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Shariah in a Fast-Changing World

2017 was a strong year for equity markets globally, but we saw even stronger performance from Shariah equity markets. While the [S&P Global BMI](#) (an all-cap global index) rose 24.8% for the year, its global Shariah-compliant counterpart rose 27.4% (see Exhibit 1). In the U.S., the [S&P 500](#)[®] saw a gain of 21.8%, while the Shariah-equivalent U.S. index rose 22% for the year. Since 2008, when financial stocks were in the doldrums, the outperformance of broad Shariah-based indices has highlighted their absence from the market. In 2017, the performance of the global financials sector was an impressive 24.1%, indicating that there were some other factors at work.

Exhibit 1: 2017 Index Returns

INDEX	RETURN (%)
S&P Global BMI	24.7
S&P Global BMI Shariah	27.4
S&P 500	21.8
S&P 500 Shariah	24.2
S&P High Yield Dividend Aristocrats	16.4
S&P High Yield Dividend Aristocrats Shariah Index	18.0

Source: S&P Dow Jones Indices LLC. Data as of Dec. 29, 2017. Index performance based on total return in USD. Past performance is no guarantee of future results. Table is provided for illustrative purposes.

A closer look revealed that the information technology sector, which reflected over 30% of the weight of global Shariah equities, grew 41.3%, far overtaking the financials gain and making up for the loss that Shariah indices suffered due to the absence of financials. Information technology and financials make up the largest difference of sector weights between broad-based global equities and their Shariah-compliant counterparts (see Exhibit 2).

Exhibit 2: Sector Weights		
SECTOR	S&P GLOBAL BMI (%)	S&P GLOBAL BMI SHARIAH (%)
Consumer Discretionary	12.3	10.9
Consumer Staples	8.2	9.2
Energy	6.0	6.1
Financials	18.1	0.5
Health Care	10.5	17.1
Industrials	12.2	15.5
Information Technology	17.2	31.2
Materials	6.0	7.0
Real Estate	4.1	0.8
Telecommunication Services	2.7	1.2
Utilities	2.9	0.6

Source: S&P Dow Jones Indices LLC. Data as of Dec. 29 2017. Table is provided for illustrative purposes.

While a small number of U.S.-based financial institutions offer Shariah compliant financing services, there is no U.S. regulatory body that governs banks based on Shariah values.

The U.S., with a Muslim population of 3.5 million—projected to be 8.1 million by 2050 (according to Pew Research Center)—presents a rich base of clients looking for Shariah investment opportunities. Currently about USD 2.8 billion is invested in U.S.-based Islamic funds, according to the IFSB. While a small number of U.S.-based financial institutions offer Shariah-compliant financing services, there is no U.S. regulatory body that governs banks based on Shariah values. Activities like Federal Deposit Insurance Corporation-approved deposit accounts, home, vehicle, and business financing, and property and commercial insurance facilities are available under a Shariah-compliant aegis; however, it is still on a relatively small scale. It is clear that there is a lot of room for popularizing Shariah equity investing in innovative ways.

Shariah indices continue to remain popular in the equity world for long-only active managers. In the past few years, a lot of innovation has happened in the space of passive investing, and we will investigate here how much of that has influenced Shariah indices.

The first space we looked at is exchange-traded funds (ETFs), which have been the fastest-growing financial instrument in the last decade, crossing the USD 4 trillion mark globally at an astonishing pace. Their growth rate has far outstripped that of active mutual funds, and investors around the world have embraced them with eagerness. When we reviewed the ETFs in the Shariah space, the outlook was far more subdued. As of March 2018, there were a total of 12 ETFs in the Shariah space, with assets under management of USD 358 million, according to Bloomberg. The listings were from a spectrum of locations, ranging from Saudi Arabia to Malaysia and to Europe.

The only Shariah-based ETF listed in the U.S. was delisted within six months of its launch, and overall, five Shariah-based ETFs have been

delisted in the past few years. Clearly, ETFs have not resonated in the Shariah-investing world. The reason that Shariah investing has been captive to long-only active investors could be that sufficient marketing initiative has not been taken to popularize these ETFs, which frequently cut into active managers' fees.

