

Transcript

The Ideas Exchange

Episode 29: An introduction to Sharia-compliant investing

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[00:00:00] **Rory Cunningham** Welcome to the Ideas Exchange by ASX, connecting you with investment experts, market updates and ideas. I'm Rory Cunningham, senior manager of investment products at ASX and this is our regular podcast, covering everything from investment trends, through to different ways to invest using a variety of products.

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[00:00:45] **Rory Cunningham** Hi everyone. Welcome to this month's episode of The Ideas Exchange. I'm your host, Rory Cunningham from ASX. In this episode I have the pleasure of talking with Muzzammil Dhedhy from Hejaz Financial Services. Muzzammil is the Chief Operating Officer at Hejaz. Muzzammil. Welcome to the podcast.

[00:01:03] **Muzzammil Dhedhy** Thanks for having me, Rory. Thank you.

[00:01:05] **Rory Cunningham** So today we're going to be talking about Islamic finance and Sharia investing. Now for context. Late last year, Hejaz Financial Services launched two of its funds the Hejaz Equities Fund and Hejaz Property Fund, as exchange traded funds on the ASX. Now, while Islamic ETF products are widely available overseas, this was actually an Australian first, with the goal of providing Muslims, and other ethically conscious investors, greater access to two of Hejaz's Sharia-compliant funds. According to the 2021 ABS census, there are 813,000 Australians who identify as Muslim, or 3.2% of the Australian population. Of this cohort, it is estimated that approximately only 20,000 engage in Sharia investing. This potentially points to a general lack of awareness as well as a lack of suitable investment options rather than a lack of interest in this type of investing. Excuse the pun there, please Muzzammil. Maybe just for the benefit of our listeners today, Muzzammil do you want to start off by describing for us who is Hejaz Financial Services and what are you trying to achieve?

[00:02:19] **Muzzammil Dhedhy** Well, thank you for that preamble, Rory. So the Hejaz group was formed back in 2014 with a view to providing the Australian Muslim community with a diversified, comprehensive, end-to-end wealth and financial services solution. For a long time, Muslims in Australia have been disadvantaged because they haven't had financial products and services that align with their unique faith requirements and their values. We felt that it was high time that this was addressed. So we went about establishing a suite of different investment products, becoming a non-bank lender and offering lending services as well, as well as an array of other products and services to really address the needs of this, of our target market. That obviously can be challenging at times as well. When you're the first to market doing things, as you mentioned earlier, about the fact that we were the first to launch Islamic-compliant ETFs on the ASX. That in itself presents a challenge when something hasn't been done before you end up, you know, having to work with everybody to educate and inform and build a business case around that. And also, you know, it can be a bit scary sometimes to embark on a path that hasn't been travelled before, but I think we've been blessed to have worked with some great counterparties in bringing this solution to life. Greatest achievement over here is that it's about making, you know, it's about respecting people's background, their faith and their beliefs. And providing them with solutions that allow them to really enhance their financial position without having to compromise, in any way, on the things that they hold dear. And in this case, it's their faith and identity.

[00:03:49] **Rory Cunningham** Great. Thanks for that background. Now, you touched on it there. So the laws of Islam govern every aspect of a Muslim's life, including how they participate in the financial system, how they invest, and also how they earn money. Muzzammil, what are the Islamic principles and laws of Islam that govern how Muslims participate in the financial system, how they invest, and also how they earn money?

[00:04:12] **Muzzammil Dhedhy** Sure. So the one principle, I guess, that's quite well known is that Muslim people can't transact with interest, they can't borrow interest, they can't earn interest, etc., etc.. But I think, you know, when we look at it in the context of investments, there are a number of different screens and filters that have to be applied to a person's prospective investments to ensure those investments align with Islamic principles. So, for example, let's say if somebody wants to invest in equities, there are a number of different industries or sectors that are explicitly excluded from an investable universe. So for example, banking and financial services is excluded. Tobacco, alcohol, gambling, military, adult entertainment, essentially, those sectors and those activities which are considered to be socially injurious, socially harmful, they're excluded from the portfolio, first and foremost. And then we go on to apply a number of quantitative factors which contemplate things like the debt ratio of a company, the extent to which it earns income from tainted sources. And there are various thresholds and benchmarks around that need to be met to ensure that the companies that are being included in the portfolio, for a Muslim client, align with Islamic pillars and Islamic principles.

