mortgage) remains fixed, but the asset collateralized against it is worth less.
3. The Bank's Nightmare: A bank is a financial business, not a real estate company. The last thing a bank wants is to find itself with an "inventory" of thousands of foreclosed apartments. A foreclosed asset requires maintenance, taxes, and management. When a bank gets stuck with an asset, the appraiser may estimate the value, but that value is a derivative of the market. If the bank is pressed to sell (to restore liquidity), it is the player selling cheapest. Mass selling of assets by banks is the event that crashes real estate prices into the abyss and creates a systemic financial crisis. This is the "snowball" Israel must not allow to roll.

Contractors Still Hold Significant "Inventory"

A Concrete "Margin Call": When Collateral Value Evaporates

To understand the depth of the risk in the Israeli real estate market, one must peek into the balance sheets of contractor companies. Contractors in Israel do not just build; they hold a vast inventory of "assets." We are not just talking about land, but finished apartments, luxury penthouses, and commercial spaces that have not yet been sold. Meanwhile, the contractors rent them out and present them as income-producing real estate, but the true purpose of these assets is financial: they serve as Collateral against the massive credit that contractors take from banks to fund their next project. Here lies the trap. The model is built on an implicit assumption that real estate prices will always rise, or at the very least, retain their value. But what happens when the asset value drops?

The Capital Market Analogy: Financial Leverage (Margin)

In the stock market, traders use Margin (leverage credit) to buy stocks with money they don't have, pledging their investment portfolio as collateral. The nightmare scenario for

every trader is called a Margin Call. This is the moment when the bank or broker identifies that the value of the collateral (the stocks) has dropped below the LTV (Loan-to-Value) ratio, and fears the borrower will not be able to repay the debt. At this point, the bank sometimes gives an opportunity to add more cash or additional collateral by a certain deadline, but sometimes it has no time. In any case, whether an opportunity was given or not, the moment the bank or broker senses risk, they execute a Firesale: they sell the borrower's assets within seconds, at whatever price exists in the market ("At Market"), to save their money. The trader has no control over the event; they wake up in the morning to discover their portfolio has been wiped out.

The Real Estate Trap: When You Can't Sell with the Push of a Button

In the real estate market, the situation is similar, but the execution is different and more dangerous due to the lack of liquidity. When apartment values drop, the funding bank sees its collateral value eroding. The ratio between the debt and the asset value (LTV) rises into the danger zone. The bank may demand the contractor inject equity (cash) or pledge additional assets. Only in extreme cases is the bank forced to take over the assets (receivership). But here is the problem: Real estate is not a stock. The bank cannot sell an entire building in seconds. There is no "Order Book" into which one can dump merchandise. A real estate firesale is a violent yet slow event. A receiver wanting to get rid of apartments is capable of slashing prices by 20% or 30% to sell fast if the bank needs the money. The moment this happens in one significant project, it determines the new "Market Price" for the entire area. The appraiser for the project across the street is forced to update valuations downward, and suddenly the neighboring contractor also enters a collateral problem. It is a domino effect.

The Psychology of the Bear Market: The Escalator and the Elevator

We discussed that in real estate markets, cycles are longer, and therefore recovery is also much, much longer.

"Markets go up in an escalator and go down in an elevator" – An old Wall Street adage.

In the real estate market, due to the lack of liquidity, this elevator tends to get stuck between floors on the way down; meaning, the drop is sharp relative to the rise, but it also lasts longer relative to the stock market. A quick two-month correction (like in the stock market in 2022) is not a bear market; it is a "correction." A bear market in real estate is a years-long erosion process. Since real estate cycles are longer and heavier than the stock market, the recovery from it is excruciatingly slow. If in the stock market recovery can take months, in real estate it takes a decade (Ruchir Sharma, in his book *The Rise and Fall of Nations*, discusses how even in the most optimistic case, 5 years is the minimum).

If a situation arises where Israeli banks start performing a sort of "Margin Call" of their own to leveraged contractors, the public will discover that the elevator goes down very fast, and there is no stop button.

Deflation

Deflation is a confusing economic phenomenon. Unlike inflation, which is felt immediately in the wallet, deflation starts relatively quietly because prices are falling. Moreover, it is a happy event for consumers. The problem begins when it happens not for one quarter, but two, and starts to snowball. There are several possibilities that can lead to this. The first is a problem the State created for itself. Let's start with the monetary foundations.

“Inflation is always and everywhere a monetary phenomenon” – Milton Friedman

Deflation is just the other side of the exact same coin. Inflation occurs due to an increase in the money supply (Milton Friedman) and an increase in credit (George Soros) (there is currently an interesting Israeli phenomenon of banks giving loans of tens of thousands of shekels with no interest if you route your salary to them), and thus there is too much money chasing the same amount of goods. This means money buys less; the currency "weakens." In contrast, deflation is the exact opposite: a contraction of the money supply. In such a situation, money becomes rarer and therefore buys more because everyone needs it, so they give more for it. The currency actually "strengthens" in terms of its purchasing power.

The First Risk - The System

The first possible trigger is government over-correction; meaning, the problem might start due to government policy. The government injected enormous sums into the economy at the start of the war (grants, compensation, defense spending) which fueled inflation. As a counterweight, the Bank of Israel raised interest rates/kept them high for a long time. Out of a desire to close the deficit and fund these expenses, actions were taken that increased taxation on citizens simultaneously with more assertive activity by the Tax Authority. Hypothetically, if the government sucked back too much money from the system through overly heavy taxation, it could dry up liquidity in the market. A situation is created where there is too little money in citizens' pockets for consumption, and too little capital with businesses for investment. This sharp transition, from massive injection to aggressive extraction, is a recipe for creating deflation while there is a credit crunch (because the drop in money supply happens before the Central Bank lowers interest rates or performs QE activities).

The source of the double risk is the Bank of Israel and the Tax Authority:

- The Central Bank, still scarred by inflation, will fear lowering interest rates too quickly. If interest rates remain high while the economy has already entered a

slowdown and deflation, this will deepen the recession and make it difficult for businesses to recover.

- Over-aggressiveness of the Tax Authority: If the state continues the line of aggressive "cash extraction" specifically from the productive population (High-Tech, small businesses, the middle class) to close the budgetary hole, it will damage the only growth engines that can pull the economy out of the mud. Sucking liquidity from the productive sector during a slowdown is like bloodletting an anemic patient.

The Second Risk - The Trap of a Strong Economy Leading to a Currency That Is Too Strong

Within this situation, another complex risk hides: the possibility that the Dollar will weaken significantly against the Shekel (or that the Shekel will strengthen), both due to Israeli economic strength and due to global fluctuations and Dollar weakness worldwide. On the face of it, a strong Shekel is perceived as a positive thing for the consumer (cheap imports, cheap flights). But for the Israeli economy, which depends on exports, this is a competitive challenge. The Israeli tech industry sells in Dollars but pays salaries in Shekels. When the Dollar weakens, the cost of the Israeli engineer in Dollar terms rises. For a global company, the R&D center in Tel Aviv suddenly becomes significantly more expensive compared to parallel centers in Europe or the US, without productivity changing. This doesn't mean they shut down tomorrow morning, but it definitely causes companies to think twice before hiring new employees in Israel, and encourages them to divert future growth to cheaper places. For factories in the periphery exporting additional products, the strengthening of the Shekel is a direct hit to profitability. Unlike high-tech, where there is some breathing room, in traditional industry every percent in the exchange rate is critical. A Shekel that is too strong makes it difficult for them to compete on prices in the global market.

In addition, the strengthening of the currency is a direct result of two things:

1. A decrease in the amount the Israeli public spends on more expensive products originating from abroad. Buying a new refrigerator for a family struggling with mortgage payments is postponed.
2. A rapid growth in investments in Israel in the Israeli stock market. A lot of money flowed into the Israeli stock market from abroad after "The 12 day war with Iran" as part of a "Sell America" and buy "International stocks" trend due to a belief that the American market is expensive and a "Reversion to the mean." Part of the story is global, and part is due to Israeli strength.

The Pressure on Local Businesses: At the same time, a strong Shekel makes imports cheap and more profitable. International companies will increase exports to Israel, and the market could be flooded with imported goods at competitive prices. For the local

manufacturer and small businesses, this could turn into harder competition. They deal with high local production costs (municipal tax, electricity, reserve duty), while competitors from abroad enjoy a cheap currency that cheapens their products on the Israeli shelf. Thus, a complex picture is created: the consumer might enjoy higher purchasing power for imported products, but the productive base of the economy erodes, and the labor market might shrink as a result.

Third Risk – Deflation Resulting from Problems in the Housing Market

The central problem in deflation is the psychology of the buyers. This is a state of "waiting." People with liquid cash prefer to sit on the fence; why buy an asset today if it will be cheaper tomorrow? The result is a slowdown in economic activity. Companies earn less, their stock value is updated downwards, and the public feels their savings (in pension and real estate) are worth less ("The Negative Wealth Effect"). When people feel less wealthy, they consume less, and the cycle feeds itself. It doesn't have to be an explosion, but simply a slow decay of growth engines, as seen in the Chinese economy today.

If the situation in the real estate market worsens, and rolls from there to the stock market, we might see the source of Israeli wealth under pressure all at once. This risk is large mainly because of the direct link between the Israeli stock market and the Israeli real estate market. In such a case, we might see a reverse effect of the Wealth Effect. The Israeli public will cut consumption sharply, and many businesses will be forced to respond by lowering prices to generate cash flow. This transition, from a market of crazy consumption "despite the war" to a market of "fire sales," could change the picture entirely, and require aggressive intervention by the Bank of Israel.

In the event that the Bank of Israel or the government acts in the economy, it takes time for things to have an effect. Therefore, even if they intervene, it will take time for it to trickle down to the whole economy. I want to add that it is rare for something to happen because of a single phenomenon. Usually, it is a combination of a variety of different phenomena, each occurring on one scale or another. It is a mistake to say that a thing happened in the economy only because of a single thing, although in many cases it greatly simplifies things and eases the discussion.

When Being a Spender Screws Me – But Us Being Spenders Saves Us

As I mentioned, the worst thing for an economy is to get stuck in place; stagnation is death for businesses. Therefore, the most important thing after October 7th was to return to general functioning as quickly as possible. When the system started coming out of the shock, and it took a few months, it was clear to me that higher taxes would be

required (to fund the war and its damages), and current defense spending would also be higher. Because of our army's structure, which is based on reserves, it was clear to me that high inflation was on the way. The equation is classic:

- **The Money Side** – The government injects massive amounts of money into the system (compensations, grants).
- **The Goods Side** – The quantity of services in the economy won't grow (and will actually decrease due to a shortage of workers), and due to damage to the supply chain (the Turkish boycott and the Houthis), the price of products will rise.

This was the time to act—in the first two or three months of stagnation, when business owners just wanted to get rid of stock and no one was thinking about moving apartments. This was the moment to upgrade housing to an apartment with a safe room (MAMAD) at a sane price, lock in rent for a long time, or advance major expenses. Whoever acted this way (and this isn't a case of the cobbler going barefoot; I performed these actions myself), beat the "Tsunami of Spending" that arrived later. While we cut expenses massively and increased investments, the public around us shifted from a state of shock to a state of FOMO.

The Public Saves the Economy

The upgrade of government grants, together with the feeling of "YOLO" (You Only Live Once), created an atmosphere of unbridled spending. In the summer of 2024, masses went on vacations abroad, purchased products, and brought about a massive wave of demand and price hikes. The difficulty for businesses wasn't a lack of customers, but a lack of workers to serve them. Here enters the lesson big companies learned from the supply chain damage (back from COVID), and the Israeli consumer mentality taught them that costs can be rolled onto the consumer without fear. This is one of the reasons why the Israeli stock market is in such good shape – Israeli companies are excellent at rolling over costs, and the Israeli public is excellent at paying them.

The Wastefulness of the Many Saves the Individual

The general Israeli conduct, the one that didn't tighten the belt but continued to consume, saved the Israeli economy from deflation and/or a recession. Public spending maintained Cash Flow in the economy, allowed businesses to meet obligations, and refinance loans. An ironic situation was created here: those hurt most by inflation are the weaker layers, whose purchasing power was eroded. In contrast, whoever tightened their belt early and acted wisely enjoyed more, but they must be thankful for the fact that people around them tightened less. Their wastefulness is the engine keeping the economy (and his investment portfolio) alive.

Is the Banks' Strength an Illusion or a House of Cards Built on Debt Recycling?

The fact that the Israeli public continued to spend and maintain cash flow (even if eroded) created a façade of stability for the banks, but in practice, it simply allowed them to buy time. We are witnessing an interesting anomaly in the data: on one hand, there is a decrease in the volume of real transactions in the real estate sector (fewer apartments being sold). On the other hand, we see an increase in the volume of "new" mortgages. How is this possible? The answer is refinancing. This increase is not the result of growth or young couples buying an apartment, but of families running to the bank to refinance their debts just to survive the month.

