Staying Buoyant

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Asset managers, whose fund sizes have shrivelled to a fraction of what they were before the international financial crisis, are capitalising on this unique window of opportunity to think out of the box. Maybe, even destroy it. They are looking for transparent innovative products with minimal risks, which guarantee capital protection and relatively good returns. It appears that these asset managers are putting into practice what economist Paul Romer once said, "A crisis is a terrible thing to waste."

Enter Islamic asset management

"The challenging environment of conventional markets is providing an incentive to explore this market segment," said Bernardo Vizcaíno, managing director of Amsar Partners, an independent consultancy which creates and develops Shariah-compliant portfolios. "The asset managers are enhancing their understanding of Shariah-compliant products and gaining the ability to structure and launch such products more easily. There is also greater access to Shariah advisory platforms which allow these firms to build their Islamic finance capabilities without the need to create an internal board," added Vizcaíno.

Transparency and minimal risks are among the reasons why Islamic funds seem more attractive at the moment to investors while most of their non-Shariah compliant counterparts are struggling. Morningstar, a US-based independent investment research provider, listed two funds from the Shariah-compliant Amana Mutual Funds Trust as among the top three best-performing, faith-based funds in Malaysia in January 2009. The funds lost 25.8% and 30% respectively last year, compared to the average 44% losses at other conventional funds.

The defensive bearing of the Islamic funds has naturally triggered demand for more Islamic funds, especially in Asia, where more and more players are jumping on the Islamic bandwagon. In late January this year, Securities Commission Malaysia awarded Islamic fund management licenses to BNP Paribas Islamic Asset Management Malaysia, Nomura Islamic Asset Management and Aberdeen Asset Management.

This is in addition to five such licenses previously granted to Kuwait Finance House (Malaysia), DBS Asset Management, CIMB-Principal Asset Management, Global Investment House and Reliance Asset Management. Malaysia allows 100% foreign ownership of Islamic fund management companies and this has triggered interest from global key players, some of which have already set up offices in the country.

Smaller basket is biggest hurdle

However, turning Islamic has its own set of challenges. Fund managers operating under the Islamic banner have a relatively smaller basket of investments to invest in compared to the basket of available investments. All must turn to the Dow Jones and Standard & Poor's Islamic indices to craft good Shariah-compliant investment products. Fund managers know this is their biggest hurdle. Islamic asset classes have yet to penetrate the market, making it a challenge to deliver good results to clients.

"Our main challenge lies in coming up with truly global products, given the limited investment universe," Nor Rejina Abdul Rahim, managing director of Nomura Islamic Asset Management Malaysia admitted. "But we are confident that we can play a greater role in developing the market further, thus we are keen on coming out with new products to meet our clients' investment needs."

The Japan-based company applied for the Islamic license for its Malaysian operations as it saw growth in the sector. "Now's as good a time as any to develop Islamic products further as there are many positive attributes of Islamic finance," said an upbeat Nor Rejina. She told Islamic Finance Asia that Nomura is targeting to manage US$1 billion in five years.

"Of course," she hastened to add, "this (amount) will be revised if things pick up. We did the same for the conventional side in 2006 and we achieved our target in 10 months. However, market conditions have changed quite a bit since the end of 2006. We want to see how the market responds to our product offerings first and then we'll take it from there."

On product offerings, or rather the lack of them, various calls have been made for greater creativity in the Islamic finance space to design new products. Islamic finance practice Norton Rose put it aptly when it said: "Current market conditions scream out for convertibles, preferred shares and other hybrids", adding that all financiers (conventional and Islamic) should be open to the opportunities the financial turmoil presents.

Need for global standards

There is definitely growth in Islamic asset management, but constraints do exist, cautioned the CEO of an asset management company in Singapore. He believes the Shariah-compliant universe of investments is much larger than perceived, but appears small because of the Shariah-compliant screening process.

"There are still windows for investments that comply with Shariah, for example, the agricultural, pharmaceutical and healthcare sectors. These are the sectors that are resilient even during tough economic times. As long as there is demand for food and medication, there will always be investors in these sectors," he said.

The problem, he said, lies in the extra cost and time involved in getting the Shariah advisory board to approve companies eligible for Shariah investments. Speaking from experience, the CEO expressed his frustration at the differences in the application of Shariah standards. "Different boards require different standards. It would be helpful if there were only one global Shariah standard that we should all follow." He believes that if the issue is settled and the levels of Shariah approval simplified, Islamic investment products could then be made more attractive to investors. BNP Paribas Islamic Asset Management Malaysia, on the other hand, does not view the process of securing Shariah approval as a stumbling block for it to grow in the Islamic asset management sector. The company, which has more than 20 years' experience in Islamic banking operating out of its hub in Bahrain, has its own dedicated Shariah board. It managed and advised on Shariah assets of around US$500 million as at 31 December 2008 and plans to multiply this fivefold over the next two years.

"BNP Paribas was among the leading banks to recognise the importance of Islamic banking. It established BNP Paribas Najma in 2003 in Bahrain as a global entity with the mission of providing Islamic solutions worldwide," said Hisham Abdul Rahim, executive director of BNP Paribas Islamic Asset Management Malaysia. "This approach ensures the consistency of the application of Shariah principles and guidelines across all of BNP Paribas Group's Islamic products."

Gerald Ambrose, managing director of Aberdeen Asset Management, is also confident about Islamic opportunities for the company. "The core of the investment process which Aberdeen uses to construct its investment portfolios will not be altered when applied to Shariah investments. Our investment style will remain essentially the same," he confirmed. "The investment process is based purely on the fundamentals of each company analysed and, therefore, has no bias toward one sector over another, although each investment will have to be approved by our Shariah advisor."

No great expectations

On the returns of the Islamic investment funds, fund managers are understandably coy. Clearly, the current market conditions and uncertain outlook on the global economy have jolted them. "Just as we take the bottom-up approach to our portfolio construction, we do not try to predict returns. Those who put emphasis on this might have come unstuck in 2008. However, Aberdeen's track record is testament to the effectiveness of our investment process," said Ambrose.

Nor Rejina of Nomura Asset Management Malaysia said, "We do not provide any estimates on possible returns as markets remain volatile, but it is safe to say that our clients' expectations of returns have in fact decreased."

Whatever the expectations may be, high or low, Shariah-compliant industry practitioners have expressed concern that Islamic asset management is not seen as a "safe haven" only during a financial crisis. The industry, they add, must take advantage of the "golden" opportunity presented by the downturn, so that it is well-positioned to partake in an economic upturn.

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