

A revolution in Islamic asset management

A new chapter begins

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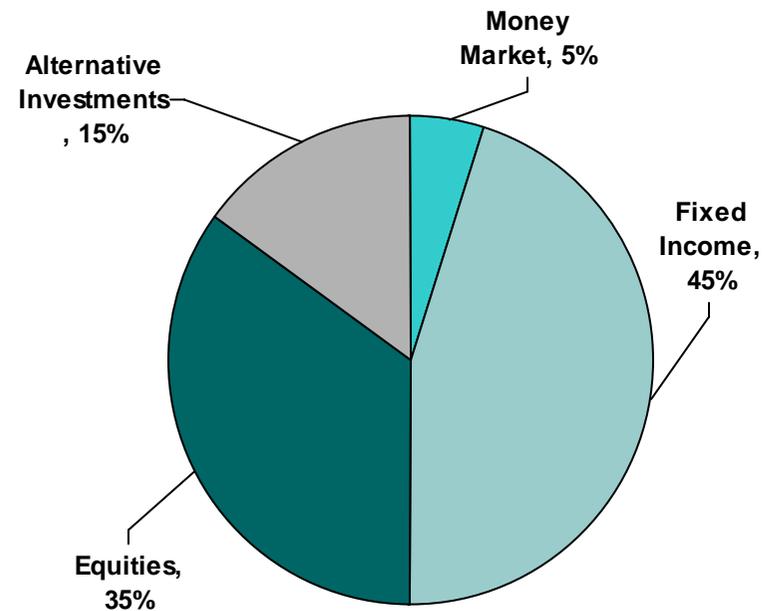
The overall market

- Over \$90 trillion in global managed wealth
- Muslim wealth not less than 3% of the total, almost \$3 trillion total
- Switzerland alone home to over \$2 trillion in global managed private wealth
- Perhaps \$200 billion or more of Muslim managed wealth in the Swiss banking system

Traditional asset management: serving millions of customers, grounded on Modern Portfolio Theory

Traditional managed wealth

- Traditional managed wealth carefully allocated along traditional lines
- Cash, bonds, equity & alternative investments are the only asset sectors considered
- Allocation by asset category consistent globally



Almost none of the Muslim money in Switzerland is managed according to sharia!



Explosive growth of mutual funds in the United States

- Over \$10 trillion total in U.S. mutual funds
- Over 6,000 institutional investors (pension funds, endowments, insurance companies)
- First mutual fund appeared in 1924, first index fund in 1976
- Government-stimulated private savings plans since the 1970s

As of April 2006 there are 8,606 mutual funds that belong to the Investment Company Institute, with combined assets of \$9.207 trillion

Example of innovation....

:::: Today more than 2,000 traditional bond funds

:::: Bond universe is huge:

- Corporate bonds
- Treasury bonds
- Emerging-market bonds
- High-yield bonds
- Convertible bonds
- Mortgage-backed bonds
- Asset-backed bonds



Bond funds allowed investors of all kinds - both retail and institutional - to achieve diversification and professional management in any style and kind of bond investing

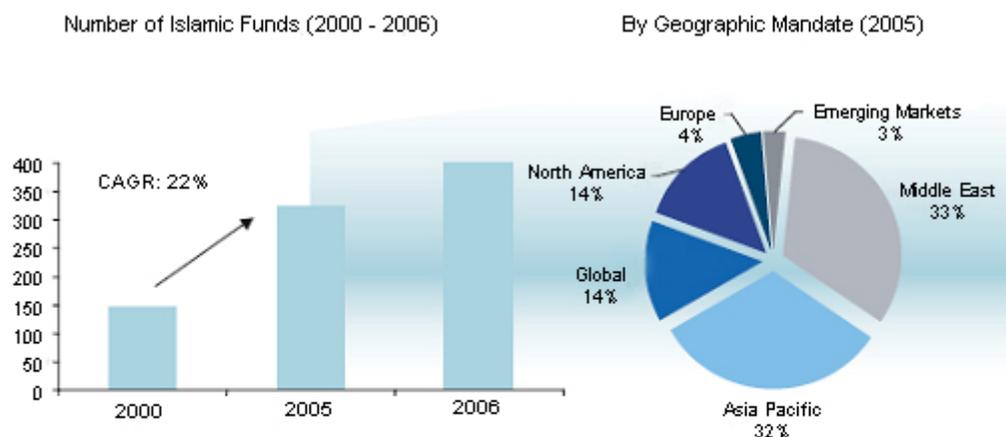
Human creativity in creating complex securities