The "Repayment Capacity" Nonsense

I recently heard an Israeli hedge fund manager enthusing on a podcast about the "resilience of Israeli banks." His central argument was: "Banks in Israel are conservative; they look first and foremost at the borrower's repayment capacity, and therefore the portfolio is safe." What bothered me was that he took for granted the assumption that "repayment capacity" is a static constant. In a growing economy, this is statistically true: people advance in their jobs, salaries rise, and repayment capacity improves. But in a weakening economy? The opposite is true. Repayment capacity is the first figure to erode. When an engineer moves from a full-time job to unpaid leave, or when a small business owner closes a weak month, his celebrated "repayment capacity" evaporates. Relying on a 2023 pay slip to predict repayment capacity in 2026 is like driving on a highway while looking only in the rearview mirror.

Kicking the Can Down the Road

The entire system is currently in a state of "kicking the can down the road." Banks, developers, and buyers are playing a dangerous game of stalling, hoping the economy recovers before the bomb explodes. The most distinct example is the contractor deals of "Pay 20% now, and the remaining (80%) upon delivery in 3 years." Where the hell will the buyers get the remaining 80% on delivery day? Everyone's implicit assumption is this: "By then interest rates will drop, the apartment will be worth more, and we can take a cheap mortgage or sell the apartment at a profit". But what if not? What if on delivery day interest rates are still high, and the market price of the apartment is lower than the contract price? The banks will refuse to give a full mortgage (because the collateral value has dropped), and the buyers will be stuck with a liability of millions they have no way to cover. This is a recipe for mass insolvency.

The "Hope" Strategy

"I'd define skepticism as not believing what you're told or what "everyone" considers true. In my opinion, it's one of the most important requirements for successful

investing. If you believe the story everyone else believes, you'll do what they do. Usually you'll buy at high prices and sell at lows. You'll fall for tales of the "silver bullet" capable of delivering high returns without risk. You'll buy what's been doing well and sell what's been doing poorly. And you'll suffer losses in crashes and miss out when things recover from bottoms. In other words, you'll be a conformist, not a maverick (an overused word these days); a follower, not a contrarian." – Howard Marks , (2008) – The Limits to Negativism

It seems that in Israel, "Hope" has become an investment strategy. There is a collective expectation that at any moment there will be a deal with Hamas, the hostages will return, Saudi Arabia will sign a peace treaty, and High-Tech will explode again. Meanwhile, the banks present very strong financial reports and distribute fat dividends. But my problem is that I am not sure these reports reflect the future, but rather the past. I fear that the real risks—the continuous war, the erosion in High-Tech, and the real estate trap—are not truly priced into bank stocks. The market is pricing in a "Perfect Scenario" of exiting the crisis. If this scenario does not fully materialize, the fall from this height will be very painful. Maybe I am wrong and everything I say is excessive pessimism, but when I look at the numbers, my feeling is that the market is living in a certain disconnect from the economic reality on the ground. In other words, I am skeptical when everyone is convinced. My style is one that acts when everyone is pessimistic (and sometimes when I think they are not optimistic enough), and chooses not to participate when everyone is too optimistic. A short seller does exactly the opposite, while quants and hedge funds try to play both sides of the ball.

On Migration (It's No Secret That the Situation in Israel Is Also Politically Problematic) and the Somewhat Illusory Population Growth

A large portion of the public that is dissatisfied (and the entire nation is dissatisfied), and it doesn't matter *why* they are dissatisfied, is a public that has the abilities and financial means to emigrate from Israel. The people who have the ability, the means, and the skills to emigrate from here are exactly those who hold the country on their shoulders: the tech industry, the doctors, the engineers, which many serve in the reserves. The lethal combination of erosion in quality of life, loss of the sense of security, and deep frustration that the State does not "see" them, pushes them out.

It is not just the "Anti Bibi" crowd. Anyone who thinks this is a phenomenon of "leftists from Tel Aviv" is wrong and misleading. I hear completely different voices. A childhood friend of mine, a Likudnik from the periphery who voted for Ben Gvir in the last elections, called me recently with a chilling wonder: "What kind of place did I bring my child into? Maybe it's better if we move abroad?" The arrogant statement of certain

politicians, "We'll manage without them" or "Whoever wants to leave can leave," is a recipe for national suicide. The State cannot afford to lose these people. When comparing immigration data, one must be careful. Many of the immigrants from the U.S. to Israel are retirees coming here because of the excellent and cheap health insurance. Comparing a 70-year-old immigrant consuming health services to a 30-year-old Israeli leaving right at the peak of his earning, taxation, and reserve duty potential is madness. In economic terms, the State is swapping an income-producing asset for a liability. Therefore, the data on "population growth" is partly a statistical fiction. What is not fiction is the high birth rate, but that too requires enormous resources.

Being a Contrarian: Seeing What the Market Misses

High returns in investments can only happen via two ways: Superior Insight or being a Contrarian.

"There's only one way to describe most investors: trend followers. Superior investors are the exact opposite. Superior investing, as I hope I've convinced you by now, requires second-level thinking—a way of thinking that's different from that of others, more complex and more insightful." – Howard Marks

The person with Superior Insight is the one who looks at all the data everyone else is looking at, but also looks at data others aren't, and says that market players don't understand deeply enough how significant—or insignificant—a certain thing will be. For example, if someone bought Nvidia shares at \$200 per share (before the split), and when it rose to \$700 (which, as of this moment, means the price of Nvidia is \$172 per share, meaning that even at \$700 the price was cheaper by more than half compared to today), he purchased more out of the thought that the market didn't understand how significant the process we are entering is. Contrarian is being in a state where you are sure the market is wrong; the example is in the movie *The Big Short*.

"Most people probably took away from The Black Swan the same lessons I did (and the lessons mentioned in "The Aviary"): "unlikely" isn't the same as "impossible," and it's essential for investors to be able to get through the low spots.

Of course, it's improbable events that brought on the credit crisis. Lots of bad things happened that had been considered unlikely (if not impossible), and they happened at the same time, to investors who'd taken on significant leverage. So the easy explanation is that the people who were hurt in the credit crisis hadn't been skeptical – or pessimistic – enough.

But that triggered an epiphany: Skepticism and pessimism aren't synonymous. Skepticism calls for pessimism when optimism is excessive. But it also calls for optimism when pessimism is excessive. I'll write some more on the subject, but it's really as simple as that.

Contrarianism – doing the opposite of what others do, or “leaning against the wind” – is essential for investment success. But as the credit crisis reached a peak last week, people succumbed to the wind rather than resisting. I found very few who were optimistic; most were pessimistic to some degree. Some became genuinely depressed – even a few great investors I know. Increasingly negative tales of the coming meltdown were exchanged via email. No one applied skepticism, or said “that horror story’s unlikely to be true.” Pessimism fed on itself. People’s only concern was bullet-proofing their portfolios to get through the coming collapse, or raising enough cash to meet redemptions. The one thing they weren’t doing last week was making aggressive bids for securities. So prices fell and fell – the old expression is “gapped down” – several points at a time.

The key – as usual – was to become skeptical of what “everyone” was saying and doing. One might have said, “Sure, the negative story may turn out to be true, but certainly it’s priced into the market. So there’s little to be gained from betting on it. On the other hand, if it turns out not to be true, the appreciation from today’s depressed levels will be enormous. I buy!” The negative story may have looked compelling, but it’s the positive story – which few believed – that held, and still holds, the greater potential for profit.” – Howard Marks

I included the above quote for a simple reason. Everyone must choose the style of play that suits them. And these points are what led me to choose the style I selected. It is always important to remember the lens through which the writer views the world and what led to it.

Not All Citizens Should Be Equal

The State must treat citizens regarding population growth as useful citizens and less useful ones. We cannot afford otherwise (I will mention a few ideas on how to do this later). A person who consumes more resources than he produces cannot be equal in the State's treatment to a person who served in the army or did full national service, and pays taxes. The latter is more important to the State, and it must preserve him. It must give him the feeling that it values him; it must give him the feeling that it sees him, and not give him the feeling that he is an idiot for giving of himself. He will refuse to show up for reserve duty not because a politician told him to, but because he will fear losing his livelihood. He will convince his children not to be combat soldiers because there is no point and no value if, in the end, you get spit out. (This isn't me; if I had children, I hope I

would want them to be combat soldiers because I see important value in it, both in giving to the State and in what the soldier gains).

The Ultra-Orthodox public (I will speak about the Arab public in a moment) must wake up and understand that if these people leave—and that is exactly who will have the ability to leave—the final result of the State's deterioration (both in terms of quality of life, but also economically and in terms of military capabilities) will be the slaughter of their population by our enemies. The existential disaster is there all the time, and I go crazy that people only remembered it existed on October 7th. If any of you used the term "Civil War" even once, or alternatively got excited by the *Eretz Nehederet* sketch with Shauli, you should be ashamed. There was one civil war; in Israel, it is called the War of Independence (between the citizens of British Palestine).

And all of Israel's non-Jewish citizens feel, and in my opinion rightly so, that they are second-class citizens. We neglect them. It is clear as day to everyone that if the murders happening in the Arab sector were happening among Jews, more would be done about it. Or like in Jadeidi-Makr, where garbage wasn't collected for weeks because of protection rackets. The Druze community was deeply hurt by the Nation-State Law.

The Israeli system needs to sanctify those who sanctify the Zionist vision. That means protecting the citizens and those working in the service of the people and the State (Police, Prison Service, IDF, Fire Department, Medicine, etc.), farmers, reservists, etc. This can be done with the Chinese scoring system that gives a score to citizens. There are citizens who are worth more, and there are those who are worth less. I don't do reserve duty; I am worth less to the State of Israel today than a person who has volunteered at Magen David Adom for 20 years. The State needs to decide *who* and *what* it prioritizes, and it needs to prioritize those who contribute to it.

We see a significant drop in Israelis returning to Israel (despite antisemitism in the world being at a peak), and we see growing talk of people saying, "What do I need to be here for?" They are experiencing a decline in quality of life today, and feel valueless.

The action our government is taking right now is to continue injecting money into the economy (like the hotel vouchers) and hope that this will bridge the period until it stops the massive reserve call-ups. Meanwhile, my partner's friend was updated that she will need to do two and a half months of reserve duty four months from today. She was a Commander in Caracal. This is a **150% increase** from what she used to do, and this is starting to be the third consecutive year of such a reserve duty burden. Less productivity, more money from the State flowing more and more into basic consumption places, which makes inflation more and more sticky.

In my opinion, the recipe cooking right now is a continued increase in inflation as time passes in the current format. And in my opinion, there is a high deflationary risk when the war ends and the demand for reservists ceases. And here I am a Contrarian, because this contradicts what the professional public in Israel thinks will happen. They

are sure that once the war ends, the State will return to the growth it enjoyed before. I wouldn't put too much weight on my opinion, because I'm not putting money on it. I abstain because it's not my style to short, and even if it was my style the situation is not clear enough for me. This is only my immeasurable (and may be worthless) intellectual opinion.

"It's true that the investing herd is often wrong. In particular, it behaves more aggressively the more prices rise, and more cautiously the more they fall – the opposite of what should happen. But doing the opposite of what the crowd does isn't a sure thing either. Much of the time there isn't anything dramatic to either do or avoid. Contrarianism is most effective at the extremes, and then only for those who understand what the herd is doing and why it's wrong. And they still have to summon the nerve to do the opposite." – Howard Marks

Spoke About the Deflationary Angle; Now Let's Talk About the Stagflation Angle (Inflation Without Growth)

When we examine the implications of higher and stickier inflation, stemming from the same structural causes we discussed, we must understand that inflation is not merely a dry statistic from the Central Bureau of Statistics, but an erosive force that alters human and economic behavior. This process is expected to lead to a consistent and continuous decline in Israeli spending on everything that is not basic consumption, such as entertainment, vacations, and dining out. This will drag workers in these sectors into a cycle of lost income and a reduction in their own consumption. This snowball effect is liable to significantly exacerbate the phenomenon of "moving back in with parents," since landlords, themselves suffering from inflationary erosion and swelling mortgage repayments, will feel a real need to raise rent, but will encounter shrinking demand from a public simply incapable of meeting the new prices.

The inevitable result of this process is that the public, which in the past could save and purchase homes, will find itself out of the game. This will exert downward pressure on real - real estate prices or lead to prolonged stagnation. The first people to taste the bitter flavor of a market correction—or "eat the rotten fish"—will be precisely those leveraged investors who purchased assets "on paper." In a scenario of falling prices, they will watch their equity be completely wiped out within an asset that, due to high leverage, effectively remains the property of the bank. This could lead to governmental forces to take actions in order to increase liquidity in the markets, resulting once again in higher inflation which will lead once more to rate hikes. Broadly speaking, higher inflation necessarily entails a higher interest rate environment, which generates unemployment, slows birth rates due to the cost of living, and accelerates the emigration of the strong population.