[00:05:24] **Rory Cunningham** Okay. And before we get into your investment process, can you describe for us more broadly, I suppose, the challenges that Muslims face in trying to invest for their financial future, given the current lack of service providers in this space in Australia?

[00:05:41] **Muzzammil Dhedhy** Well, as I said, if we wind the clock back, let's say 10 years ago, 10, 12 years ago, the concept of Islamically-compliant superannuation really didn't exist in Australia. Every Muslim was in a conventional fund. They knew that their moneys were being invested into assets that weren't aligning with their beliefs, but they really had no alternative. I think fast forward 10, 12, 15 years now. We now have investment options available to them for their superannuation, for their cash investments. Similarly, for their lending, there are now a diverse array of solutions available in the market as well. So I think we're now seeing that participation and engagement with Islamic products and services increasing. Is it where it should be? Not really, because as I said, it's still relatively new. People are now coming to terms with the fact that there are products and services available in the market that are presented in-line with the conventional offering. So they're priced in a competitive manner, they're available and being distributed like any other financial product. For example, ETFs on the ASX, which have been available for such a long time. But for a Muslim person, they haven't been able to engage with those products because the products weren't designed to meet their requirements. Now they can. So we're starting to see that shift occur and I think in the years to come that will only improve. So the next generation of investors coming through, the younger generation coming through, will I think see a better day. I guess when it comes to products and services, financial products and services, that are in alignment with their beliefs. And I think that will enable them to be a lot more innovative, a lot more, maybe even more risk-taking. I guess more adventurous when it comes to their finances. And really set themselves up well and these opportunities weren't available, for example, to their parents who simply did not have any instruments to use or any financial products to utilise, to build and enhance their wealth.

[00:07:25] **Rory Cunningham** As you mentioned, two of the financial products that you offer are ETFs, that are available on the ASX. And they are both Sharia-compliant funds. And you started talking earlier about how in order to be Sharia-compliant, there's a particular screening process that's applied. So can you talk us through that Sharia ethical screening process as they work for your current funds?

[00:07:47] **Muzzammil Dhedhy** So the screening process that we apply, in a way, is similar to what an ESG or SRI manager would apply. Except that the filters or screens and the principles that we have are quite binary, it's a black-and-white proposition. We tend to find that, for example, when it comes to ethical investing, for argument's sake, there are various shades of ethical investing. You know, some ethical managers might exclude one or two industries or one or two sectors. Some do more, some do less, and they're all

broadly considered to be ethical. Depends on the eye of the beholder, really. Whereas when it comes to Islamic investments, it's very clearly stipulated as to what those requirements are. So for example, when we're applying our Islamic filters, of which there are four essentially. So the first is what we call a business activity screen. So when we apply the business activity screen, we are explicitly excluding investments that are considered to be socially injurious and Islamically impermissible. Things like investing into conventional financial services alcohol, tobacco, gambling, pig products, military, adult entertainment, these sorts of sectors which are Islamically impermissible and socially injurious, excluded from the portfolio. And if a company, for example, were to pass that first degree of, first level of screening, it then goes on to have a number of other filters applied. So for example, we look at the debt-to-equity ratio of a company to ensure that it's below a certain threshold. We look at the income-generating sources of that company itself to see, okay, what are those sources, and if there are any tainted sources, for example, let's say the company earns certain revenue from interest-bearing investments, does that exceed a particular threshold? And if it does, that's outside our tolerance level and therefore that company would be removed from the screening process. So we start with a pretty broad universe and as we apply those filters that gets more and more narrow, until we end up with roughly around about probably 5 to 7000 listed investments globally. And then we apply our fundamental and technical filters across those. Things like, we're looking at P/E ratio, PEG ratios, dividend yields, management of that company, financial forecasts, all the different metrics that your regular manager would apply. And then we apply some technical factors across those as well to determine entry and exit points for those investments and then we go on to implement our portfolio. So at any given time we would probably have 60 to 80 holdings, within our portfolio. But it's important also to keep in mind that, the Sharia or Islamic filtering process that we apply, is not really a set-and-forget proposition. So let's say, for example, if we apply the filters today. And we identify a pool of investable assets that we can that we've identified and then from them we'll select the investments that we choose for our portfolio. It's every week, every few days we apply those screening again on the investments that we hold in our portfolio to ensure that, do they continue to be aligned with our Islamic screening principles? Because as you can imagine, these companies are, you know, living, breathing organisms. There are boards making decisions every day about the debt position of the company, the investments that it undertakes, the activities that it undertakes. So at any given time, it is very, very possible, and it happens quite often, that a company that is compliant today may become non-compliant next month and therefore we have to exit those holdings. So it is a very active, involved process. That's something that sometimes people don't truly appreciate how involved this really is. It's not as if I can do it once and forget about it for six months, no. I must apply my filters and my screening again and again to ensure that I maintain compliance.

