

## Islamic Wealth Management: Trends and challenges

# A new direction for Swiss asset managers

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*Islamic wealth management lagged the evolution of Islamic commercial and retail banking. Only now are sharia-qualifying securities and funds available in numbers and quality that meet strict standards for wealth managers. For the first time in history, it is possible to construct portfolios that meet professional standards. And, Muslims worldwide are anxious for this new direction in wealth management.*

Economic growth rates in predominantly Muslim or all-Muslim nations are relatively strongly positive, often in the range of five percent to eight percent annually. Even if the Muslim world has only ten percent of world gross domestic product, its high savings rate means that wealth is being generated in the hundreds of billions of dollars per year, if not more.

Statistics confirming these trends are hard to come by. But, intuitively we know the process is true: Muslim economies are following the general trend of emerging markets and growing, sometimes fast. High savings rates mean high levels of new wealth to be managed. So, what happens inside the Muslim communities around the world is important to wealth managers. Changes in tastes

and preferences, and importantly in risk and reward appetites, should be monitored for signs of opportunity.

### Sharia-compliant assets wanted

The biggest and most challenging opportunity for wealth managers is the clear and unambiguous trend now widespread in the Muslim world: the desire for sharia-compliant assets. Without a doubt, we have fallen behind in efforts to learn and understand what exactly Islamic wealth management is, and how to satisfy the newly awakened Muslim appetite for Islamic portfolios.

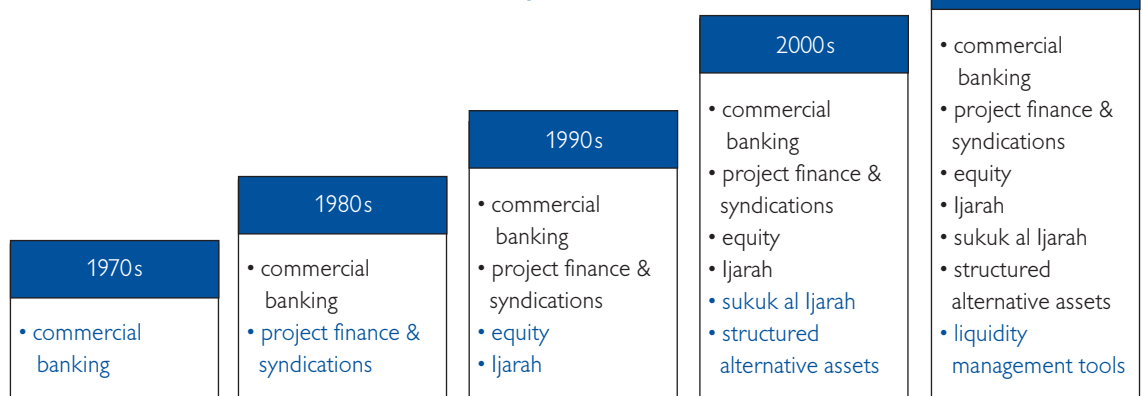
It is helpful to first remind ourselves what exactly is wealth management, and then by extension to understand how the rules of wealth management apply to Muslim savers. First and foremost, we

all understand the basics of asset allocation and portfolio diversification. These rules are unyielding, and apply to all customers regardless of their faith. Second, we know that after allocation decisions we move on toward security selection, insuring the assets chosen for a particular customer will meet the general targets of that customer's investment objectives.

Finally, we also understand that our managed portfolios are nearly always only a fraction of a client's total wealth. A managed portfolio in Switzerland is rarely more than five percent or at most ten percent of the total assets owned by a typical Saudi or Kuwaiti customer. The rest is heavily biased toward real estate properties, direct investments and share markets in local economies. Managing assets in a vacuum – without the benefit of understanding the client's total allocation – leads to irrational or improper portfolio management choices. These principles of investing are in fact universal. They apply to citizens of Abu Dhabi as they do to those in Arkansas or South Africa.

When it comes to security selection, we start to have difficulties. Our initial analysis of a client's portfolio objectives may show he has a general «balanced»

### The evolution of Islamic finance industry



Source: Bahrain Monetary Agency

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PHOTO: DEPARTMENT OF TOURISM AND COMMERCE MARKETING, DUBAI

*Today's Arab world is much more than the picture of the traditional falconer implies. Time, for the western asset managers to extend the range of their services with sharia-compliant products and consulting.*

strategy investment profile, where one would normally place five percent of his funds in cash, 45 percent in fixed-income securities, and the remaining 50 percent in various types of stocks, stock funds and alternative investments.

Today, there is a wealth of choices for several parts of the typical Islamic allocation: *Murabaha funds* nicely fit in the place of deposits (cash), an abundance of stock funds from regional and global money centre banks now allows for some highly defined equity allocations, and even in the alternative space there are a few decently structured securities.

What has been sorely missing from the above is fixed-income assets. By nature Islam prohibits the explicit payment of interest, thereby banishing all traditional bonds. Since bonds make up about 45 percent of all managed wealth worldwide, you quickly realise the sorely exposed gap facing Islamic wealth managers.