Some might say this is an extreme nightmare scenario, but I suggest waiting to see what happens when the first massive wave of layoffs in High-Tech arrives from the U.S. When a serious American recession meets the Artificial Intelligence revolution, we are liable to see giant companies exploiting the crisis to lay off engineers and administrative staff who are simply no longer needed, because AI is capable of replacing a significant portion of their work. This is not a distant futuristic forecast; in places like Shopify, a manager wishing to recruit an additional employee is already required today to explain why the task cannot be performed via AI, a discourse not yet discussed on the news in Israel, but which is already the reality in boardrooms in the U.S. and Israel.

The greatest psychological danger lies in the Israeli public's reaction to a change of direction in the real estate market. If we see a real decline in prices, combined with sticky inflation that might even require further interest rate hikes, the public here might literally "lose it." The reason is that the entire economy is founded on the axiom that apartment prices can only go up. Therefore, a trend change lasting several years could create a reflexive snowball effect in the opposite direction, where the expectation of price drops generates further drops and deepens the recession.

Into this cauldron enters the dangerous cocktail of a government spending more and more money while its revenue (taxes) shrinks, creating a deep crisis requiring rapid and aggressive decision-making.

"If money isn't loosened up, this sucker could go down!" — George W. Bush

This is a statement President Bush made in 2008 to expedite decision-making in the U.S. Senate and Congress regarding injecting funds into the financial system. According to Warren Buffett, this is the most important economic statement in history.

Here, we are witnessing a culture of slow and systemic decision-making, where critical decisions are postponed again and again. We cannot decide on a hostage deal or an attack, which we tend to give the politically correct name "maneuver." This is a culture where plans for national infrastructure, like new airports, are dragged out over years and cost billions more than planned. And one cannot blame only the government, when large parts of the public, out of burning hatred for one leader or another, act with irrationality that harms the State itself. The only thing that can truly heal the system is a deep cultural change, which is indeed critical, but as a realist, I am very skeptical about the chance of it occurring. At the end of the day, whether the currency is strong or weak, the Israeli public is the one who will pay the price. We have been seeing a trend of rising prices for years, yet the public continues to purchase, mainly thanks to the large funds the government injects into the economy in the form of reserve duty salaries and grants. However, the true test of the Israeli economy will arrive a few months after this government tap is turned off, when the massive call-ups cease and the painful post-election budget comes into effect—only then will we discover "who has been swimming naked".

The inflationary danger is that by the next election date, there will be too many interest rate cuts facing a government that will spend too much money in an election year.

The Insurance and Banking Anomaly: An Island of Stability or an Optical Illusion?

It's no secret that Israelis don't trust "the system" in general, but there are a few institutions that Israelis do trust on an economic level, and both are tied at the hip to the Israeli housing market: banks and insurance companies. In my opinion, this is because in 2008, when the entire world collapsed in these sectors, in Israel they remained stable and strong.

A Quick Course in the Insurance Business

Warren Buffett did a public service for all of us by teaching us about the insurance field. Insurance is composed of two businesses. Let's start with the part everyone knows (which is very difficult). Insurance companies collect money from customers and put it together. Insurance works on a method where it's as if all the people paying insurance money are actually insuring each other with their money, and the insurance company seemingly facilitates the matter. They need to price the insurance premium so that it will be high enough to cover future payments (which it doesn't know how much they will be and doesn't know when), and on the other hand, that it won't be too high so that a rival can price lower and take the customers. Therefore, one must not enter a price war with rivals downwards (Race to the bottom) because then everyone might go bankrupt. When Warren Buffett was in his 20s, he learned this field from the CEO of GEICO. He discovered them by looking for where his role model, Benjamin Graham, was on the board of directors, and he found out that Graham was a board member at GEICO. He traveled to their company offices on a Saturday (or Sunday) and asked the janitor if anyone was in the building. The janitor told him yes, there was a single person, and sent him to some floor and room. This single person happened to be the CEO, who explained the insurance field to Buffett for several hours. Buffett understood GEICO excellently from this lecture; he would purchase its shares, and later take over via Berkshire during their moments of crisis. Apart from GEICO, he didn't get along too well with the insurance business until Ajit Jain arrived.

So let's summarize this part for a moment: insurance earns in its first part by collecting more money than it will need to pay back one day. The second part of the story is the fact that insurance companies hold the insured's money over time. This is called Float (the money that remains with the insurance company until it is returned). Meaning, you are paid to hold the money to invest it for your personal benefit until you need to return the money. It's like you are given a loan to invest and paid for the pleasure.

A small word on depreciation - depreciation is exactly the opposite: you pay today and can record it as an expense only at later stages. This is the reason Warren Buffett doesn't like profits that rely on depreciation (he said this in Berkshire shareholder meetings): *"Depreciation is negative float"*. As we said, in real estate it is a bit different. Here Warren Buffett enters the picture, and this is what made Berkshire the best insurance company in the world. On one side, in the premium pricing part, and perhaps this can be defined as the insurance branch in general, Ajit Jain manages it, who is perhaps the best at pricing insurance and managing this part of the business. But Buffett deals with the Float. Let's repeat this again: an insurance company takes the money sitting with it in the meantime and invests it. The situation created is such that the insurance company seemingly takes a loan from the public (which one day it will have to return to individuals), gets paid for the right to be given the loan, and invests it in the meantime. The insurance company needs to ensure it always has enough cash to cover what it will need. Usually, this money (needed in the short term) is invested in short-term government bonds. The rest, and this is the cherry on top, manages an investment portfolio whose goal is to generate more profits.

Insurance companies are an excellent business, but if it were so easy, more would be doing it. It is a very, very difficult field. Recently, insurance company stocks skyrocketed meteorically. Even, and this is a very large part, in the last five years some by 400% or 700%. Let's look at the last 5 years for a moment. Did insurance company activity grow so much relative to the entire population? Did Israelis decide to pay very expensive insurance on everything? Did the Israeli population grow so much? Did the purchasing power of an Israeli household strengthen to such an extent that it can withstand insurance company payments? Probably not. Insurance companies in Israel are large businesses. It is hard for me to think that the Israeli market was so wrong in pricing them. I can understand pricing errors during an economic crisis, or if there was some technological development that came to them out of nowhere, or they entered a new market, etc. But all this didn't happen. So the answer to where all these profits came from is probably not from the insurance field.

The Investment Field

The Israeli stock market performed 125% in recent years, more than the Nasdaq. Can this alone explain the profits? No. Additionally, in the years 2020-2023 interest rates were low. They didn't earn so much from the bonds they held. An insurance company cannot build a portfolio that is 100% stocks. Moreover, we know that a larger percentage of the public invested in the American stock market. Meaning, there were fewer people chasing stocks in Israel. Insurance companies, together with banks, constitute a part of the Israeli stock market and are responsible for a significant part of its performance. Additionally, Israeli insurance companies have the field of managing study funds (Kranot Hishtalmut), pensions, etc. They take 1% of the underlying assets

at maximum. They also give credit to savers in the funds. And now we have reached the beginning of the deep questions.

The Questions

We know that people took loans against funds (which are invested in Israeli stocks, among them also the banks, and in Israeli corporate bonds) and took a mortgage (with the same equity they borrowed against the fund). The mortgage they took made the bank more profitable, which raised the value of the investment portfolio of that same "saver." This is just one situation. We know that the purchasing power of the Israeli has eroded, that government support will stop sometime, that there might be further tax hikes, and meanwhile? The new car market, the place where insurance companies earn the most from car insurance, has completely stuck.

Insurance company stocks reflect optimism higher than ever. The banks don't talk about their fear of customer bankruptcies and don't talk in investor meetings about keeping a larger cash inventory to protect against losses. The banks and insurance companies are invested in real estate, even if indirectly, and we see signs showing weakness in this market. Even if apartment prices can skyrocket to the sky, if contractors cannot get enough workers to complete construction on time, they will go bankrupt. We are witnessing today that contractors don't have enough workers. The demand for purchasing apartments is dropping, not due to lack of desire, but due to lack of ability. Imagine what will happen if Israelis calm down from the bug that real estate only goes up when they discover it can also go down?

Stock market shares indeed reflect optimism, but it is in total ignorance of the fact that Israel's hour of testing will end within 2027 [Note: Check context, likely means *by* 2027 or *within* a period ending in 2027]. I want to mention one really important thing. The Intifada broke out in 2000, Operation Defensive Shield was in March 2002. The deep recession was felt in 2003. I don't hear any conversation today about a recession in Israel, only contractors remembering there hasn't been such a hard time for them since 2003. Meanwhile, the stock market reflects optimism with recent price increases; contractor promotions testify that they expect the public will be able to meet the 20-80 payment at the end of the period.

I remember the things **Sam Zell** said about real estate. I think about everything I know, and what I think I know, and look at a field I am not a professional in, and listen to people who *are* professionals in it, and I don't understand either what is happening in the field or the professionals. How can one say in one breath that there is a real estate bubble, that contractors in Israel leveraged themselves excessively, and then say that banks in Israel are excellent and insurance company portfolios are in good shape? The banks and insurance companies are the ones supplying credit to real estate companies and they also purchase their shares and each other's.

And this brings me to the fact that I stand today and am very, very confused by the things I see.

Chapter 12 – Last Thoughts, But Not On Woody Guthrie

*“When yer head gets twisted and yer mind grows numb,
When you think you’re too old, too young, too smart or too dumb” – Bob Dylan, ‘Last Thoughts on Woody Guthrie’*

As I look forward at the data, I see many clouds on the horizon. Some are dark storm clouds, some are fleeting wisps. It is possible that the wind will push this storm straight at us, and it is possible it will dissipate before reaching the coastline. But the only truth I cannot deny is that these clouds exist. My cognitive dissonance stems from the fact that most experts and professionals in Israel speak as if the sky is completely blue. As if a person can control the forces of nature and promise that a gust of wind will divert the danger. The markets are pricing assets in Israel as if there are no clouds at all, as if the risk is zero. This situation leaves us with only two possibilities:

1. There is a bubble. The professionals and the Israeli market have been captured by such deep conviction that everything will work out fine, that if they only see a small bump in the road, afterwards the road is smooth. They do not believe that beyond it could be other problems.
2. I am wrong. And all the intellectual knowledge and analytical methods I have laid out before you not only failed to lead me to be right, but perhaps even misled me. Whether this entire book is redundant or holds and value is for you to decide in this case.

Process vs. Outcome

The fundamental problem in the world of investing is that you can't really know in real time if you were right. It is possible that your thought process was brilliant, but a random event (a "Black Swan" or just bad luck) created the opposite result. Alternatively, it is possible that the analysis was completely foolish, but the result was positive thanks to blind luck. Warren Buffett once said that 4% of his decisions made all the difference. Mathematician and investor Jim Simons (of the legendary Medallion Fund) noted that they were right about the market direction 51% of the time and wrong 49% of the time – and that was enough for them to generate phenomenal returns of over 30% a year. Investments and economics are mostly not driven by precise mathematical equations; they are an art (most quant funds fail to produce excess returns). No one can speak of the future as solid fact, and nothing that was true yesterday guarantees it will be true tomorrow. The only thing an investor has to hold onto is the process. The big bet is that this process holds a real statistical advantage; that it is capable of tilting the distribution of outcomes in our favor enough times to generate Alpha. This is the only condition to

reach the “desired land” (not the promised land, since no one is promising you anything) – to defeat not 'the market,' but the most tangible opponent: the purchasing power of the community in which we want to live.

In investing, the focus must be on the signs along the way, but one must not treat them as deterministic data. Every sign has a spectrum of meanings. This profession is abstract and fluid. Very rarely does an investment "jump off the page" so clearly that you are 100% convinced of it, and even then – there is a probability you are wrong.

Sentences that may sound like axioms are not equal, like "You can't go bankrupt without debt" (Peter Lynch) or "The most dangerous words are 'This time it's different'" – only as Sir John Templeton taught us, sometimes it is different.

The Speaker's Position Clarifies His Confidence Level

An investor's level of confidence is reflected not in his words, but in his portfolio. A person holding 50 stocks in equal weights is playing a broad statistical game; he is not taking a material risk on any single idea. In contrast, a person holding 10-15 stocks is taking significant risk ("concentrated portfolio"), and therefore must have a decisive opinion and very high confidence in each of them. The mental journey we underwent in this book was intended to challenge the axiom "Is the market right?". My chain of reasoning led me to the conclusion that I do not agree with the Israeli market about the pricing of risk, and therefore I chose not to participate in it (and in real estate I disagree with the pricing of future cashflows). Here enters humility (or arrogance): luckily, in recent years I have beaten the markets (including the Israeli one) by a significant margin. For the Israeli market to "catch up" and beat me, I would need to undergo a catastrophe in my portfolio, or Israel would need to undergo an unprecedented economic miracle. If the Israeli market is right and I am wrong, it will "punish" me for my arrogance by me missing out on the gains. And that is fine. I only act in places where I have high confidence. In investing, you don't need to be right 100% of the time (like VC investors for whom one success out of 20 suffices), but you need to avoid fatal mistakes.

