

Exchange traded funds gather pace

Investors are embracing Islamic exchange traded funds and the rise in popularity is evident in exchanges worldwide, writes Sabrina Sobri

In less than a month, four Shariah-compliant exchange traded funds (ETFs) listed in the UK and Malaysia. In December last year, the ETF division of Barclays Global Investors, iShares, launched three Islamic ETFs simultaneously on the London Stock Exchange, the first such Islamic investment assets in the UK. These ETFs were reported to have further augmented the UK's development as the global Islamic financial centre. Soon after, Malaysia announced a national Islamic ETF, which was quickly pegged as Asia's first Islamic ETF and was seen as developing Malaysia's bid to be the Islamic banking and financial hub. Barclays and government officials in Malaysia acknowledged the possibility of more Islamic ETFs.

Counting the two older Islamic ETFs listed in Zurich and in Turkey, there are six Shariah-compliant ETFs trading around the world. But this is likely to increase as enthusiasm to provide this Shariah-compliant investing instrument is apparent in other countries. At the start of this year, the Taiwan Stock Exchange Corporation reported efforts with Abu Dhabi Securities Market to develop Islamic ETFs to trade in both markets. Dubai is looking to be the first ETF holding physical gold to trade in the Middle East while Qatar is setting up regulations to allow ETFs to list on its exchange.

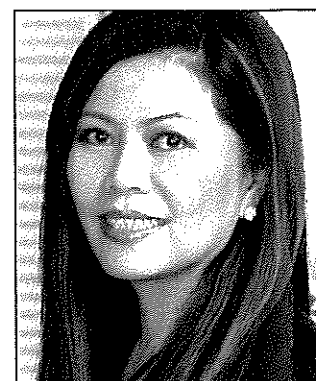
Clearly, these Islamic ETFs are



Rushdi Siddiqui Industry showing definite signs of maturing



Daniele Tohme Adet Middle East investors will buy Islamic ETFs



Datuk Bridget Lai ETFs effective way of increasing liquidity

intended to cater for increasing demand from Muslim investors. Interest in assets that abide by Shariah law has grown in parallel with the spread of wealth across GCC countries in the past years.

Daniele Tohme Adet, head of ETFs and indexed funds development for

More than US\$40 trillion of wealth in the GCC has been created in the last six years

BNP Paribas Asset Management says: "More than US\$40 trillion of wealth (in the GCC) was created in the past five to six years, of which 75% is saved compared with

10% in the 1970s. Last year, the number of Islamic customers in the UK increased by 120%, Islamic bank accounts surged by 200% and Shariah compliant bank deposits grew by 76%. The sukuk market is well developed but there is much to do in the arena of Islamic asset management tools."

Besides demand, countries are expressing interest in ETFs as these assets can be used to increase liquidity of its stock market. Datuk Bridget Lai, group chief executive

officer for Alliance Financial Group, says: "ETFs are an effective way of increasing liquidity as they provide a low cost way to invest in equity. The Malaysian Islamic ETF has an initial fund size of RM3.5 billion and it is intended to improve the free-float of shares in the market [as opposed to being held by government companies] and to encourage retail participation."

As passively managed funds designed to track performance of an index, ETFs are similar to index mutual funds. ETFs are listed and traded on a stock exchange and this makes them much cheaper to buy, especially in Asian countries like Malaysia where mutual funds levy upfront sales fees that go as high as 5% of net asset value.

Islamic ETFs are different from their conventional counterparts because the indexes they track are made up of companies that have passed filters specified by the strictures of Shariah law.

These filters eliminate companies that operate in certain industries such as tobacco, alcohol, gambling, conventional banks as well as

companies that do not satisfy certain financial ratios.

Rushdi Siddiqui, global director for Dow Jones Islamic Market Indexes, says: "The listing of these Islamic ETFs shows that the Islamic finance [investing] industry is maturing, and the fact that it is demand-based, implies a level of sophistication."

Demand

Global investors are expected to embrace this newly introduced Shariah-compliant asset to leverage the advantages of an ETF and its adherence to Islamic law.

Daniele Tohme Adet says: "Middle East investors as well as high net-worth individuals and private banking advisers based in Switzerland, Monaco and Luxemburg will be investing in these Islamic ETFs."

According to i-VCAP Sdn Bhd, the fund manager of Malaysia's Islamic ETF known as MyETF-DJIM25, foreign investors had already entered the market to acquire units.