:::: For the last 25 years bonds have been stripped, separated, and otherwise shredded into pieces to create an enormous universe of hybrid securities: treasury zeros, mortgage strips, interest swaps, and the never-ending line of collateralized debt obligations



Financial professionals are in constant search for yet another way to create a unique investment product that fits some niche in professional portfolio allocation

The universe of Islamic funds

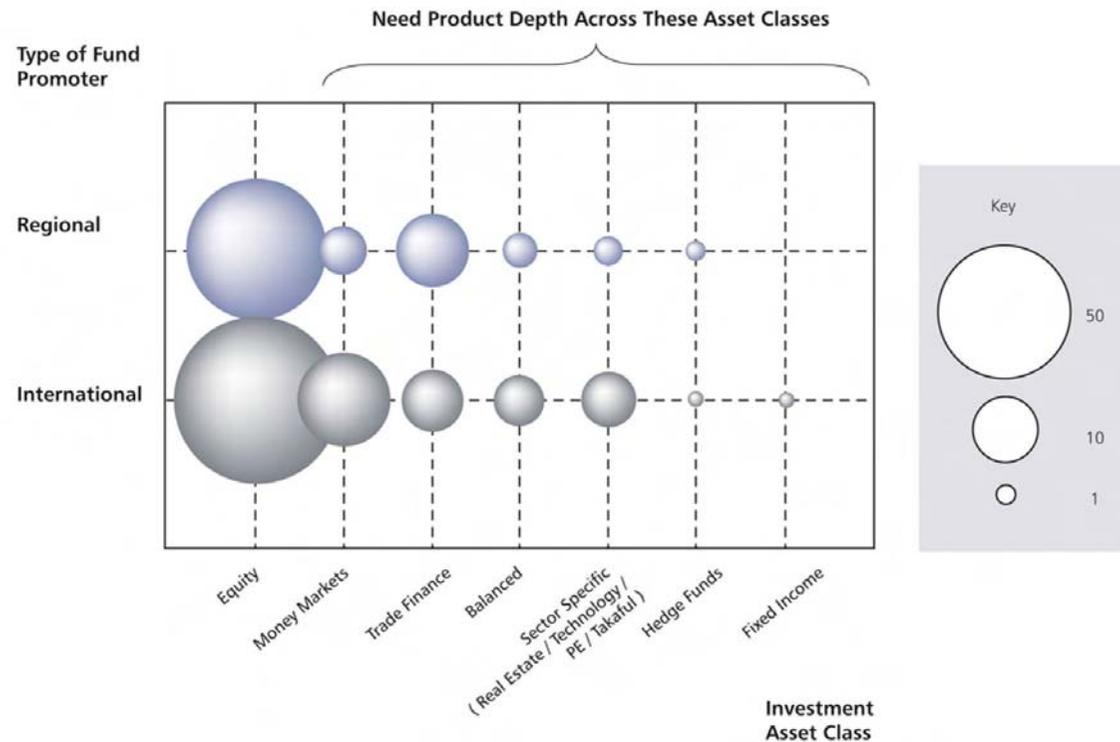


- The universe of Islamic funds has grown by an approximate CAGR of 22% between 2000 - 2005
- The total number of funds forecasted to have reached 400 by 2006
- Geographical mandates in 2005 were dominated by the Middle East / Africa and Asia Pacific regions, accounting for 33% and 32% respectively
- North American and global mandates together accounted for approximately 28%

Source: Eurekahedge, YE analysis

Today Islamic funds are predominantly concentrated on equities. There is so far only one sukuk fund in the market – Sanad Sukuk Fund

