CHALLENGES IN MANAGING ISLAMIC PORTFOLIOS

by

AMEER ALI MOHAMED
CEO/CIO
ASM Investment Services Berhad

Sime Darby Convention Centre
19th December 2013
AN INTRODUCTION TO ASM INVESTMENT

- The holder of Capital Market Services Licences in the following regulated activities:
  - Fund Management
  - Dealing in Securities Restricted to Unit Trust
  - Dealing in PRS
- Has been involved in the unit trust business since 1967 under the name of Amanah Saham MARA Berhad (now Pelaburan MARA Berhad (PMB), the parent company of ASM Investment)
- To be a full fledged Shariah-compliant fund manager by 1 January 2014.
- Has 14 unit trust funds under its stable:
  - 11 Equity Funds
  - 1 Balanced Fund
  - 1 Cash Management Fund
  - 1 Principal Protected Fund (maturing 19 January 2015)
- Manages equity portfolios for corporations and institutions.
- A wholly owned subsidiary of PMB, which in turn is wholly-owned by MARA
UNIT TRUST FUNDS OF ASM INVESTMENT
CHALLENGES IN MANAGING ISLAMIC PORTFOLIOS

• Availability of Shariah approved lists
• Malaysia experience – Issues in Sector selection
• Malaysia experience – Issues in Securities selection
• Malaysia experience – Issues in Big- and Mid-Cap PLCs
• Malaysia experience – New Listing
• Index issue
• The need for cleansing process, or otherwise

The above list is non-exhaustive.
AVAILABILITY OF SHARIAH APPROVED LISTS

• Some make their respective Shariah approved lists public:
  • Makes it easier for investors, either institutional fund managers or retail investors, to follow
  • No extra cost in managing Islamic portfolios
  • Helps in the development of the Islamic capital market in the particular country

• Some provide their approved list only to their subscribers:
  • An extra cost in managing Islamic portfolios
  • Islamic investing seen as being exclusive

• In the interest of the development of the Islamic Capital Markets, Government - at least those of Muslim countries - should play the role managing and providing the investing public the Shariah Approved List free of charge.
MALAYSIA EXPERIENCE – ISSUES IN SECURITIES SELECTION

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Shariah Compliant</th>
<th>SC/All</th>
</tr>
</thead>
<tbody>
<tr>
<td>No of PLCs</td>
<td>914</td>
<td>653</td>
<td>71%</td>
</tr>
<tr>
<td>Total Market Capitalization</td>
<td>1,633,241</td>
<td>1,029,280</td>
<td>63%</td>
</tr>
<tr>
<td>(RM mil)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Although 71% of the PLCs are Shariah-compliant, they represent only 63% of the total market capitalization.
- Only 166 Shariah-compliant PLCs have market capitalization of > RM500 million

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Shariah Compliant</th>
<th>SC/All</th>
</tr>
</thead>
<tbody>
<tr>
<td># Stocks with Mkt Cap &gt; RM500</td>
<td>254</td>
<td>166</td>
<td>65%</td>
</tr>
<tr>
<td>mil</td>
<td>28%</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>Total Mkt Cap of Stocks</td>
<td>1,548,633</td>
<td>966,514</td>
<td>62%</td>
</tr>
<tr>
<td>(RM mil)</td>
<td>95%</td>
<td>94%</td>
<td></td>
</tr>
<tr>
<td>&gt; RM500 mil</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
MALAYSIA EXPERIENCE – ISSUES IN BIG- & MID-CAP PLCs

- Only two-thirds of the PLCs with market capitalization above RM7 billion are Shariah-compliant. They represent 63% of the total market capitalization for this group.

- Only 61% of the PLCs with market capitalization of between RM1 billion and RM7 billion are Shariah-compliant. They represent only 58% of the total market capitalization for the group.
MALAYSIA EXPERIENCE – ISSUES IN SECTOR SELECTION

- Finance sector is not well represented in the Shariah-approved stocks although Malaysia is the leader in Islamic banking and finance.
- In terms of the number of stocks, the Shariah-compliant finance PLCs represent only 6% of the total finance PLCs.
- Against the total Shariah-compliant companies, the two approved PLCs represent a miniscule 0.30% in terms of number. This compares against all the 36 finance PLCs representing 3.9% of the overall market.