The 450 or so existing sharia-compliant funds worldwide (only one of which is fixed-income) do not compare in size or scope with the more than 300 000 in traditional funds. Their small comparative number leaves managers with less choice, meaning in the best cases sub-optimal allocations that could be improved with more sharia-qualifying assets.

#### **Despite high fees and limited applicability interesting**

Finally, while we can admire a few of the sharia-compliant alternative investments, many of them are absolutely worthless for modern portfolios. Excessive fees, ultra-narrow applicability and general randomness are common traits among most sharia-compliant assets today. We cannot adhere to modern portfolio theory with anything but the smallest slice of the alternative-asset funds and securities available today.

The above is a pretty grim picture of Islamic wealth management. That's because those of us trained by Markowitz, Tobin and Sharpe understand there is still a very long way to go in the production and distribution of Islamic-qualifying securities that meet professional wealth management

standards. The sharia-compliant securities that are both available today and worthy of our Muslim client portfolios represent perhaps only 1.0 percent or less of the securities available for non-Muslim clients.

But, this is no reason to despair. The Islamic banking space is growing so fast that we really don't have to wait long for the full depth and breadth of security selection to reach that level of critical mass for truly professional portfolio management to work. And, there are now some very good assets to start the portfolio construction process. Among them is the world's first sukuk fund, a compilation of Islamic «bonds» that neatly fills the gap for fixed-income securities.

Since sukuk trading sizes tend to range in the millions of dollars, they are out of reach for all but the wealthiest Muslim investors. The sukuk fund permits the construction of portfolios that are both professionally compliant and sharia compliant, something that until this year was impossible for all but the very rich.

Since the other two main allocation sectors – cash and equities – have reached the minimum level of security population, we can now say that for the first time in modern history a Muslim saver can in fact have a fully sharia-compliant portfolio professionally managed in his Swiss bank account, or indeed nearly anywhere else in the world.

#### **Who are the clients?**

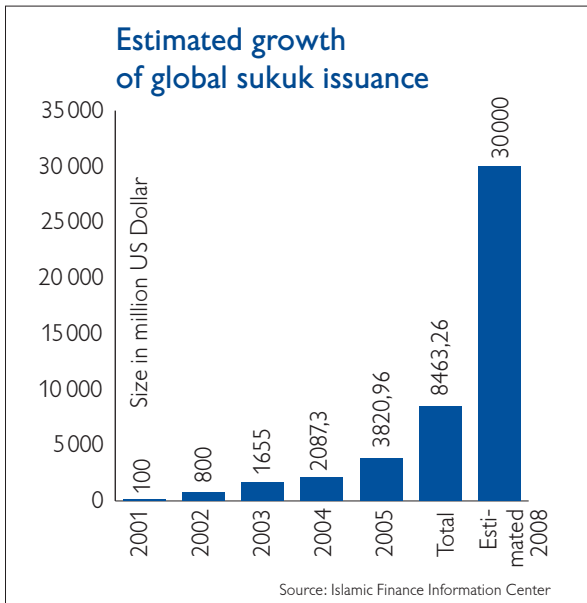
To close, some notes on clients of Islamic wealth management, and the offerings available in Switzerland, should be made. We know that the Muslim world is not homogenous, and in fact is so wildly heterogeneous as to be almost unrecognisable from one region to another, such as Morocco to Indonesia. But, let's not fool ourselves. The cultural heterogeneity hides the underlying homogeneity of Islam. Muslims everywhere do honestly and sincerely want sharia-compliant investing if it is equal in all respects to traditional investing, regardless of their origin.

In the west, we often don't respond fast enough to fundamental changes in other regions of the world. Islamic wealth management is no different. Any regular observer could have easily seen over the last ten years a fast-growing popularity of Islamic banking. But, western banking institutions have had feeble or inadequate responses to this evident phenomenon. For example, without naming names one can say without qualifications that western banks have done almost nothing to close the supply gap for Islamic bonds, despite their hundreds of billions of dollars in annual generation of asset financing worldwide (asset financing is a central value to Islamic banking, and is easily the most quickly converted western security for sharia compliance).

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## A lot to be done

A closing prognosis is as follows:

- We cannot bend the basic rules of asset management for any customer. However, converting Modern Portfolio Theory into Islamic-compliant professional portfolio management is easier than one might think.
- Muslims everywhere are different, but they are united generally in a desire to invest according to their religious principles, all other things being equal.
- Western banks have been slow to create appropriate products – and in fact have muddied the field with many inappropriate securities – in responding to the obvious need for more sharia-compliant assets.
- Western banking centres are not moving fast enough to counter the increasing Islamic wealth management credentials of financial centres such as Dubai and Singapore (both of which are actively and eagerly attempting to lure Swiss private banking customers).
- We are at the nascent stages of proper, professional Islamic wealth management. The rules are simple enough to understand, and the increasing volume of sharia-compliant assets – especially now with the world's first sukuk fund – makes it possible for the first time in modern history to properly serve Muslim customers.



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