The universe of Islamic funds: lack of fixed income (sukuk) funds

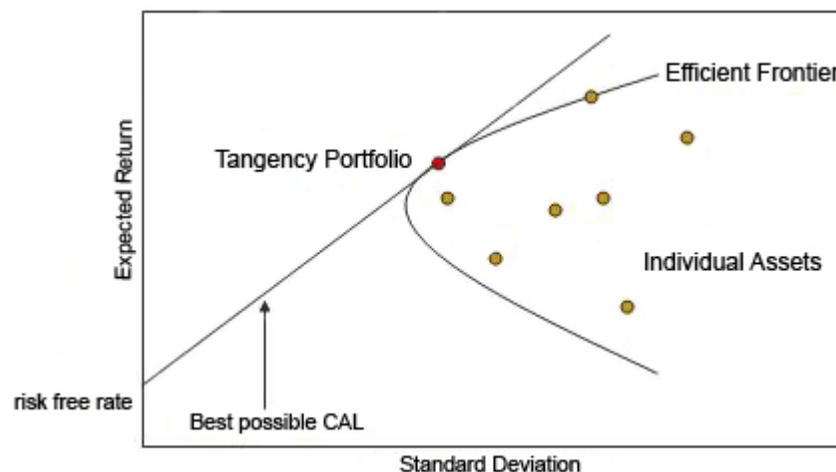


Source: GCC Stock Exchanges; Zawya; The Banker; E&Y Analysis

Ernst & Young: "The supply of Islamic funds is concentrated on equities with substantial gaps across other asset classes"

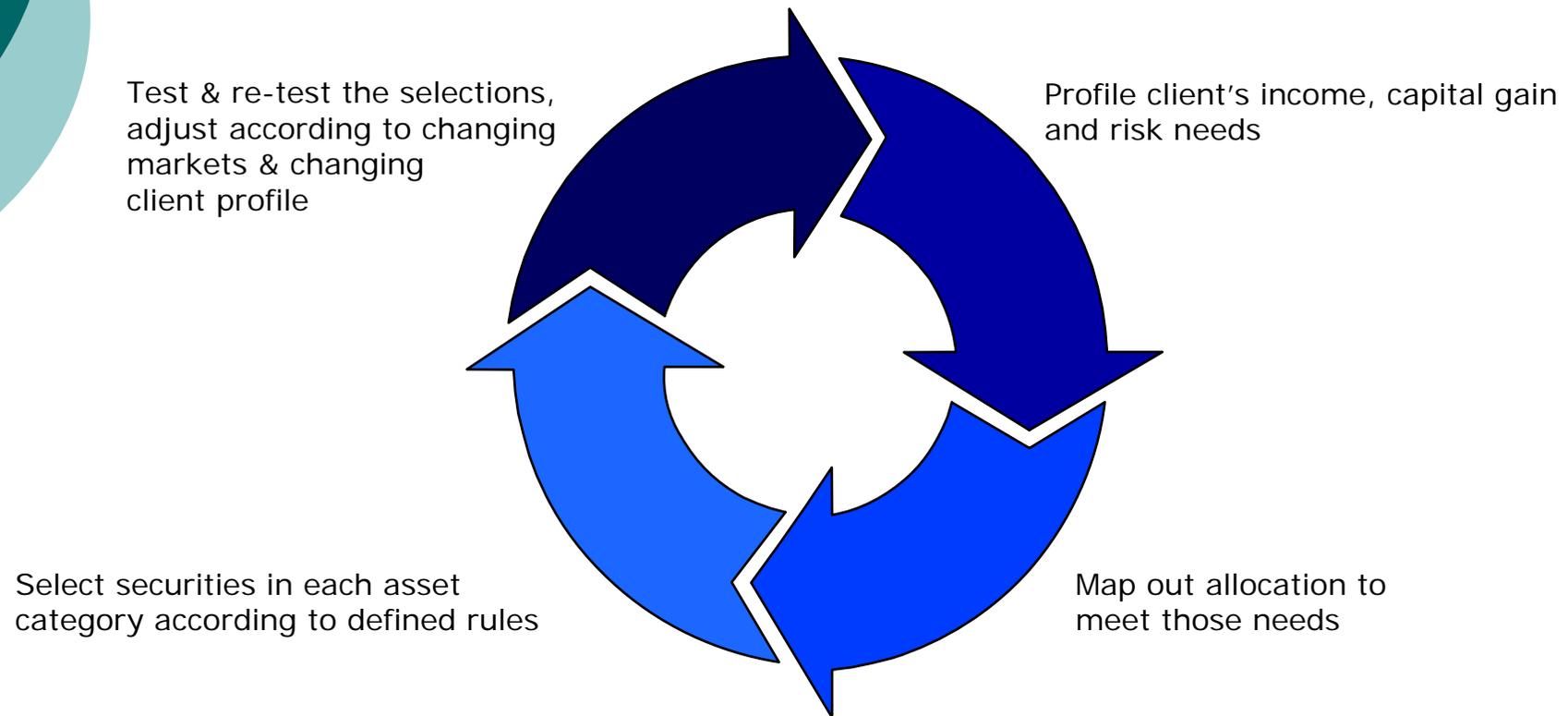
Asset managers drive financial market innovation