<table>
<thead>
<tr>
<th>Sectors</th>
<th>All</th>
<th>Shariah Compliant</th>
<th>SC / All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Products</td>
<td>133</td>
<td>106</td>
<td>80%</td>
</tr>
<tr>
<td>Industrial Products</td>
<td>261</td>
<td>194</td>
<td>74%</td>
</tr>
<tr>
<td>Mining</td>
<td>1</td>
<td>1</td>
<td>100%</td>
</tr>
<tr>
<td>Construction</td>
<td>44</td>
<td>36</td>
<td>82%</td>
</tr>
<tr>
<td>Trading / Services</td>
<td>206</td>
<td>143</td>
<td>69%</td>
</tr>
<tr>
<td>Properties</td>
<td>86</td>
<td>59</td>
<td>69%</td>
</tr>
<tr>
<td>Plantation</td>
<td>39</td>
<td>34</td>
<td>87%</td>
</tr>
<tr>
<td>Technology</td>
<td>95</td>
<td>71</td>
<td>75%</td>
</tr>
<tr>
<td>Infrastructure (IPC)</td>
<td>6</td>
<td>5</td>
<td>83%</td>
</tr>
<tr>
<td><strong>Finance</strong></td>
<td><strong>36</strong></td>
<td><strong>2</strong></td>
<td><strong>6%</strong></td>
</tr>
<tr>
<td>SPAC</td>
<td>2</td>
<td>2</td>
<td>100%</td>
</tr>
<tr>
<td>Hotels</td>
<td>4</td>
<td>Nil</td>
<td>0%</td>
</tr>
<tr>
<td>Closed-end Fund</td>
<td>1</td>
<td>Nil</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>914</strong></td>
<td><strong>653</strong></td>
<td><strong>71%</strong></td>
</tr>
</tbody>
</table>
MALAYSIA EXPERIENCE – ISSUES IN SECTOR SELECTION

• There is a huge disparity between the contribution of finance & insurance sector in the economy and the presence of Shariah-compliant finance and takaful listed companies on Malaysia bourse
  • 7.3% vs 0.8%
• It is PROPOSED that one of the main drivers of the next expansion of Malaysia’s Islamic Capital Markets is to get the locally incorporated Islamic banks, that meet the listing requirements, listed.
• But without any PAL to the shareholders of the listed parent.

Malaysia GDP by Sector (3Q2013)

- Agriculture, 10%
- Mining & Quarrying, 9%
- Manufacturing, 24%
- Construction, 4%
- Services: Others, 45%
- Services: Finance & Insurance, 7%
MALAYSIA EXPERIENCE: NEW LISTING

- The Shariah compliance review for Pre-IPO securities states:
  - The SAC of the SC conducts Shariah compliance review on securities listed as well as for securities to be listed on Bursa Malaysia. Prospective issuers, at pre-IPO stage MAY apply to the SC to have such reviews conducted and have an opportunity to advertise or disclose the Shariah status of their securities in the prospectus of the company during the offering period.

- Well …
  - It is only an option for companies going for a listing to undertake this exercise.
  - Hence, some companies don’t and wait for the six-monthly review
  - Is the pre-IPO fee prohibitive? But companies can pay million ringgit for listing exercise

- In the interest of the Islamic Capital Markets in Malaysia, it is PROPOSED that the authorities – both the SC and Bursa Malaysia – make it compulsory for a company going for a listing exercise to engage the SAC of the SC to determine whether the company is Shariah compliant or otherwise, and the status to be released before the offer is made by MITI to eligible Bumiputra investors. Exemption to this rule be given only to companies whose core activities are against the Islamic principles that fall under the 5% threshold.
INDEX ISSUES

- Reference Date: When an index component becomes Shariah non-compliant on a particular day.
- Index Removal Date: The removal is not immediate, but on a later date which is determined by the index provider as per its SOP.
- PLCx: The PLC that becomes Shariah non-compliant
- As a result, there are investment issues between the reference and the index removal dates:
  - Price change of the PLCx will influence the index movement, but for Islamic portfolios, price increase of the PLCx will not affect the portfolio value if the price > cost / reference price
  - An Islamic Portfolio set up in between the two dates will not be able to have the Shariah non-compliant PLCx in the portfolio for the purpose of benchmarking during the period
  - More issue for an Islamic Portfolio that is benchmarked against the index
THE NEED FOR CLEANSING PROCESS, OR OTHERWISE

• Let it be the differences of opinion on whether or not Islamic funds should do cleansing process.

• Cleansing is not required for investments in Shariah-compliant securities approved by a recognized body where the decision on Shariah-compliant is made based on:
  • thresholds determined by ijtihad by scholars at least at the national level; and
  • financial figures supplied directly by the PLCs to the Council for analysis.

• Cleansing is a must for investments in securities in markets where it is impossible to use the thresholds set in Muslim countries, but practice a much “lenient” level of thresholds.

• The issue is whether cleansing should be on:
  • dividend return only; or
  • total returns (capital return + dividend return)
POINTS TO PONDER

• Does Islamic fund or Islamic investing only refer to the following three factors:
  • Approved PLCs?
  • Types of securities?
  • Cleansing, where applicable?

• How about Settlement issue?
  • “Trading on the air”

• How about Investing issue?
  • “gamble” vs “invest”

• How about Ethical issues relating to approved PLCs?
  • Unethical practices with stakeholders
  • Unethical practices in securing contracts
  • Unethical practices in human capital management

• The above list is non-exhaustive
Thank you

Ameer Ali Mohamed
CEO/CIO
ASM Investment Services Berhad

Tel. : 03-4145 3800
Fax : 03-4145 3801
Email : investorrelation@asminvestment.com.my

www.asminvestment.com.my