When this ETF was introduced,

the number of units available to private investors was oversubscribed on the second day.

Zainal Izlan Zainal Abidin, CEO of i-VCAP, says: "Foreign investors were among the initial subscribers of MyETF-DJIM25. This ETF provides convenient access into the Malaysian equity market and the Shariah-compliance filters eliminate financially weak companies. Therefore, the component stocks of these ETFs are generally of strong financial ground."

While the industry and financial ratio filters for Shariah compliance may initially appear to limit the universe of investible stocks, investors have benefited from this characteristic common among financial assets.

Global Islamic actively managed funds, for example, were not severely affected by the scandals afflicting companies such as Enron

and WorldCom several years ago, as these companies' highly leveraged balance sheets restricted Shariah funds from investing in them.

More recently, global Islamic funds managed to circumvent effects of the sub-prime crisis as their Shariah-compliance filter prohibits investments in conventional banks and mortgage companies. As a result, non-Muslim fund managers have found it beneficial to invest in Islamic assets for strategic purposes.

Mr Rushdi says: "As an investing tool, ETFs overcome several major hurdles including cost, distribution and access. With an Islamic ETF, where there is confidence of compliance to Shariah rules, its appeal cuts across spiritual and secular boundaries."

Mr Zainal points out that ETFs are already regarded as diversified assets while their exclusion of conventional finance companies

further reduces volatility and risk.

Ms Lai of Alliance Group, says: "Foreign-based Islamic funds that track benchmark indices will find the availability of Islamic ETFs helpful, as this tool improves efficiency compared with trying to emulate a given index by buying the component stocks."

"Fund managers will use Islamic ETFs for indexation purposes or simply to increase or reduce exposure to short-term trading. Institutional investors can also use Islamic ETFs to hedge underexposure to equities much like how they use conventional ETFs", says Ms Lai of Alliance Group.

Expected performance

A common misconception is that performance of an ETF depends on trading volume. Unlike shares, units in an ETF can be created or retired to ensure it stays in line with its underlying securities.

Thus, trading volume is more accurately used as a sign of investor's sentiment but not performance of this asset. This means that the

outlook of each security held by the ETF is a better indicator to gauge expected returns of this asset. For example, the prospects of the energy sector is directly linked to the outlook for the Malaysian and London-based ETFs, as all these ETFs have an energy stock bias.

Pong Teng Siew, head of research for MIMB Investment Bank, says: "MyETF-DJIM24 is a proxy to the plantation sector in the country. As this sector is expected to do well in the coming year, investors are buying this ETF as opposed to individual plantation companies."

Performance of the underlying index of EasyETF DJIM Titans 100 in Zurich has outperformed its conventional index counterpart. This Islamic index is made up of the top 100 global companies that comply with Islamic investment guidelines.

Daniele Tohme Adet says: "This Islamic index has been surpassing the conventional index (DJ Titans 100) by 20% per year since 1996 and has been an excellent tool in circumventing effects of the sub-prime crisis."

Exchange traded funds on world exchanges

Name	MyETF-DJIM25	iShares MSCI World Islamic	iShares MSCI Emerging Markets Islamic	iShares MSCI USA Islamic	DJIM Turkey ETF	DJIM Titans 100
Listed in	Malaysia	London Stock Exchange	London Stock Exchange	London Stock Exchange	Istanbul Stock Exchange	SWX Swiss Exchange
Managed by	i-VCAP Management Sdn Bhd	Barclays Global Investors	Barclays Global Investors	Barclays Global Investors	BMD Securities	BNP Paribas Asset Management
Description	Consists of the 25 biggest Shariah compliant Malaysian companies by market capitalisation	Invest in the Shariah compliant constituents of the MSCI USA index	Holds sharia compliant constituents of the MSCI Emerging Market Index	Invest in the Shariah compliant constituents of the MSCI USA index	26 major Turkish corporates including Petkim, Arcelik, Turk Otomobil and Ulker	Tracks the top 100 global companies that comply with Islamic law
Total number of securities held	25 companies including Sime Darby Bhd, IOI Corp Bhd and Digi Bhd	793 stocks. Sectors include energy, healthcare and IT	206 stocks across markets like China, South Korea, Brazil and Russia	276 stocks in the energy, healthcare and IT sector	26 companies	100 companies
Inception date	Jan 2008	Dec 2007	Dec 2007	Dec 2007	Jan 2006	Jan 2007