My confidence in my intellectual knowledge and the way I apply it is high enough for me to invest considerable time presenting it to you. Therefore, there is also certain value in estimating my confidence level in my opinions.

The Process and the Result

Generally, at any point where I sounded negative in the thought process here regarding the State of Israel, it is a situation where in an investment I usually make, I cannot find the negative thing "in the story," and then my question is whether it is priced in, or alternatively, perhaps there is something negative but everyone is exaggerating its negative consequences or ignoring **What could go right**. This book describes the many reasons why I chose to be a sideline player in the Israeli market. Honestly and truthfully,

if I were an investor examining this story, I would have stopped at a very, very early stage in the process and ceased looking because the story is too complex. Because I live in this reality and this thought process happened every day, my conclusion was immediate: too many troubles on the horizon and total disregard for risks by the markets and overestimation of the value of future cash flows for rental units. There is a chance the market is right regarding the result, but I am convinced wholeheartedly that it is wrong regarding the process.

“Markets can remain irrational longer than you can remain solvent.” – John Maynard Keynes

The more I tried to simplify it for the reader, it is completely felt that the future picture is not clearing up. I continued on this journey I started because it was an interesting intellectual game, and I truly and innocently tried to present to my friends my thoughts regarding where the State of Israel is situated and how I arrived at these opinions. The **how** is essential, because as I spoke before, the thought process is what matters. The result can once or twice turn out opposite to an excellent thought process, but I believe that an excellent thought process in the long run generates excess return according to the strategy it is in. Ultimately, I am convinced that eventually the Israeli economy will hit a wall, but the Israeli miracle found within it—high mental resilience and excellent engineering and entrepreneurial ability—can kick the can down the road for some more time.

Classic Cases

The reasons for the future crisis are classic: bubbly psychological behavior, unwillingness or inability to look at risks beyond one bump (anyone talking about housing prices in Israel being bubbly ignores how this domino chain will operate), and all-time high pricing in Israeli assets that does not align at all with the future map. I understand well why there hasn't been a crisis until now (also classic reasons like money injection, mentality, and a consumption culture). And I also understand how it is possible there won't be a crisis in the immediate term. But what I am unable to understand is the sweeping disregard for the possibility that it could happen. The market and the financial intelligentsia broadcast a "rosy future," and if they do talk about the possibility of a real estate bubble, they treat it as a localized problem that will pass, while ignoring the destructive domino chain such an explosion could trigger. Or as professionals call it, 'Contagion'.

The American Degree, the Chinese Groom, and the Israeli Apartment: An Anatomy of Social Bubbles

It is common to think that the Israeli real estate market is unique. "We don't have enough land," "we are a small country," "people will always want to buy an apartment." But when you look outward, you discover that the psychology driving this madness is not an Israeli invention. It remarkably resembles two other global crises that seem, on the face of it, unrelated: the student debt crisis in the US and the real estate bubble in China. The common denominator? Social pressure masquerading as a rational economic decision, and "dumb" money fueling the fire.

The American Lesson: When Price Becomes Irrelevant

In the US, one of the most severe socio-economic problems is student debt. Tuition is astronomical, especially at private universities or for those studying out-of-state. Beyond being one of the dumbest cultural epidemics I can think of—sending 18-year-olds mostly for an "experience" under the pretext that it pays off financially in the long run—the willingness of all those "consumers" to pay a very high price is insane. Few are the universities and degrees that will yield a wage gap (in percentage terms) compared to the cheapest alternative plus working during studies. In today's internet age, this is even more severe, yet tuition has continued to climb.

"You wasted \$150,000 on an education you coulda got for \$1.50 in late fees at the public library." - Will Hunting (played by Matt Damon) In the movie Good Will Hunting

Two things contributed to the surge in tuition. The first is the growth in the number of parents funding their children's tuition (parallel to parental help for buying an apartment). The second is the increased ability of students to take on large debts that will accompany them for many years (taking a mortgage and supplementary loans at low interest rates to leverage as much as possible, and then instead of looking for a maximum monthly payment to reduce the debt, looking for a minimum monthly payment). Initially, these two things lock the middle class and lower classes (which in the US is anyone worth, in my estimation, up to \$3 million net. Upper Middle Class is 3-10 million Dollars net) in their economic class. A person can be worth half a million dollars net in Oklahoma and have an identical standard of living to someone living in the suburbs of New York City. Because they must "save" money for their child's future, this forces funds to be invested in ways that are not long-term and likely yield a much higher return over time. Meaning, parents must "save" capital for studies in avenues that are too "safe," instead of investing for the long term in a way that would yield the highest possible return. On the other hand, those whose parents cannot help them to that extent choose to take loans to pay tuition, out of the same thought: "It's a degree, you have to do it if you want to get ahead in life." They don't sit down to calculate ROI (Return on Investment); they simply buy the dream, or do the "right thing" at an exorbitant price.

Parents want to please their kids and make sure they are happy, while they pay the bill. Others pitch to kids about how these loans for the degree and experience will pay themselves off after college. The truth is that those “helping” kids who can’t afford a degree without the loan are being sold in many cases a lie. Parents try to ensure their kids happiness instead of preparing them for the real world. In the real world, if you work hard and don’t expect other people to foot the bill you learn that

*“You can't always get what you want
But if you try sometimes
Well, you just might find*

You get what you need” – The Rolling Stones, You Can't Always Get What You Want

People are angry when they have expectations and they get disappointed, they feel like a failure compared to their parents. They feel the system is rigged because they are told a fantasy that if you do X life will work out itself and they find out that it has not.

The Israeli Version

In Israel, they do exactly the same thing, just with concrete instead of diplomas. Parents give children a "gift"—equity for an apartment. The intention is good, the heart is generous, and I certainly don't judge; it is better to give with a warm hand and a hug while parents are alive, than to bequeath when hands are cold in the grave. But there is an economic trap here: most families condition the gift on its purpose. "This money is **only** to buy a home." By doing so, parents artificially raise the demand for housing. They pour capital into a specific market, regardless of whether the price at that moment is logical or bubbly. If parents gave the young couple half a million dollars and said, "Do the smartest financial thing for your future with this," there is a chance some would invest in the capital market, open a business, or buy a cheaper property for investment. But when the money is "colored" for a residential apartment for themselves, it fuels prices and screws those who don't have rich parents. What this action does is introduce demand into the market today instead of that demand being later; meaning, **they are pulling forward demand.**

Dynasty vs. The Last War

The most significant difference between rich families who know how to manage capital versus families fighting the last war is managing family capital together, for the long term, rationally, driven by increasing family capital for generations. I'll give a personal example. I talk to my grandparents all the time about investments, and they are terrible investors. The reason: on one hand, they think about leaving an inheritance for their children (which is planning capital after their death, meaning an investment horizon longer than their own lives), but all their engagement with investment is trying to maximize as much money as possible for the short term. This in many cases either leads them to being way too conservative, or to trading and speculating. This is in contrast to me, where everything I think about is for the long term. What happens in

practice is that even in the short term, I have had returns they wish they were theirs. Long-term thinking allows the short term to surprise for the better, because an excellent business usually has positive surprises, and when it struggles, it finds how to solve the problem. A bad business usually has bad surprises. And having money in a governmental bond or a savings account means no surprises besides inflation and deflation. Short term thinking has led them to either stay out of the game by being too conservative or too aggressive by chasing the last trend and investing in any hot new ETF (My grandfather invested in the ARK at the top in 2021 and sold near the bottom somewhere in between 2022-2023).

Meaning, it seems that if everyone calmed down, and didn't feel pressured to help children *only* if they buy an apartment, they would allow their children and everyone else to buy an apartment themselves. Generally, they would do better for their family if they made a decision that is financially smartest for the family out of rational thought, not a decision that is 100% emotional. It could be that the decision would be that buying an apartment is indeed a good thing to do.

In China, one of the central factors in the monstrous real estate bubble was purely cultural: social pressure on men to own an apartment to be considered "marriage material." Without a property, there is no bride, so people bought real estate in the middle of nowhere, just for the sake of owning real estate. This created immense artificial demand from families who bought apartments for their sons just for the status. In Israel, we see a refined (but pressuring) version of this. Parents pressure children to buy an apartment before the wedding, with the other side's family "having to participate." This leads to pressures around prenuptial agreements (which I am for in principle, but not when forced by parents as part of an economic transaction), and leads to a general feeling that a couple without a home is at some economic risk.

If families in Israel acted with the rationality of hedge fund managers rather than the emotionality of panicked retail investors, reality would look different. If they released the condition of "money for an apartment only" and allowed the younger generation to make smart capital allocation decisions, we would see two things happen: housing prices would cool down, and total family capital would grow much more. But as long as the public is captive to the view that "apartment = security" (just as Americans are captive to "degree = success"), the Israeli public will continue to fuel the fire that burns the economic future of other children or their grandchildren.

For a wealthy family, spending a small percentage of their capital on housing, tuition, or any other major expense is negligible—even if the economic return is sub-optimal. From a wealth management perspective, these can be treated as mere living expenses because, relatively speaking, they impact a very small fraction of their net worth. For middle-class families, however, this same decision holds them back relative to the wealthy. They often create psychological rationalizations to justify the cost, convincing themselves it is a "great investment." They forget a cardinal rule of portfolio

management: it is not just *what* you hold that matters, but the *percentage* of your portfolio it occupies.

Furthermore, if managed correctly, wealthy families consume a much lower percentage of their capital compared to the general population (this is the key to avoiding **lifestyle creep**). Therefore, when the middle class allocates a disproportionately high percentage of their portfolio to lower-yield investments like savings accounts (towards purchasing a home in 5 or 10 years) or purchasing residential housing in prices where the math does not make sense, it only exacerbates the wealth gap.

The effect of **pulling forward demand** created a situation where demand for housing remained artificially high for a prolonged period. Early price increases fueled by this demand created a feedback loop, feeding on itself and driving prices higher. Naturally, this fueled demand eventually pushes housing prices beyond the reach of young couples, and even beyond the ability of their parents to help. If this ceiling hasn't been hit yet, it is inevitable. Ultimately, families will simply "lose" more money on more expensive housing.

People love to tell me that "whoever bought a decade ago profited." But in investing, we don't celebrate the trade made ten years ago. We ask ourselves: will buying *today* yield the desired result in *another* decade? By exhausting future demand today, we create a vacuum—an **"air pocket"** of supply and demand—in the future housing market. This is dangerous because of **reflexivity**: when the market hits this air pocket and prices stall or drop, the psychological desire to buy evaporates, potentially causing material damage to the market. The question is not whether people will "always want" to buy a home (they certainly won't if they believe they will lose money); the question is whether they *can* buy the next home. And sometimes, to buy the next one, they must sell the current one first. If they cannot sell, the chain breaks. My goal in this book is to offer these points of thought so that we can act out of deep understanding, avoiding mistakes and spotting opportunities. I hope this adds a layer of complexity to the simplistic narrative that "everyone will always want to buy a home."

Is Renting Throwing Money Away?

There is an axiom burned deep into the national psyche, an undeniable truth in living room conversations: "Paying rent is throwing money down the drain. It's better to pay a mortgage because at least the house stays yours." This sentence sounds logical, but behind it lies a deep logical and mathematical failure which shows that people never actually **went over the numbers**. This "fact that everyone knows" ignores that in any economic situation where a person does not hold the full amount, they are renting *something*. Just as the tenant rents the **property** from the landlord, the buyer rents the **money** from the bank. The price of renting money, as we said, is called "interest." And interest is money "thrown" down the drain just as much as rent. It evaporates, it does not offset the debt, and it does not add a single brick to the walls of the house.

I am going to use round numbers in the next part. I recommend you sit at home and plug in your own numbers. After we play the following numbers game, we will talk about how this is strategically relevant to us.