[00:11:22] **Rory Cunningham** Understood. So, if I was to summarise the process at a high level, I think there's around about 30,000 companies that are listed on stock exchanges across the world. The first step there is you apply

the Sharia ethical screen that whittles the number of permissible stocks in your universe from that 30,000 down to, let's call it around about 5 to 7000. And then from there you undertake, what's called bottom-up fundamental analysis, in order to choose the 60 to 70 stocks that make it into your portfolio. And then on an ongoing basis, you're continually reviewing that to ensure that those stocks and other stocks continue to meet the criteria.

[00:12:01] **Muzzammil Dhedhy** Absolutely. Absolutely. And I think in addition to that, we also have an external Sharia-compliant body as well. So they audit us every six months to ensure that we are true to label. One is enough for us to go out to the market and say, okay, well we applied these filters and we applied these processes, but we need an external authority to come in and actually audit that to check and confirm that, okay, well, let's pick up the portfolio at any given time and see what are the what are the underlying holdings and what processes were undertaken in the selection of those investments and what is your broader process overall. So that provides our members and our clients with that added level of comfort and assurance that we are actually doing what we say we would be doing.

[00:12:40] **Rory Cunningham** Now, as you've mentioned, you may have up to 70 stocks that are inside of your portfolio, and I'm sure you love all of your children equally, but is there one stock in particular that you can talk about that exhibits the characteristics that you've discussed already and you're excited about its future?

[00:12:58] **Muzzammil Dhedhy** Absolutely. I think there are a number of, you know, really interesting stories that we're tracking at the moment in our portfolio. But I think the one that really stands out is BYD, the world's largest manufacturer of EV, electronic vehicles, electric vehicles. So I think the EV sector overall is booming. I think there's a lot of growth and a lot of potential in that space and that's an area that we've identified. In terms of, you know, a really interesting technology play, coupled with the automotive industry as well. We're seeing a lot of larger big name car manufacturers moving into that space. But BYD, I think, really own that space and are manufacturing their vehicles and exporting them around the world. So I think that's doing really well for us in our portfolio. So we continue to track that pretty closely. And I think another one that stands out is probably Microsoft and this new world of AI and ChatGPT and all that. Really the sky's the limit in terms of where AI and all these things will go. So we're tracking that very closely as well and have an interest in Microsoft and I daresay many managers around the country probably have an interest in Microsoft right now anyway. So, I think these sorts of sectors, obviously they meet the Islamic principles, in terms of their business activity, but at the moment they're tracking well in terms of their debt-to-equity ratios and their tainted income and all of those sorts of things as well. And even fundamentally, as companies overall, we hold them in pretty good stead as well. So, I think they're two stories at the moment that really stand out to us.

[00:14:22] **Rory Cunningham** Great. Thank you for sharing those. Now, when we talk to investors, we always educate that it's really important for them to understand both the benefits of a particular investment idea and also the risks. So when it comes to Sharia-compliant investing, from your perspective, what do you see as the benefits to investors and also the risks?