- Asset manager's aim is to seek a combination of securities that achieve rational objectives according to Modern Portfolio Theory



Asset managers have no choice but to constantly seek the highest order of efficiency in investing client funds

Asset allocation for Muslims & Non-Muslims





Normal asset allocation in traditional portfolios

Traditional Balanced Investment Strategy

- Deposits allow for opportunistic purchases
- Bonds provide stable, guaranteed returns
- Stocks provide extra yield, but with added volatility
- Alternative Investments provide uncorrelated returns

ASSET	ALLOCATION
Deposits	5%
Bonds	45%
Stocks	35%
A.I.	15%

Like it or not, this is how Islamic funds should also be managed.

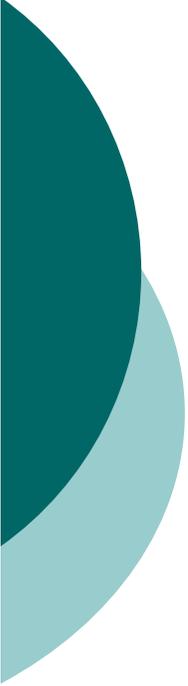


Normal asset allocation in Islamic portfolios

Islamic Balanced Investment Strategy

- Murabaha allows for opportunistic purchases
- Sukuk provide stable, (but not guaranteed) returns
- Stocks provide extra yield, but with added volatility
- Alternative Investments provide uncorrelated returns

ASSET	ALLOCATION
Murabaha	5%
Sukuk	45%
Stocks	35%
A.I.	15%



Islamic asset management and Modern Portfolio Theory

- A common form of investing has evolved after nearly 6 decades of research, statistical evaluation and professional practice
- MPT's applies to everyone regardless of nationality, religious affiliation, or geographic location
- There is no difference between asset allocation for Muslims, Christians, Jews, or Hindus except when one arrives at the final step: security selection

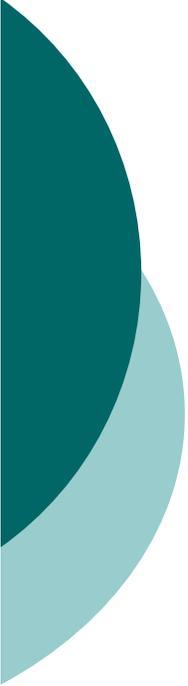
Income, Balanced and Growth strategies: identical, but with different weightings to achieve lower or higher levels of volatility, risk and reward

Problems exist with Islamic asset allocation

- Murabaha and equity funds well enough represented in the Islamic space
- Alternative investments are few, but can work around this with structured or specialized products
- Fixed income was the major block for true Islamic Asset Management

ASSET	ALLOCATION
Murabaha	5%
Sukuk	45%
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Islamic asset management did not exist until the creation of the Sanad Sukuk Fund