A Tale of Three People

Let's assume we have a property worth **\$500,000**. The potential buyer does not arrive empty-handed; he saved, toiled, and raised a respectable equity of **\$100,000** (20% down payment). The remainder, **\$400,000**, Buyer A will take as a 20-year mortgage, and Buyer B as a 30-year mortgage. Both at an interest rate of 5%. Conversely, the rental yield on this property stands at only 2.5% (The yield on rentals in Israel is between 2.5%-3.5% in most of the country. Yes, The interest rate to borrow is higher than the rent. Newer landlords are cashflow negative). Naturally, the buyer with the 20-year mortgage, Buyer A, will pay the highest payment from his monthly cash flow for housing. Because of the nature of **Amortization**, part will go to paying the principal, meaning increasing the personal capital of the mortgage payer every month. Buyer B will pay a lower payment, and the renter the lowest payment for housing. For our thought experiment, we will add that whoever pays less for the mortgage or rent – must invest the difference in the exact same Apple bond (yield of 4.5%). We will add another parameter of inflation which will be identical for the renter and the property owners, 2.5%.

Let's place the players on the board:

1. **Buyer A** – Pays **\$2,640** to the bank. Every dollar goes to the mortgage. He has no spare dollar for additional investment. He puts all his eggs in the real estate basket.
2. **Buyer B** – Pays a reduced mortgage payment of about **\$2,147** (spread over 30 years). The surplus, about **\$493**, he buys in bonds every month.
3. **The Renter** – Pays an initial rent of **\$1,042**. The surplus (about **\$1,598** a month!) and the initial equity (\$100,000) he invests in bonds.

The Amortization Mechanism

The mechanism determines how the fixed monthly payment is divided between two components:

1. Interest Payment – The cost on the remaining debt balance.
2. Principal Payment – The part that actually reduces the debt and increases equity.

The guiding principle is that interest is always calculated on the current debt balance.

The higher the debt balance, the higher the interest component in the payment.

Month Number 1 In the first month, both buyers hold an identical debt of \$400,000. The annual interest is 5%. Therefore, the initial interest payment is identical for both: The difference between the buyers stems from the amount paid *beyond* covering the interest.

Buyer A (20 years):

- Total monthly payment: \$2,640.
- Interest component: \$1,666.
- Principal component (net debt reduction): \$974. *The meaning is that about 37% of the payment is directed to debt reduction.*

Buyer B (30 years):

- Total monthly payment: \$2,147.
- Interest component: \$1,666.
- Principal component (net debt reduction): \$481. *The meaning is that only 22% of the payment is directed to debt reduction.*

Dynamics Over Time Since Buyer A reduces the principal by a higher amount (\$974) in the first month, his debt balance in the second month is lower compared to Buyer B. Consequently, in the second month, Buyer A's interest payment drops more sharply, which releases a larger part of the fixed payment (\$2,640) in favor of principal reduction. This process accelerates itself from month to month.

Comparison After 5 Years (60 Months):

Buyer A (20 years):

- Debt balance dropped to \$325,000.
- Monthly interest payment dropped to about \$1,350.
- Principal payment rose to about \$1,275. *At this stage, the ratio between interest and principal payment is almost equal. The rate of debt payoff has accelerated.*

Buyer B (30 years):

- Debt balance dropped to only \$365,000.
- Monthly interest payment is still high: about \$1,525.
- Principal payment rose moderately to about \$600. *Even after 5 years, most of the monthly payment is still directed to covering interest, and the rate of equity accumulation remains slow.*

To summarize the mechanism, the gap in capital accumulation stems from the fact that Buyer A pays interest on a principal that is shrinking at a rapid pace, while Buyer B pays interest on a principal that remains high for a much longer time.

When Does the Buyers' Capital Accumulation Rate Overtake the Renter?

I remind you, for our thought experiment, we added that whoever pays less for the mortgage or rent – must invest the difference in the exact same Apple bond (yield of 4.5%). We add another parameter of inflation which will be identical for the renter and the property owners, 2.5%.

At the beginning, the renter accumulates capital at the fastest rate due to the high monthly deposit. Over time, the buyers' interest payments decrease (in favor of the principal) and the rent rises, which changes the trend.

- **Buyer A (20-year mortgage):** The cash flow break-even point occurs in year 7.3. Until this stage, the renter saves more money each month than the amount

Buyer A reduces from his debt. Starting from year 8, Buyer A begins to reduce the debt at a faster rate than the renter's ability to save.

- **Buyer B (30-year mortgage):** Due to the long payment spread, the principal payoff component is significantly lower. The break-even point occurs only in year 16.4. Until then, the renter directs a larger amount to investment each month than the amount by which Buyer B's debt decreases.

Periodic Snapshot: Net Equity (*Data is based on property value increase of 2.5%, bond yield of 4.5%, and rental inflation of 2.5%*).

Year 5 At this stage, the gaps are negligible.

- Buyer A (20 years): **\$230,500**.
- Buyer B (30 years): **\$230,000**.
- The Renter: **\$227,500**.

Year 10 Rent rose to **\$1,330**, which reduces the renter's monthly deposit. Mortgage payments remained fixed.

- Buyer A (20 years): **\$390,000**.
- Buyer B (30 years): **\$387,500**.
- The Renter: **\$375,000**.

Year 15 Rent rose to **\$1,505**.

- Buyer A (20 years): **\$582,500**.
- Buyer B (30 years): **\$575,000**.
- The Renter: **\$550,000**.

Year 20 (End of Buyer A's mortgage) Buyer A finished paying the mortgage. Buyer B continues to pay for another decade. Rent stands at **\$1,700**.

- Buyer A (20 years): **\$817,500**.
- Buyer B (30 years): **\$804,250** (equity in property + bond portfolio).
- The Renter: **\$756,500** (bond portfolio only).

Summary of Data and Thoughts

I want to focus for a moment specifically on the first period, in the range of the first 4-5 years. I am here mainly to challenge the worn-out narrative that "renting is burning money" – a narrative designed mainly to create psychological pressure and push people into rash real estate deals.

1. **Conservative Assumptions vs. Historical Reality** – In our simulation, we assumed the renter invests in a "safe" bond with a yield of 4.5%. This is a very conservative assumption. True, one cannot rely on past performance, and I am the last to tell investors "Look, the S&P 500 made 10% on average so it's safe" (the benchmark I prefer to work with is 7%. Check the average returns of this index after a crash and not at an all-time high). But, if the renter had exposed his money to stock indices and achieved a higher yield than those 4.5%, it would have taken the buyers much longer to close the gap – if at all. In our experiment, the break-even point arrived around year 4. This means there is at least a

reasonable chance that a young person who decides to wait with the purchase and accumulate liquid capital is doing themselves a huge financial favor.

2. **The Buyer's Transparent Costs** – Our model was "clean," but reality is dirtier. The buyer has heavy entry expenses that evaporate the moment of signing: purchase tax, lawyer, broker, and necessary upgrades to the property. Meaning, in a real view, even if he has an asset worth \$500,000 on paper, he actually spent more on it. The renter might deal with uncertainty regarding contract renewal, but he maintains financial flexibility and reaction ability – he can at any given moment take the money and purchase the property the buyers bought, sometimes from a better position of power.
3. **The Short-Term Trap and Leverage** – The advantage of leverage (the mortgage) is situation-dependent. It manifests positively mainly in the early years, when equity is small relative to the asset. But pay attention to the trap: if a person buys a home and intends to sell it within 5 years (to "upgrade"), he might bury himself in a hole relative to the renter without noticing. In these years, he paid the bank almost exclusively interest (money down the drain), and paid high transaction costs on entry and exit. If he sells, he must know how to roll the leverage to the next asset smartly, otherwise he simply buried himself in a pit of financing costs and taxes, without enjoying the fruits of principal payoff.
4. **Erosion of Leverage and the Alternative** – If the buyer holds the asset throughout the life of the mortgage, the advantage of leverage evaporates over time (because the debt is small and equity grows, so the return on equity drops). To truly utilize the real estate advantage, it is necessary to perform mortgage recycling and refinancing along the way, as we discussed in previous chapters. Without these active actions, at the endpoint of 20 years, the gaps between the buyer and the renter are not dramatic and depend almost exclusively on the asset price increase. Historically, the US stock market beat real estate by a significant margin over 20-year timeframes. A disciplined renter who invested in American indices would have won by a knockout against the average home buyer.

Rules of Thumb for Summary (My Personal Opinion)

I will try to distill the insights into a few simple ideas:

- **The 7-Year Rule:** If you do not intend to live in the home for more than 7 years, in a very high probability, it is better for you to rent. Entry and exit costs, together with the high interest payment in the early years, make the purchase unprofitable. You have to **go over the numbers**. Low interest shortens the amount of time, high interest lengthens it. High rental yield on a property also shortens the amount of time; the lower the yield, the longer it gets.
- **Self-Discipline Tax:** If you know you lack the discipline to save and invest the difference between rent and mortgage, buying a home is an excellent option for

you. Not because of the return, but because of the psychology. The mortgage is a "Forced Savings" mechanism that compels you to increase your capital against your will. It is the real estate equivalent of pension contributions – a protection mechanism against wastefulness.

- **The 30-Year Trap:** Whoever takes a 30-year mortgage just to "breathe" in cash flow, and doesn't know how to buy assets at an opportunity price (below market price), is probably making his biggest long-term financial mistake. He pays the most expensive price for money, and accumulates capital at the slowest rate.
- From a serious economic perspective, the Israeli situation is an extreme one. It is very rare for the interest rate to be so much higher than the rental yield. The lower the interest rate is relative to rent, the better it is to buy; the higher the interest rate is relative to rent, the better it is to rent. The most important factor in the buy-or-rent decision is the ratio between the two. In a period of near-zero interest rates, it is generally better to buy. Everything depends on the situation. The situation in the US is different from Israel, just as the situation in Tel Aviv differs from Haifa or Be'er Sheva. However, what remains identical anywhere in the world is the mathematical equation. You plug in the numbers unique to a specific time and place, and based on that, you can and should make decisions according to your personal preferences and your mental capacity to handle certain risks and hardships.

Ultimately, the conclusion is that one needs to **go over the numbers**, and everything depends on the situation.

Government Intervention—"Winning" the Governmental Real Estate Lottery and Promises of Peripheral Development

Every state intervention in the housing market is, in practice, a public decision to subsidize properties for population groups the state has deemed "important" to help. There might be a national necessity for this, but in reality, this mechanism suffers from deep problems of transparency, fairness, and economic distortions.

Dividing the Spoils Behind Closed Doors

Beyond the allocation of building permits and land pricing for various sectors, we are witnessing a reality where the state grants massive support to specific sectors—and mostly, this is done in the dark. These decisions are made in closed Knesset committees, without data transparency and without a vibrant, open public discourse on how resources are allocated. This lack of discourse allows politicians to sometimes prioritize populations that do not carry the economic or security burden. If we operated,

for example, on the Chinese "Social Credit" system, it is doubtful whether certain groups would be worthy of receiving subsidized housing solutions before they committed to more active participation in Israeli society. But on the flip side, you also cannot make excuses for sectors that receive massive assistance (like the Ultra Orthodox sector) and do not provide a proportional return, using the sole claim that "others don't serve either" (and yes, new methods are needed here too). If the state transparently published the housing budget allocated *per capita* by sector, we would likely be exposed to a deeply unsettling narrative.

Meanwhile, the newspapers publish superficial headlines and the public moves on. Those who pay the price and are pushed to the back of the line are mostly the young middle class. Those who serve in the active military and reserves, do national service, sustain the public sector (like the healthcare system), and pay the majority of taxes. This demographic's almost sole encounter with "help" from the state boils down to the faint hope of winning the "Mechir Lamishtaken" lottery.

[Context: What exactly is Mechir Lamishtaken?] For those unfamiliar, "Mechir Lamishtaken" (Buyer's Price)—and its newer iterations like "Target Price" or "Discounted Apartment"—is an Israeli government program designed to lower housing costs for first-time buyers. Instead of auctioning state-owned land to the highest bidder, the state heavily discounts the land. Developers bid on these tenders, and the winner is the contractor who commits to selling the finished apartments at the lowest possible price per square meter to the consumer. Eligible citizens (mostly young couples and singles over 35 who do not own a home) enter a state-run lottery. The "winners" earn the right to buy an apartment at a massive discount, often hundreds of thousands of shekels below market value. However, there is a catch: winners are legally forbidden from selling the property for a specified lock-up period (usually 5 to 7 years), though they are allowed to rent it out immediately.

"You are not a lottery ticket" — Peter Thiel

The lottery system takes the housing market, which today is already highly sensitive to matters of "luck" (whether you were born to parents who can help you with a down payment or not), and turns it into a state-sponsored lotto.

The absurdity starts with the terminology: the state calls it "winning." This word frames the apartment as a philanthropic prize bestowed by the government upon the citizen, while in practice, it is a patchwork solution born out of governmental desperation, aimed at pacifying the public and preventing a new tent city from popping up on Rothschild Boulevard.

