Islamic Equity Funds:
A Brief Industry Analysis
October 1, 1999

By Tariq Al-Rifai, President
Failaka International Inc.
www.failaka.com

Islamic Funds – Background & History

The first known Islamic equity fund, ironically, did not emerge from the Gulf or even the Middle East. The first Islamic equity fund was the Amana Income Fund*, established in June 1986 by members of the North American Islamic Trust (NAIT), an organization based in Indiana which oversees the funding of mosques in America among other things. The fund is still in existence today and has been one of the better performing Islamic funds. Saturna Capital Corp., a small asset management company based in Washington, manages the Amana Income Fund as well as the Amana Growth Fund.

When comparing Islamic funds to the fund industry at-large, one can easily conclude that Islamic equity funds are still in their infancy stage of growth and development. Islamic equity funds have been around for less than six years, with few exceptions.

Other Early Islamic Equity Funds:
- Mendaki Growth Fund, Singapore (5/91)
- Southern Pure Specialist Fund, South Africa (6/92)
- Al Rajhi Local Share Fund, Saudi Arabia (7/92)
- Tabung Ittikal Arab-Malaysian, Malaysia (1/93)

Most of the other 55 equity funds on the market today were launched in 1995 or later. Today, we hear of new funds being launched on a regular basis by an increasingly diverse group of financial institutions.

<table>
<thead>
<tr>
<th>Major fund managers/advisors</th>
<th>Institutions entering Islamic fund management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wellington Management Co., USA</td>
<td>Nomura, Japan</td>
</tr>
<tr>
<td>Al Baraka Investment Bank, Saudi Arabia</td>
<td>Brown Brothers Harriman &amp; Co., USA</td>
</tr>
<tr>
<td>Faisal Finance, Switzerland</td>
<td>Saudi American Bank (SAMBA), Saudi Arabia</td>
</tr>
<tr>
<td>The International Investor, Kuwait</td>
<td>Securities House, Kuwait</td>
</tr>
<tr>
<td>UBS, Switzerland</td>
<td>Commerzbank, Germany</td>
</tr>
<tr>
<td>Robert Fleming, Luxembourg</td>
<td>Morgan Stanley Dean Witter, USA</td>
</tr>
<tr>
<td>Citibank, USA/Bahrain</td>
<td>Pictet &amp; Cie, Switzerland</td>
</tr>
</tbody>
</table>

* There were Malaysian funds launched before 1986, however, it is not clear whether these funds were operated according to Sharia at that time.
Industry Development

Prior to 1995, there were approximately 10 equity funds on the market. Since 1996, the number of equity funds has been nearly doubling every year and numbers approximately 59 today. Fund assets have grown accordingly. This has not been a result of investors rushing to pour their money into these new investment vehicles. Much of the money flowing into equity funds has come from founding institutions or a few high profile investors. This is expected given the fact that the industry is still in the development stage and has not yet gained mass-market appeal.

Islamic funds are pretty diverse for a young industry. There are funds for almost every type of Islamic investor. This is a clear sign of rapid industry development and innovation by Islamic bankers. As global financial institutions develop niche markets to differentiate themselves from the ever-increasing competitive environment, new and innovative products and services will be available for the Muslim investor.

Types of Islamic equity funds:
- Global funds (NCB Global Trading Equity, Wellington Hegira, Al Sawfa, Al Baraka)
- Regional funds (Mendaki Growth, Al Rajhi Middle East, TII Ibn Majid, Al-Nukhba)
- Sector funds (TII Small-Cap, AmanA Income)
- Country funds (Saudi Trading Equity, Al Rajhi Egypt, most Malaysian funds)
- Hedge funds (TII AlKhawarizmi Fund)
- Index Funds (Dow Jones Islamic Market Index Fund)

Industry Size and Future Outlook

Failaka International has been monitoring Islamic equity funds for almost three years and has yet to calculate an accurate figure of the industry size. This is due to the difficulty in gathering data from financial institutions. Therefore, it is believed that no organization or institution has an exact figure of the industry size. Since Failaka has been monitoring over half the funds in the industry, its best estimate or “guesstimate” suggests that total assets in Islamic equity funds are approximately $1.5 billion, but no larger than $2 billion. This figure is dwarfed by the trillion-dollar fund industry in the US where multi-billion dollar funds are the norm.

Islamic investments, as well as Islamic banking in general, have been plagued by negative publicity and mishaps, which have led many Muslims to be cautious towards Islamic finance. In addition, Islamic bankers have not done enough to attract mainstream investors. There are several unresolved issues related to developing uniform Sharia rulings as well as setting benchmarks and disclosure requirements to improve transparency and promote the sharing of information.

The environment, however, is beginning to change with the introduction of Islamic indices by Dow Jones. This is a turning point for the industry as standards and benchmarks have finally been established. Dow Jones has pushed the industry to the next level of development and is attracting new players to the field. The unresolved issues may soon be resolved.