Islamic Funds Proliferate, And Results Prove Divine

By SARAH MCBRIDE
Staff Reporter of THE WALL STREET JOURNAL

Fund houses are falling all over themselves to launch products aimed at the world's 1.2 billion Muslims. And these days, many Islamic funds are leaving their secular counterparts in the dust, making it a lot easier to persuade investors to jump on board.

Just 10 years ago, not even half a dozen Islamic funds existed; today there are 88 worldwide. The situation started changing in the mid-1990s when, after generations of shunning stocks, scholars of Islamic law began to agree that certain equity investments were compatible with the Muslim religion. The funds started springing up by the dozen. Last year 14 were launched, and six more were started in the first quarter of this year, according to the Kuwaiti-American consultancy Failaka International Inc.

"A lot of people until very recently used to think it was not possible to develop an investment program that is in line with Islamic law," says Mohamed Elgari, an Islamic economics scholar at Saudi Arabia's King Abdulaziz University who advises a dozen or so Islamic funds. "They used to think that all public corporations are so involved with interest and other un-Islamic activities that the only solution was to shun all equity investment."

But with some prodding from major Islamic banks -- which saw a huge market in Islamic investing -- the scholars started to find ways it could be done. The funds stay away from non-Islamic banks and other financial-services companies that charge interest, which is against Islamic law. They also screen out companies involved in the alcohol, pork and gambling businesses. They impose limits on the amount of interest-bearing debt owed by any company they invest in, typically cutting out companies with debt of more than 33% of market capitalization.

It's a formula skewed toward newer companies that raise money on equity markets rather than through banks -- in other words, the big technology companies that have done so well over the past several years. Take Citibank's $200 million Citi Islamic Portfolios Global Equity fund, run out of New York but available globally. Nine of its top 10 holdings are
technology heavyweights such as Cisco Systems Inc., Oracle Corp. and Nokia Corp. That bias helped the fund return 72% in the year ended March 31, handily beating its benchmark MSCI World index, which returned 22%.

Tech stocks have taken a beating the past several weeks, so many Islamic equity funds might not do so well in the second quarter. But there are plenty of Muslim-targeted investment alternatives -- funds based on commodities, hedge funds, guaranteed-return funds and Islamic leasing funds, for example. One new fund with less emphasis on growth stocks, Commerzbank AlSukoor European Equity Fund, is up 9% since its launch March 1.

Funds typically collect most of their money from institutions and rich individuals, but their managers are eagerly sizing up the pool of money belonging to ordinary Muslims, which often just sits in non-interest-bearing accounts. Islamic funds now hold just under $4 billion, calculates Tariq Al-Rifai, president of Failaka. Estimates of the untapped cash range from $100 billion to $150 billion globally.

In Asia, Malaysia is leading the way, offering about 13 Islamic funds to Malaysian residents, according to Standard & Poor's Fund Services Asia Ltd. They returned an average of 81% for the year ended March 31, with the top-performing product, the Tabung Ittikal Arab-Malaysian fund, posting a 116% gain. Additional information on Islamic funds is available at [www.failaka.com](http://www.failaka.com) and [www.muslim-investor.com](http://www.muslim-investor.com). That second Web site is excellent on general Islamic investing principles, but it is very U.S.-oriented on product facts.

For very devout investors, it's worth remembering how hard it is to fully meet Islamic strictures. Shahrazad Khayami, who manages the Citi Islamic fund, recalls dealing with a tricky question at an investor conference in the Arabian Gulf: A client asked how Ms. Khayami could be sure the businesses the fund bought shares in didn't serve alcohol and pork at company functions.

"They may spend a lot on pork and alcohol," she recalls telling the client. "But if it doesn't show up in their balance sheet, we can't second guess the company." The investor stuck with the fund.

Write to Sarah McBride at sarah.mcbride@awsj.com