Forced Subsidies, Market Distortion, and Collateral Damage

The luck factor in these lotteries creates economic chaos. There is a lightyear of difference between a person who wins an apartment in an area where they actually live

and want to raise a family, and a person who wins an apartment in a city they aren't willing to step foot in. This reality effectively turns these projects into state-subsidized investment property ventures. On paper, the winners receive an asset with significantly higher profit margins than their neighbors who bought apartments on the free market. Because they have no intention of living there, and they enjoy the "safety cushion" of the government subsidy, they can afford to aggressively slash prices to rent out or sell the property once the lock-up period ends. (It always amuses me when people rush to tell me, "But you can't sell for a certain period." To this I always answer, "Bro, whenever it becomes possible, the profit margin game still exists; it's just a matter of time."). When dealing with peripheral areas or neighborhoods without massive organic demand, I believe the result will become disastrous. The state creates artificially high demand in the short term (people buy just because they "won"—and remember that "short term" here means 5 years), which leads to an oversupply in the long term. Even in places that *are* considered "high-demand areas," like Herzliya and Netanya, winners (who bought their apartment through the subsidized lottery system) cut prices, compete with one another, and often find themselves with empty apartments that are hard to find tenants for. The number of such cases has been growing in recent years. Others who are hurt by this distortion are the regular real estate investors and families who bought apartments in those same areas at market prices. They didn't understand the shockwaves of "Mechir Lamishtaken," and woke up one morning to discover their apartment is actually worth much less, or that they are entirely unable to compete with the rental prices of dozens of "winners" who received a massive discount from the state and are now desperate to find a tenant.

Real Estate Investments in the Outer Rings: The Local Version of Chinese Ghost Cities

To understand the next stage in the psychology of the Israeli housing market, it is worth looking at China. One of the most fascinating and destructive phenomena of the Chinese economy in recent decades has been the "Ghost Cities" phenomenon—entire metropolises built in remote areas, packed with residential towers, that remained completely empty. The reason was not demographic, but financial: middle-class Chinese citizens, looking for a safe investment avenue, bought apartments in places they never intended to live, just to "park" their money in concrete. The apartments were bought as a financial asset, not a consumer product. In Israel, we are witnessing a local version of this phenomenon. As housing prices in the center of the country (the inner rings of the Gush Dan metropolitan area) skyrocketed out of reach for middle-class investors, they began to migrate to the "outer rings"—peripheral cities in the north and south. The result is identical to the Chinese one: the creation of massive artificial demand in the short term (from investors buying only to hold the asset), which leads to

an oversupply in the long term in areas where organic demographic or employment growth does not necessarily support the volume of construction.

The "Local Resident" Warning Sign: What Winning a Distant Lottery Really Means

A clear indicator of this distortion can be found in the lottery data of "Mechir Lamishtaken" (Buyer's Price) and other government subsidy programs. As a rule, the state grants a certain percentage of priority to "local residents" in every lottery. But when we see entire projects in the outer rings where a large number of the winners are *not* local residents, but rather young couples from the center who entered the lottery just to secure the financial benefit, it serves as an economic warning sign: **there is a lack of local demand there**. Let me establish a basic rule of thumb here: **Demand is not defined by who wants to buy, but solely by who wants *and can* (financially) buy**. Some will try to make excuses and claim that local demand does exist, it just doesn't meet the lottery criteria, since these programs are designed for "first-time homebuyers" and not for those looking to upgrade.

"Let's talk 'Dugri' [straight to the point]." — Benjamin Netanyahu

Let's talk *Dugri*. Existing homeowners wouldn't rush to upgrade to "Mechir Lamishtaken" apartments anyway, because both types of properties are generally considered basic starter homes, not a true upgrade. Beyond that, you cannot rely on the fantasy that there is a young, wealthy population in the periphery that simply "doesn't meet the criteria" to buy because they aren't married yet (a condition for lottery participation for those under 35). Demographic and economic realities show that young people earning salaries high enough to finance an apartment purchase—even a cheaper one in the outer rings—are mostly concentrated in the center, where the job market supports those wage levels.

Therefore, if the original residents of the city aren't entering the lotteries or cannot afford even a subsidized apartment in their own city, it means the organic demand there is weak. The larger the number of outside winners (those who have zero intention of living in the property), the greater the risk that local demand simply does not exist at these price levels. The day after, these investors might discover they have no one to rent or sell to, because the local population cannot afford the prices. This exact dynamic is what intensifies my fear of the creation of modern ghost cities.

The Hedging Illusion: The Erosion of Purchasing Power

The primary motivation of these "outside" investors is psychological: the fear of being left "out of the game." They buy an apartment in the periphery aiming to peg their purchasing power to the housing prices. But there is a fundamental failure in financial thinking here, which we discussed earlier in the book. A person who rents in Tel Aviv or Ramat Gan, and buys an investment apartment in Dimona or the Krayot, is executing a flawed "hedge." The rate of wealth accumulation and land value appreciation in the economic center (where they consume their housing) is historically higher, in absolute

numbers, than the appreciation rate in the periphery. As the years go by, the cost of living and housing for that person in the center rises at a faster pace than the yield and value appreciation of their asset in the periphery. In practice, instead of protecting their purchasing power, they experience a slow, continuous erosion of their ability to buy a property in the future in the area where they actually want to live. In my eyes, there is no better evidence for the lack of organic demand than the massive billboards stretched along the Ayalon Highway in the heart of Tel Aviv, advertising real estate projects in the Krayot north of Haifa or in southern towns, targeting the pockets of "real estate investors" in the center. The use of famous presenters—actors, entertainers, and reality TV stars—to market these projects is yet another stage in the disconnect between real estate and rational economics. Development companies are targeting an audience that has barely ever visited the city they are hoping to invest their life savings in. To generate trust, they use familiar faces from television, or offer large "pre-sale" discounts to create a bit of media buzz. This is classic marketing manipulation; there is absolutely no connection between the success of an actor on screen or a singer on stage and their ability to analyze if an economic investment in a specific area is sound, or to evaluate future rental yields or the risks of neighborhood oversupply. And yet, the public buys an illusion of security instead of demanding dry micro-economic data. Historically, the use of celebrities usually indicates "financial investments" that end in tears. Just look at the US during the 2021 crypto bubble.

Ofakim as a Test Case

A live example of this dynamic is currently taking place in cities like Ofakim. Over the past decade, there was an influx of investors from the center or other southern cities to Ofakim, anticipating price increases (due to infrastructure development, trains, and promises of regional development). The public broadcasting channel (Kan 11) dedicated several investigations and segments to the phenomenon unfolding there, during which apartment prices skyrocketed relative to the purchasing power of the original local population.

I see Ofakim serving as a real-time test case right now. As the supply of apartments (built mostly for investors and outside lottery winners) enters the rental market, the "Ghost Cities" theory is being put to the test. Will the city manage to attract a strong population and renters who can justify the purchase prices? Or will investors discover they are competing against each other for too few local renters who can afford to pay, forcing them to slash prices or leave apartments empty? In the coming years, the numbers will reveal whether the rush to the periphery was the decision of smart investors who were ahead of their time, or a herd mistake of buying concrete in the wrong place.

What Capital Markets Signal to Us: The House of Cards of Finance and Real Estate

It is a well-known concept that capital markets are forward-looking. They price today what the economy is expected to do tomorrow. Drastic surges in stock prices usually signal an expected real improvement in the economy. However, when we examine the Israeli financial sector—insurance companies and banks—the suspicion arises that these gains do not tell a story of healthy growth, but rather one of dangerous leverage.

The Paradox of The Israeli Insurance Companies. Why Sometime Corporations Chase Revenues While Losing Profitability

Let's look at the insurance companies. We see their stocks rising, but a look into their core insurance operations reveals a complex picture. Take car insurance, for example: on one hand, since the start of the war, there has been a decrease in car thefts and mileage, which reduced claims and temporarily increased profit margins. On the other hand, the pace of new car purchases has slowed down, which hurts the top line (revenue).

This is where Jeff Bezos's famous saying comes into the equation: *"Your margin is my opportunity."* High profit margins attract competition. Insurance companies, operating in a highly concentrated market where the only way to grow is to "steal" customers from one another, increase their marketing expenses to fight for market share. The promise of increased revenues might be what is pushing their stocks higher, but the market is missing a critical point: in a saturated market, an increase in revenue (through aggressive marketing and price wars) usually harms overall profitability. This is a classic situation of an inherent conflict of interest between senior management and the shareholders (most of whom are the general public, invested through pension funds). Management loves to show revenue growth because it justifies massive salaries and fat bonuses. These bonuses become less conspicuous as revenues grow, since the expenses appear more negligible in comparison. In other words, as revenues grow by tens of millions, bumping the CEO's salary by another million or two largely goes unnoticed. This shouldn't matter to shareholders; what should interest them is the future net profit line. If they believe profits will rise in the future, it makes sense for them to pay more for those shares today. This pushes the stock price up, causing the P/E (Price-to-Earnings) multiple to jump temporarily, under the assumption that the multiple will contract back down once the actual profits materialize (this is exactly why some analysts and wealth managers look at the Forward P/E). When I look at pure insurance operations, in an environment of eroding purchasing power, it is hard to see real, profitable growth engines. For that to happen, you need more people flying abroad and buying travel insurance; you need more people buying newer and more expensive cars so that insurance premiums will jump.

The Cycle of Management Fees, Local Investments, and Loans

To understand how this system feeds itself, we need to look at another central profit model of the institutional bodies (insurance companies and investment houses. I am reminding you that in Israel the companies who manage retirement funds like 401Ks are the Israeli Insurance Companies), the collection of management fees. These entities generate their revenues as a certain percentage of the total assets they manage (AUM - Assets Under Management)—meaning, they collect fees (on accumulated balances and new deposits) from our pensions, provident funds, and study funds (*Kranot Hishtalmut*). Every month, billions are poured into these institutions through the public's mandatory deposits. Where does this money go? A large portion of it stays in Israel—whether due to public demand, regulatory requirements, or the preferences of investment managers. The institutions purchase stocks and bonds of local banks, real estate companies, and even other financial and insurance companies.

This consistent injection of capital into the local market creates two major distortions:

- **Cheap leverage for local companies.** One of the podcasts by a hedge fund specializing in the Israeli market talks about this constantly: pension funds provide extremely cheap credit and leverage to local companies (especially real estate developers). The small investor, through their pension, is practically subsidizing the financing costs of Israel's largest companies. All of this happens while investment managers could have easily directed the money abroad and purchased equally high-quality bonds with higher yields (for example, US Treasuries or those of major global corporations). In other words, large public companies in Israel enjoy relatively cheap credit at the expense of the saver.
- **The self-fulfilling demand loop.** The more money saved for retirement enters the Israeli market, the greater the demand for local stocks—including the stocks of the banks and insurance companies themselves. This demand pushes stock prices up. When prices rise, the total value of the public's investment portfolios grows. And when the portfolio swells? The insurance companies collect more management fees in absolute numbers, and their profitability jumps accordingly. This profit growth attracts more investors, pushing stock prices even higher, which further increases the value of the managed portfolios. Pension and study fund savers see their portfolios growing and route more and more money into these tracks, adding even more fuel to the wheel. Portfolio profits grow, and demand for Israeli assets rises, alongside with more fees being collected... Furthermore, as the value of these portfolios grows, people are able to take out larger and larger loans against these assets to use as "equity" (a down payment) for purchasing other assets, like real estate. This drives up housing prices, increases the profits of contractors and banks, and thereby raises the stock

market valuation of these companies. That, in turn, raises the value of the pension and study funds all over again, allowing the *next* "saver" to take out an even larger loan against a larger portfolio. The problem is that this wheel can spin in the other direction, too.

Simply put, the institutions buy the stocks of the financial and real estate sectors in which they themselves operate, inflating the value of the local market with the public's money, and thereby increasing their own revenues based on a "return" they generated themselves.

But this concept, which we discussed earlier as "reflexivity," works with the exact same force in reverse. On the day the local market experiences a real, tangible slowdown (or god forbid a meltdown)—for example, if a freeze in the housing market hits the profits of banks and developers—local stock and bond prices will fall. A drop in asset values will immediately shrink the total managed portfolios, which will slash the insurance companies' management fee revenues and may lead to their stock price to drop. Moreover, if the public panics and begins routing funds to non-Israeli tracks or cash, the institutions will be forced to sell assets to provide liquidity. This sell-off will create additional pressure on a narrow market, driving prices down even further, and accelerating the negative trend.

In other words: The current rise in price of Israeli assets rests, in my opinion, largely on a self-inflating mechanism. As it climbs, everyone profits, but when the trend reverses—this structure is built to accelerate the fall.