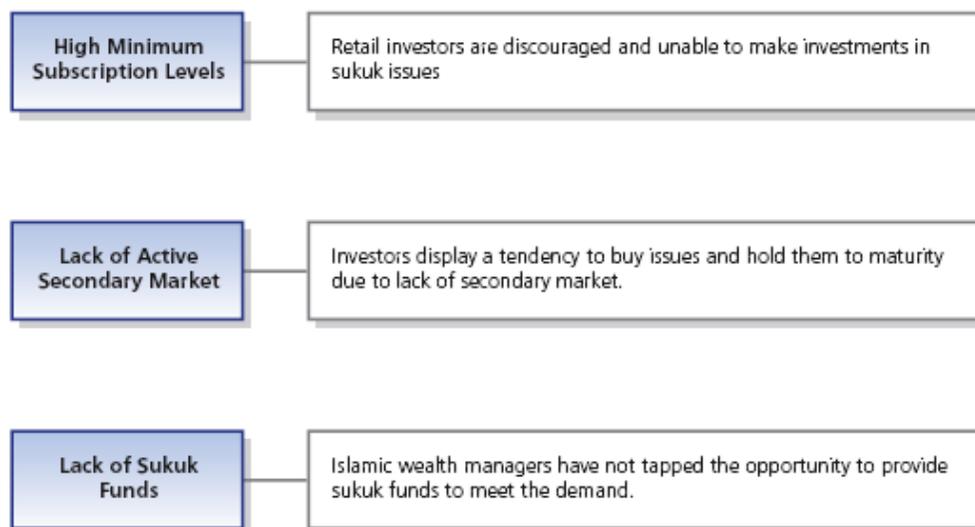
Only now minimum sufficient assets available

- Almost 600 Islamic funds
- Over 400 of them are traditional mutual funds
- Range across asset categories is not bad, but not perfect
- Sukuk and Alternative Investments most problematic
- Islamic banks are extremely slow to respond to obvious need

The most challenging opportunity for asset managers is the growing desire for sharia-compliant assets in the Muslim world



Main barriers to sukuk investing



Despite growth in sukuk issuances, there are still major barriers to investing



Choosing Islamic securities

Avoiding complications and following the same criteria as for traditional securities:

- Liquidity
- Transparency
- Clearing & settlement
- Risk-adjusted return probability
- High levels of confidence

Responsible sharia-compliant investing has same rules as traditional investing



Achieving optimality in the Islamic asset management industry

Growth in every category is essential

- Murabaha (especially new money market instruments)
- Sukuk (non-Malaysian sukuk in particular)
- Equities (over 300 Islamic equity funds, over 2,700 stocks in DJIM Index, \$17 trillion market capitalization)
- Alternative Investments: Number growing, but still only today 4 hedge funds with acceptable fatawa

Result: A near-optimal portfolio (non-Malaysian) can be constructed



Reef and rocks in Islamic asset management

**Common answers from potential sukuk fund buyers
(Islamic bank asset management departments):**

The yield is too low. Our bank only wants LIBOR + 3.00% fixed-income assets

meaning junk?

Our clients are naïve. They only want private equity and real estate

what is the meaning of "financial advisor"?

Our treasury is already too big. We can simply buy Sukuk ourselves

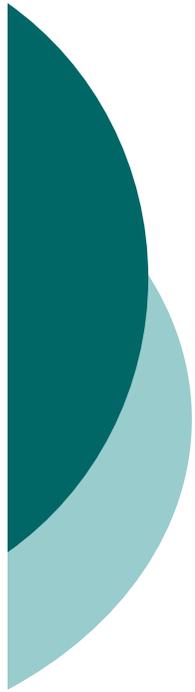
meaning a static portfolio, always fully allocated?



Asset allocation for Islamic portfolios

- The asset allocation process: a rational plan for achieving a specific investment goal
- Religious aspects of allocation: “it is a science, not an art” (the basic principles are the same for Muslims, Christians, Hindus and Jews)
- Selection of securities: Religion does matter

When we choose securities that will have a high probability of achieving investment objectives, we don't change the rules for Islam



For further inquiries contact john@encoremanagement.com

THANK YOU!