

ISLAMIC FINANCE

IN PRACTICE

GMB | PUBLISHING | www.gmbpublishing.com

Issue 3 | Winter 2009



INSIDE >

Insurance

Islamic Finance Today

Consumer Finance

Corporate and Investment
Banking

Financial Markets

A quarterly magazine for professional investors, multinationals
and the international business community

**EUROMONEY
SEMINARS**

 **Middle East
Association**



Published by
GMB | PUBLISHING

Conquering Aerophobia

Douglas Clark Johnson gives his view on where the Islamic Finance sector stands in the current climate and where it is heading in the months to come.

Keep your seatbelts fastened and prepare for a bumpy ride and a hard landing," declaimed Giovanni Bisignani, head of the International Airline Transport Association (IATA) in releasing scheduled results for last year. He may as well have been speaking for market sentiment as a whole. Most players to whom we speak—private bankers, institutional investors, asset managers—echo the same dire view. It is the rare investor who is now willing to put money to work boldly, if at all.

To follow-through with our metaphor, given the potential for mid-air turbulence, only a minority of passengers are even willing to get on the plane. The rest are sitting in terminal, despite the low probability that turbulence will cause the airborne plane to careen wildly.

Fear is a powerful emotion, especially when there is no sense of individual control. Most investors now feel they have no at-hand mastery over market outcomes. These players are simply not going to board the plane, no matter how hard you argue the facts.

Bad economies, of course, are not necessarily bad markets. Investment gains presumably anticipate economic growth, based on relatively more positive demand expectations and business confidence. While no one seems

prepared to be anticipatory nowadays—reinforced by a bleak employment outlook as financial-sector losses pummel the real economy—we can still find straightforward ways, perhaps representing non-speculative valuation, to put cash to work. We argue that there is virtue in simplicity.

In our advisory and product-development work, we are now focusing on thematic opportunities, especially since we can identify elements that offer immediate affinity to the Islamic investor. These ideas are defensive in their visibility; they are transcendent, as they move beyond stock-picking entertainment; and they are durable because they resist the wear-and-tear of market cycles. We group them in three meta-theme categories:

1. Approaches focused on the Ummah

We see commonalities among frontier markets with dominant or sizeable Muslim populations, ranging from Bangladesh to Libya. There may also be opportunities associated with widespread urbanization and the securitization of remittance flows. The latter concept may be particularly ripe for development:

Remittance flows.

Interestingly, given that remittance flows from workers may increase during

times of economic crisis, the idea of securitizing these flows may be counter-cyclical. We also support development in ways that more fickle direct-investment flows cannot.

2. Concepts oriented to industries

The life sciences area may be unusually relevant, given youthful populations. Energy-intensive industries like steel and aluminum also have a role because of selected comparative advantage in low-cost energy sourcing. One area that ties directly to concerns over global food security is agribusiness:

Agribusiness

We highlight opportunities afforded by cultivation and distribution. The concept may stretch from fertilizers to farm machinery to international wholesale trade. There may also be targets in livestock development.

3. Ideas based on demographics

The burgeoning populations of the Muslim world require governments to address both infrastructure and home ownership issues. The second concept relates to the proven role of property rights in economic development. We also look to rural empowerment, given the dislocations of urban centers:

Rural empowerment.

Investment guidelines are driven by manufacturers and service providers looking to engage local communities. Early-stage targets may include textile-related firms and selected outsourcing enterprises.

One of the most powerful secondary arguments for thematic investing is that the opportunities are often cross-border in scope, affording some degree of geographic diversification. Infrastructure needs are as prevalent in Indonesia as they are in Egypt and Turkey. Rural empowerment is a singularly powerful concept across the broad swath of the Subcontinent.



One of the most powerful secondary arguments for thematic investing is that the opportunities are often cross-border in scope, affording some degree of geographic diversification.

Even as such concepts span the Muslim world, though, we acknowledge the current environment may put limit what performance gains can be achieved.

As a sign of the delicate state of the global economy, the dire warning from the air transport chief referred to a 23% drop in December in year-on-year international air cargo traffic. That decline is about 50% greater than the one seen in September 2001, when much of the global airline fleet was grounded. The good news here is that the figure is a lagging indicator, likely representing order flow placed late in the third quarter and early in the fourth quarter of last year. Assuredly, turbulence will subside.

For the Islamic investor, a theme-based approach to portfolio structuring may appear hypothetical. Relatively few such investment funds exist, and the ones that do are most likely private-equity vehicles, with attendant redemption constraints. In practice, we may be limited to investing through subcomponents, such as individual securities or financing structures, batched through separately managed accounts. That process is fundamentally more time consuming than looking at a performance record.

We think the complexion of Islamic product offerings may be poised for change. Until recently, robust deal pipelines preoccupied most Islamic banks. And theme-based fund concepts require global professionalism—they do not, for the most part, conveniently fit into a single geography.

Moreover, our themes do not easily translate into "bubble" funds that benefit from the advanced stages of a liquidity cycle. They probably do a better job of addressing investor unease, than of inciting speculation. Accordingly, we think our thematic approach is a constructive way to sort through the current turmoil.

Douglas Clark Johnson is CEO and Chief Investment Strategist for Calyx Financial, a Wall Street-based developer and manager of offshore funds for Islamic investors. douglas.johnson@calyxfinancial.com.

somewhat different

Your international partner in the Takaful market.

hannover **retakaful**

somewhat different

Your pearl of wisdom in the Takaful market.

hannover **retakaful**