Are the Banks Blind, Ignoring the Facts, or Do They Know Something I Don't? A Hidden Risk and Visible Profits

Insurance companies are only part of the story. The beating heart of the risk lies within the banking system. Banks in Israel are reporting record profits, but my hypothesis is that a significant portion of this profitability rests on the stretching of valuation multiples in the housing market. Banks are charging higher interest rates on loans and mortgages, which by their nature have become riskier (due to the interest rate environment and the high leverage of households). But because of the unquestioned dogma (belief) that "apartment prices in Israel always go up," the banks (and perhaps the regulator too) haven't truly internalized the new level of risk. Instead of slowing down the pace of credit distribution for real estate and locking up larger capital reserves (safety cushions) for credit losses, they continued to party (The number of new mortgages is rising while real estate sales drop). The market looks at the banks and sees supposedly "cheap" P/E (Price-to-Earnings) multiples. But in my humble opinion, the expensive pricing isn't in the bank's stock itself, but in the underlying assets the bank holds (the mortgage portfolio and credit to developers). The market simply isn't

correctly pricing the risk embedded in these assets. Meaning, in the event of losses in the credit portfolio, current profits will be slashed. Therefore, historically, when there is a fear of credit losses, investors worry that current profits will be cut and reprice the company relative to what the markets believe the new profits will be; meaning, the profit multiple contracts. Additionally, a large portion of bank profits right now stems from technical fees, early repayment penalties, mortgage refinancing fees, and one-off payments from customers trying to escape the higher monthly payments. These are one-time profits, not stable growth. What does all this tell me? The Israeli economy has built a sort of financial house of cards whose foundational floor is cast entirely out of the housing market. A structural problem in real estate won't remain confined to brokers and contractors. It will bleed directly into the balance sheets of retirement accounts, insurance companies, and banks that inflated the bubble. This is an extreme scenario, but economic history proves time and again: when systemic risk reaches the banks, governments are forced to intervene to prevent a collapse. And ultimately, the one who will foot the bill through taxes, bailouts, or the erosion of retirement accounts will be, as always, the public.

The History of Bubbles

Global economic history, which we discussed a lot in the first part of the book, teaches us an important story about bubbles. If there is or will be a real estate bubble in the State of Israel, almost everyone will be captive to it: from economic commentators in the studios and the news anchor, to civil servants in the Ministry of Finance, key figures in the Bank of Israel, bank managers, contractors, investment managers, and of course the general public. The peak of the bubble is when the consensus is at its absolute highest that there is no bubble, and it manifests in almost everyone, including top economists, excusing problems as small, temporary bumps. Due to the fact that markets are efficient on average, and since markets can also behave inefficiently over extended periods of time, being in the minority against the consensus is something that, most of the time, is not worthwhile or profitable. The average efficiency of the market proves that the consensus is mostly right, and on the other hand, the ability of markets to be inefficient over time causes the contrarian, even when right, to often go bankrupt along the way, or lag so far behind that even when the correction happens, it would have been better for them to get swept into the bubble from the start.

"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." - Peter Lynch

This insight places me in a complex position facing you, the readers. There is a reasonable chance that I am wrong in my analysis. Furthermore, even if I am right in the direction, it is possible that until the correction arrives, standing on the sidelines and not participating in the momentum will cost me much more money in the long run (because I determined that investing in Israel is too hard for me, and I invest in other places, but my purchasing power is tied to Israel in terms of living; if asset values in Israel rise at a

much higher pace, I "lost" in terms of purchasing power because my purchasing power will erode). The correction I am "waiting" for might not arrive anytime soon, and even if it does, it might stop at a higher price point than today's. There is nothing harder and more pretentious than trying to time the market, and there is nothing more dangerous than specifying a specific year, as I do when I point to 2027, after the passing of the next government's first budget. My way of hedging the risk that I am wrong is to distance myself from absolute doomsday prophecies and absolute certainty. The main thing I am pointing out is not necessarily a guaranteed collapse, but rather a mispricing of risk. Furthermore, even if I am absolutely right about the risks, if Israel manages to produce the miracle I will talk about in the next section, we will never know that I was right regarding the risks. Meaning, the most important thing to look at in this whole book is the thought process and not the outcome. And in the thought process I have laid out before you in this book, I cannot see it any other way than that the Israeli market, and most of the experts covering it, suffer from a kind of blindness—in my humble opinion, out of a deep psychological defense mechanism, which is the psychological mechanism that creates bubbles. The vast majority of them are invested in real estate in Israel directly or indirectly (in the Israeli stock market, which I believe is 50% tied to real estate directly and indirectly), and therefore they do not want to believe there is a long-term and fundamental problem in the Israeli real estate market. They do not correctly assess the statistical probability of these economic risks materializing. In the Israeli stock market, investors are downplaying risks and exaggerating profit expectations. In the real estate market, they exaggerate the extent of organic demand (and remember: demand is defined not just by who "wants," but by who wants and *can* pay), while ignoring the growing difficulty of the future Israeli consumer. The erosion of purchasing power means that if prices continue to rise, they will completely detach from the public's ability to finance them. In such a situation, the current profit multiples of apartments (the ratio of the apartment's value to the rent that can be charged for it) will become completely economically unjustified (in my opinion it already is).

Transparency in the Dark: The Securities Authority, Real Estate Reports, and the Financing Time Bomb

(Including an addition to the book I added during editing. Written on February 22, 2026)

In audits conducted by the Israel Securities Authority (ISA) in 2025, a disturbing reality was exposed: material gaps were discovered between the financial reports of several real estate companies and the true value of their assets. Publications noted that "the Authority is not naming the companies or the appraisers who engaged in 'unreasonable' practices, but these are very severe findings that required aggressive intervention" (from *Israel Hayom* in April 2025). This decision raises a difficult question and a fundamental paradox. The ISA's primary role is to ensure transparency so that shareholders—

meaning the general public, invested partly through their retirement and study funds (*Kranot Hishtalmut*)—know exactly what is happening in the companies they are invested in. It is hard to understand how the Authority can simultaneously correct this wrongdoing without exposing the companies' names. After all, if the reports have to be retroactively restated (or in future “correct” reports) the reporting gaps will be exposed anyway, and along with them, the names of the companies. Worse still, if the Authority chooses to fine the companies themselves for misleading reports, it is effectively fining the shareholders for an offense they didn't even know existed (and once again, the companies' names would be revealed). An absurd situation is created where the public suffers from the concealment and also pays the fine. A large part of the attractiveness of any given capital market is based on the “rule of law” principle, where the enforcement system protects investors. The ones who should be held personally accountable are the officers, managers, and appraisers who signed the problematic reports (and I'm not talking about prison or even a fine; but at least inform the shareholders so they can make a decision regarding their continued employment), rather than closing the incident in dark rooms that leave the public in the dark. (*This is the addition from February 22, 2026*) And I will add that today, about half a year after I wrote the previous paragraph, nothing else has been published on the matter.

Buying Time (Written on February 22, 2026)

The problem runs even deeper. According to a report in *Globes*, at the annual conference of the Corporate Finance Department, the Authority presented a series of material “errors” found in the reports of real estate companies—ranging from blatant overestimation of revenues to the exclusion of heavy financing costs (an accounting trick that allows developers to hide the high interest rates they pay). In response, the Authority announced that it is working on a “new disclosure framework” that will be presented to the public in the first half of 2026. This timeline raises critical questions regarding the second half of 2026 and heading into 2027: Will companies only be required to report according to the stricter (and truer) rules in 2027? It's possible that this delay is simply meant to “buy time” for the market. To allow companies to catch their breath, hope that interest rates will drop, and make material problems disappear by resolving them in the meantime without them surfacing. On the other hand, it's a dangerous gamble. If the problems aren't solved but only worsen, the new framework could be the trigger that exposes the black holes in the balance sheets all at once, creating massive panic in the market in mid-2027. It is important to remember that between black and white, there are all the colors of the rainbow, and likewise, many other possibilities of what might happen.

And where are these problems already starting to surface? With the end consumer. Those future inflated revenues that real estate companies report often rely on balloon payments and other “promotions”. In late December 2025, the Ministry of Finance revealed a staggering figure, also quoted in *Globes*: about 6% of the transactions for

purchasing new apartments "on paper" in 2023 (meaning the deals were signed in 2023) were completely canceled by the buyers. This phenomenon is especially prominent in the Southern District, an area characterized by a very high rate of aggressive financing promotions from contractors (paying 10% or 20% at signing, and the rest upon occupancy).

The implication is clear: people bought apartments at peak prices using leverage they couldn't afford, driven by a fantasy of selling the apartment at a profit before construction ended, or hoping that interest rates would drop. When the deadline approached and they failed to secure a mortgage to complete the deal, they were forced to cancel.

The main victims of this mechanism are usually not the developers (who keep the earnest money and the compensation, meaning the cancellation penalty, and can then resell the apartment), but the buyers themselves. Young people and families who are forced to pay fines and lose the initial capital they put down at the start of the deal are now left with nothing. Meanwhile, other apartment buyers are suing contractors because today, contractors are trying to sell identical apartments at a lower real price than what the buyers paid with "discounts" in presales.

The Negative Scenario

We will now gather the list of points and risks we have expanded upon throughout the book. Examined individually, each poses a challenge; but combined, they could create a "perfect storm" for the Israeli economy.

1. The Debt and Tax Trap (The Government Anchor) As the war and the rehabilitation of the homefront prolong, the government is forced into massive expenditures. To fund this, it must either increase the national debt or raise taxes (in practice, it is doing both). Increasing the debt today means higher interest payments tomorrow, which will require cuts to civil services and further tax hikes in the future. As the proverb goes: *"The fathers have eaten sour grapes, and the children's teeth are set on edge."* The money the state is currently injecting as a financial "aspirin" could choke growth for the coming decade.

2. The Danger of Stagflation: Inflation Meets a Slowdown The government is injecting money into the market to fill the void left by impaired productivity (closed businesses, reservists, evacuees). The classic result of too much money chasing too few goods and services is sticky inflation. To fight this inflation, the Bank of Israel will find it difficult to cut interest rates (and might even be forced to raise them). Herein lies the real danger: the combination of inflation alongside a drop in productivity and slowing growth creates *stagflation*. This is the hardest economic disease to cure, where the cost of living skyrockets while the economy is in a recession and unemployment rises.

3. The Liquidity Illusion and the Threat of Deflation on "The Day After" There is also an opposite, equally extreme scenario: what happens when the war ends and the faucet of defense budgets and government grants shuts off all at once? At that moment, we will discover that inflation and taxes have already "drunk" the public's savings. If the Tax Authority continues to siphon liquidity from the market to cover the deficit exactly when government injections stop, the public will be left with no disposable income or savings. The growth that occurred during the war will be revealed as artificial, demand will crash, and asset prices could begin to drop sharply (deflation). The question is whether the Bank of Israel will identify this inflection point in time and cut interest rates and inject liquidity before the economy enters a tailspin.

4. White-Collar Recession and the High-Tech Crisis The economy is at a dangerous crossroads due to the Artificial Intelligence revolution. We might see waves of layoffs under two extreme scenarios: either AI proves to be a smashing success that makes many programmers (and other white-collar jobs like analysts) redundant, or the massive investments in AI turn out to be a bubble that bursts, dragging the entire software and hardware industry down with it. Additionally, there is the demographic fear: "brain drain" and the negative migration of essential, talented workers (the top decile that pays the vast majority of taxes in the economy). The result will be a decline in the median wage of the economy. When people accustomed to high salaries lose them or earn less (in real terms, due to inflation), overall purchasing power will erode, immediately hurting the profitability of all businesses in the country.

5. The Shattering of the Real Estate House of Cards As we explained, the Israeli housing market is stretched to the limit. If the public's purchasing power erodes (due to inflation, taxes, or unemployment), their ability to continue paying astronomical housing prices will halt. This will roll over into a freeze or a decline in apartment prices. The problem is that real estate is not an isolated sector. A drop in housing prices might trigger layoffs of realtors, contractors, appraisers, construction workers, and finance professionals. Worse, the more today's apartment prices are disconnected from their true economic value (the rental cash flow they generate), the more painful the fall could be.

6. The Negative Wealth Effect Economics is driven by psychology. Most of the average Israeli's wealth is "locked" in their apartment and their retirement and study funds (which are also invested in real estate and banks, as we saw). If real estate and local stock market prices drop, the public will *feel* poorer, even if they haven't sold a single asset. This phenomenon, known as the "negative wealth effect," causes people to close their wallets, reduce private consumption, and cancel vacations and restaurant visits. Reduced consumption hurts businesses, which hurts employment, deepening the recession.

7. Economic Isolation (The Quiet Boycott) Finally, there is the geopolitical risk. The "bad name" and wave of hostility toward Israel following the war (alongside the legal

proceedings abroad) could leave a lasting economic mark. This is not about an official, declared boycott, but a quiet, technical one: foreign companies will prefer not to import from Israel, foreign investors will steer clear of Israel, and international bodies will reduce collaborations. The world will do business with Israel only where it is absolutely necessary and irreplaceable, but will avoid Israel wherever it has an alternative—even if that alternative is more expensive for them.