[00:14:41] **Muzzammil Dhedhy** Well, I think the benefits are quite self-evident because I think more and more consumers around Australia, and around the world really, are starting to make investments or making, their making choices. It may not even be financial, but broadly speaking, we're starting to see more and more inclination towards participating in activities that are socially beneficial. For example, people will boycott clothing from a particular brand that engages in poor employment practices or modern slavery. Products and services that are sourced without any consideration for the environment and are being boycotted as well. Albeit, the alternative may be a bit more pricey, the alternative may be harder to acquire. But as a society overall becoming far more concerned about our consumerism and what impact we're having on the world and on society around us. So, when it comes to the investment philosophy that we adopt and the overlay that we have in our portfolio, which we've just outlined, I think a lot of investors, Muslim and non-Muslim, we tend to find that about 4 or 5% of our client base are non-Muslim clients, who simply come to us because they say, well, you have a very, very clear outline of what your definition of ethical and socially responsible looks like. And that is something that we can align with. You're not in any sort of grey area over here. You're very, very clear about it. You apply that. We can see that translated through your disclosure documents. We can see that translated through your investment practices, and that's something that we align with. So that's really the upside where people can make investments that align with their values, with their ethos. And if they are from a faith background, it aligns with their faith as well. So that's definitely the upside. The downside or the risk of it. As I said, we do end up selecting investments from a far narrower universe than a manager who doesn't apply these overlays. And also it's important to note that an Islamic investment manager, or Sharia-compliant investment manager, can not utilise conventional derivatives and instruments like that, speculative instruments like that because they are in breach of Islamic principles. So things like, you know, your CFDs or options, all these sorts of things, short selling, you know, an Islamic investment manager can't utilise those. So that again, it's one more tool that would otherwise be in the toolkit that we don't have at our disposal. That makes it a little bit more challenging as well. But with that being said, a lot of investors don't tend to see that as being a big downside. They find that some people fundamentally don't even align with the notion of short selling or shorting the market. So our investment process and mandate is quite simple and straightforward, and a lot of investors see a lot of value in that. And in terms of performance, we tend to find that this overlay, during periods of market downturns, our Sharia-compliant portfolios perform quite well relative to market average because we're fundamentally investing into companies that have lower debt, that aren't that speculative, that are in an industry that are quite sound and robust. So they tend to perform quite well.

And during periods where the markets are going up and you have bull runs, we might underperform slightly because we're not, again, investing into the highly speculative, you know, real small microcaps which might have a lot of debt and therefore are excluded from our investment screening processes. So, there are pros and cons to it, but we tend to find that overall the pros do outweigh the cons.

[00:17:55] **Rory Cunningham** Muzzammil, interested in any closing comments and in particular around education. In prepping for this, I obviously visited your website and there's a lot of education material that you have there and no doubt as you're building out this segment of investing, there'll be a lot of investors, Muslim and non-Muslim alike that you need to educate about your particular processes and investment philosophies. So closing comments about your views of this style of investing, but also where investors should go to get more information and education.

[00:18:29] **Muzzammil Dhedhy** Yeah, look, I think we've really sort of taken, you know, some significant steps towards improving investor education over the last few years and also in forums like this, today's podcast. I think it goes a long way in familiarising, not only the Muslim community, but the broader Australian populace about what Islamic investing is. There is a place for it in the broader Australian financial services sector and there are opportunities over here. So our website has plenty of details about the way we go about selecting our investments and how we, how we operate. But there are plenty of other resources out there. I think we've made a number of different publications in different, you know, different forums. I think the ASX have been tremendously helpful to us in really sharing that message and really demystifying or debunking a lot of the misunderstandings that may exist about the Islamic method of investing and that in essence, ultimately, all it really is is that it's an ultra ethical form of investing. And one that has very very clear mandate and very clear parameters. And one that, you know, a lot of people, Muslim and non-Muslim alike, would find to be of interest to them.

[00:19:33] **Rory Cunningham** Thank you for joining us today, Muzzammil. And also thank you to our listeners for joining us and we look forward to welcoming you next month on the Ideas Exchange podcast.

[00:19:44] **Muzzammil Dhedhy** Excellent. Thanks Rory.

[00:19:45] **CTA** Are you keen to learn more? Why not visit the ASX blog - asx.com.au/blog - for a wide range of articles, videos and insights from ASX experts, listed companies and investment professionals.