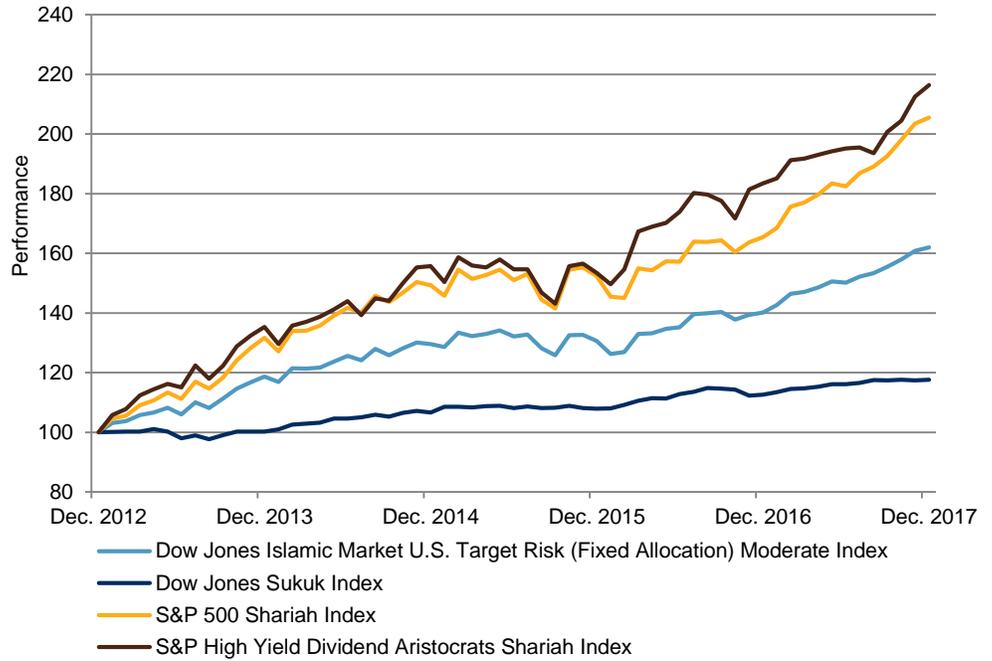
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More encouraging have been some recent innovative index launches for Shariah investors, including Shariah dividend indices. Dividend indices have been popular with conventional investors, as they help tap into a source of income and, for some, are an indicator of long-term value. Constituent stocks forming the [S&P Composite 1500®](#) are first screened for Shariah compliance and companies that have consistently increased their dividends for 20 years form the [S&P High Yield Dividend Aristocrats®](#) [Shariah Index](#). Additionally, the [S&P Global 1200 Shariah Low Vol Dividend Cycle Index](#) combines the advantages of low volatility stocks with that of dividend payouts, giving exposure to two factors: low volatility and dividends.

Demand for multiasset indices has increased significantly in recent years, as investors seek to maximize growth and minimize risk. The S&P Pan Arab Shariah Balanced Indices are designed to take a long position in Pan Arab Shariah-compliant equities and sukuk bonds at fixed weights to form a composite portfolio. Varied equity-to-sukuk allocations are available, including 75% equity, 50% equity, and 25% equity offerings.

Most recently, the DJIM Target Risk Shariah Indices have been the most innovative offering to investors. Each available index has a predefined allocation to equities, fixed income, and a cash component in order to target defined risk/return profiles. For example, the [Dow Jones Islamic Market Target Risk Moderate Index](#) reflects a 60% allocation to Shariah-compliant global equities, 36% to sukuk, and 4% to a cash component. The assigned risk level depends on the allocation to equities and all the indices are risk weighted, with moderate, aggressive, and conservative versions available. In addition, clients have a choice of investing in global equity exposure or U.S.-only equity exposure. Such recent offerings allow a wider variety of choices available in terms of asset classes and allocation options.

Exhibit 3: Performance of Shariah Indices



Source: S&P Dow Jones Indices LLC. Data as of Dec. 28, 2017. Index performance based on total return in USD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

All of these indices illustrate the variety of choices that are available to Shariah investors to give them innovative and optimal investment options that fit their needs.

PERFORMANCE DISCLOSURE

The Dow Jones Islamic Market U.S. Target Risk (Fixed Allocation) Moderate Index was launched on December 27, 2017. The S&P High Yield Dividend Aristocrats Shariah Index was launched on June 1, 2017. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. Complete index methodology details are available at www.spdji.com.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the Index is set at a fixed value for calculation purposes. The Launch Date designates the date upon which the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its datafeed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown. The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at www.spdji.com for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

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