8. The Next Enemy After the war with Iran, there is an atmosphere of euphoria in the Israeli economy, as if all security threats have been removed. But in reality, this is not the case at all. The Ayatollah regime is still alive and kicking, and there are additional threats to the State of Israel that the country will need to prepare and brace for.

What Can Go Right

If there is one thing that can "save the situation" and generate true growth in the economy, it is entrepreneurship and innovation. This means startups, new businesses, and groundbreaking technological products. However, the main problem is that the State of Israel punishes the entrepreneurs operating within it through an unfair taxation and regulatory system. This is not about the mega-corporations toward which the state actually displays great friendliness, but rather startups and individuals opening private businesses. It begins with National Insurance (Bituah Leumi) payments: entrepreneurs and the self-employed pay higher rates, yet receive a significantly smaller safety net than salaried employees. This is a painful lesson many of them have learned the hard way over the past five years. At the same time, heavy regulation in Israel favors wealthy corporations, which enjoy a lack of competition and navigate the bureaucracy easily because they have the deep pockets to fund armies of lawyers and accountants to handle the situation. As a result, tech startups today have a massive incentive to incorporate and operate in the US. An entrepreneur who establishes their company in the US enjoys a huge tax advantage: under the American tax code (Section 1202 - QSBS), the first millions of dollars upon an exit or the sale of shares (usually up to \$10 million or ten times the investment) can be completely exempt from capital gains tax, a mechanism that Prof. Scott Galloway frequently discusses as a massive catalyst for innovation. In the US, there is more available capital and far less regulation. Conversely, Israel punishes innovation by imposing heavy income taxes higher income earners, which many are scientists and engineers, and uses these funds to subsidize entire populations that do not contribute economically to society (Ultra Orthodox men engaged solely in Torah study are one example of this). By comparison, in the US, there are massive Haredi (Ultra Orthodox) communities that flourish and thrive economically,

simply because they do not rely on state stipends. Finally, the Israeli system also punishes retail investors. In the US, there are progressive tax brackets: households with low or average incomes pay a significantly reduced tax (and sometimes enjoy a complete 0% tax exemption) on long-term dividends and capital gains. In contrast, in Israel, which is characterized by a more "socialist" orientation, capital gains taxation is flat. The state effectively punishes the "newly wealthy" and preserves the power of the old rich, even if this policy blocks the middle class from accumulating wealth and prevents greater prosperity for the general population. Yet, despite all these structural hurdles, the most astounding element of the Israeli economy is its human resilience. Time and again, against all odds, Israeli entrepreneurs and engineers demonstrate phenomenal survival skills and success. Through wars, prolonged military operations, and global pandemics like COVID-19, this human capital refuses to stop. It continues to produce incredible technological innovations that change the world. This entrepreneurial spirit, which refuses to surrender to local bureaucracy or security crises, is the true, organic engine that continues to drive the Israeli economy forward and keep it relevant and growing on the global stage.

Food for Thought

I cannot share some of my opinions with you, because I lack formal certification, and additionally, I am seeing a drastic decline in the quality of public discourse and freedom of expression among the population in Israel. This has become part of the game in Israel, which has devolved into a direct power struggle, coming mainly at the expense of ordinary people who cannot afford to retain an army of lawyers or waste their time dealing with nonsense. Meanwhile, we watch as powerful figures do exactly as they please.

I believe that what I am offering here, in some cases, is *superior insight*—a depth of thought that I simply do not feel exists in the national discourse, neither in financial articles nor in interviews with key economic figures.

Risk Management: The Blindness of Optimism and the Real Estate Bubble

It is glaringly obvious that the Israeli market is exhibiting classic bubble behavior: a mass frenzy to purchase investment apartments at any price. The most interesting question is what stage of the bubble we are in right now—is it the stage where investors like George Soros would pour fuel on the fire to ride the momentum, or the stage where they are already quietly looking for the exit? I see a complete lack of understanding all around me regarding the concept of "risk management." There is a total disconnect between the ability to identify what threatens assets and the ability to price the probabilities of future extreme scenarios. The local stock market (which is highly concentrated in banks, insurance, and real estate) reflects peak optimism, even though we haven't even begun the true stress test of the Israeli economy. The "*Yihye Beseder*"

("it will be fine") mentality dominates everything. Taking out a 30-year mortgage is, at its core, a leveraged bet made by a household on its future earning potential. Taking out "balloon loans" with the mindset that "in three years God will provide, and in the worst-case scenario we'll just sell for a profit"—is a blind bet that the real estate market will continue to behave exactly as it has over the past decade. It is important to clarify: I am not claiming that the situation here is as dangerous as the real estate bubbles in the US or China. It is entirely possible that we will dodge all these scenarios, that there won't be a crash, and that the economy will continue to soar forward on the back of an economic or technological miracle. But even if nothing happens, it doesn't mean the decisions people are making today aren't dangerous and statistically flawed in terms of risk expectancy. The tragedy is that if the bubble continues to inflate, it will only amplify this irrational behavior, because the public will receive positive reinforcement that dangerous bets pay off. As I have said more than once: a rising market is incredibly forgiving of mistakes. But the moment it crashes, it is ruthless.

In my estimation, the situation here is not as dangerous as it was during the real estate bubbles in China and the US

but that does not mean there is no danger at all. Even if nothing happens, there is no crash, and the economy continues to soar forward, it does not mean that the probability of these scenarios right now wasn't dangerous, and that a true miracle didn't just occur. What would be even more dangerous is that dodging this bullet will likely amplify irrational behavior in the future, because making certain decisions paid off, even if they were mistakes in terms of calculating risk probabilities. As I have said many times: a rising market is very, very forgiving, but the moment it crashes, it is ruthless.

When there is irrational behavior by market players, it is crucial to understand why. No one has yet managed to explain to the public what contractors and banks actually gain from "contractor loans" by artificially keeping housing prices high. No one—until I did it here in this book. This game, which is purely an accounting game, is designed to buy time for the market to run its course. The gamble paid off for Bank of America mainly because the public did not withdraw funds, there was no immediate economic crisis in the US, they held a massive amount of cash in general, and they were alert to the situation from the very first moment. Silicon Valley Bank operated with a "*Yihye Beseder*" ("it will be fine") mentality, until it was too late.

My gut feeling is that culturally, this "*Yihye Beseder*" mentality also exists within Israeli banks. From the little I hear on the street, they continue to operate as if what was is what will be moving forward, and are still taking on risks. Despite the reputation they gained for conservatism due to things that happened 17 years ago [the 2008 crisis], they act as if that is still the reality today. I am absolutely convinced that their power has grown stronger in the country, largely due to their ability to prevent complaints from

reaching the Bank of Israel by requiring that complaints first be directed to the bank itself. This is just one sign that their power has increased.

While American banks communicated with the public during interest rate hikes, warning that an "economic hurricane is coming" (as Jamie Dimon said), hoarding cash for credit losses, and tightening the credit belt, we are witnessing the exact opposite trend with our banks. They are providing new customers with zero-interest loans and relying on income capacities from recent months as if they are a guarantee for the coming months. Our banks are banking on tomorrow being at least as good as today—something we know that, in proper risk management, healthy paranoia dictates assuming the exact opposite.

The Israeli stock exchange is highly concentrated among real estate companies, insurance companies, and banks. And to all those who try to bullshit me by saying that most real estate companies on the stock exchange don't deal with residential housing at all—they are idiots. Who will they rent mall stores to when there are no shoppers to buy new clothes? 2008 wiped out malls in the US because brick-and-mortar stores had built-in expenses, whereas online stores did not. A halt in consumer spending created a severe crisis for retail companies, and the hunt for discounts strongly bolstered online stores. Who will they rent offices to when economic activity declines, when all the software companies in Israel need 10% fewer employees? This is an extreme scenario, but it is one that has to be considered.

The problem is exacerbated by a communication disconnect between the economic leadership and the public. We don't have financial stars like in the US to serve as a compass. There is no transparency from macroeconomic figures (the Governor of the Bank of Israel is mostly heard at closed conferences that aren't broadcast to the public). This void is filled by financial "online influencers," most of whom have a clear economic agenda, commercial ties with investment firms, and paid courses. Most of them are too young for their worldview to have been tested through real historical crises. The main difference between me and them is that I don't put a price tag on my opinions, nor do I think I deserve to charge a price for them.

The Median vs. The Average: Price vs. Cash Flow

When I *do* hear communication directed at the public, I hear about how much foreign exchange reserves the Bank of Israel holds, what the average wealth of the nation is, and all sorts of other macroeconomic statistics. The problem is that the average between one billionaire with a billion shekels and 99 people worth zero shekels is 10 million shekels.

What I focus on in this book, unlike everyone else, is not the assets but the *cash flow*. I do not focus on the average, but on the *median*. Because when looking at a large

aggregate, these are the figures that actually matter when it comes to real estate for the general public.

The significant danger in the event of a contractor's default is to those who buy apartments "on paper" (presales). I am guessing that in an extreme scenario, due to the crazy underlying strengths of the Israeli economy, the fallout will be contained and handled very quickly. I simply wouldn't be surprised at all if a bank or a contractor gets caught offside due to cash flow issues, or if a true repricing of assets creates financing problems for contractors. The goal of this book is to provide a mental framework for how to ensure that "it won't happen to me," rather than relying on luck, fate, or God. Let's assume 5% of the State of Israel bought an apartment in recent years and will watch as a price drop erodes their personal equity in the property; the goal of this book is to clarify what I would look at so as not to be one of those 5%.

The general problem with our real estate market is that people look at a price increase as an increase in the property's intrinsic value, without expecting a parallel increase in the rental market. In a healthy real estate market, housing prices rise slightly until it becomes more cost-effective to rent. Then, rental demand goes up, pushing rent prices higher until buying becomes more worthwhile again, and this seesaw continues. The moment there is an extended, rapid acceleration in one over the other, a warning light should go off.

In a podcast featuring an interview with the CEO of a company tied to the housing market, he was asked what someone from a weaker socioeconomic background—whose parents cannot help with the initial down payment and the monthly mortgage payment—should do. He jokingly answered:

"Be born again to rich parents." - A CEO of a company dealing in the housing market, whose name is better left unmentioned.

He then moved right along and talked about how important it is to buy now just to "get on the wheel" (the property ladder). Aside from the fact that this is a shocking statement, even though he sounded like a very smart guy, it reflects a fundamental problem for the country moving forward, both economically and politically. It reflects a national obsession that one *must* buy an apartment, no matter what.

You have to distinguish between volume businesses and high-margin businesses.

Banks, for the most part, are volume businesses, unless there is a bank specifically designated for the wealthy. If there were such a bank in Israel, I might look at it with a great deal of interest, because the wealthy population in Israel is very wealthy.

The problem is the bottom half. That is the half that buys at any cost, just to buy. That is the half of the nation taking out loans against their investment portfolios. That is the half taking out supplementary loans just to scrape together a down payment.

"The Financial Struggle" Between Two Types of Economies

Unlike in the US, China, or Australia, real estate is not the primary labor market for property owners in Israel. Meaning, the Israelis who own these apartments usually do not work in the construction industry, whereas in the countries I mentioned above, many of them do. This makes the danger to the Israeli economy somewhat smaller in the event of a drop in housing prices, because the earning capacity of the majority of the market does not depend on this sector. But it *does* depend on the tech sector. And that is one of my main points here.

While everyone in the country is primarily obsessed with falling apartment prices, I am focused on the cash flow that is currently preventing a collapse of the credit market. The economist Ruchir Sharma, in his book *The Rise and Fall of Nations*, points out two opposite extremes regarding economies and bubbles. An excellent bubble to have is a technology bubble, because despite the subsequent drops in stock prices or the temporary rise in unemployment, real growth does occur, and countries can leverage this later on. Countries that have a wealthy class engaged in technological developments possess a wealthy class that funds these innovations, thereby upgrading the lives of their citizens in the long run.

On the other end of the spectrum, he places the real estate bubble, which is a devastating bubble mainly due to the issue of credit. It can financially wipe out households, cripple them, and bleed into other areas of the economy (damaging the money supply and market liquidity, and causing real harm to ongoing business activity). The US still hasn't fully recovered from 2008. It is enough to walk through the tent cities now present in major US cities, which weren't there before, to understand just how terrible such an event can be.

Additionally, he talks about a very wealthy class that exacts a "tax" on the use of basic and essential products and services (like food, banking, and payments). They do not innovate or create technological developments; they stifle competition and exploit their proximity to centers of power to add more regulations and prevent competition, leaving the public completely trapped. The fact that Israel is an "island economy" greatly strengthens this specific wealthy class, which is exactly the type Sharma says harms nations.

Israel is a very rare case where a country has both the absolute best kind and the absolute worst kind of economic drivers operating simultaneously (according to Ruchir Sharma and the research he conducted on the subject).

