STANLIB Multi-Manager

Shari’ah Balanced FoF

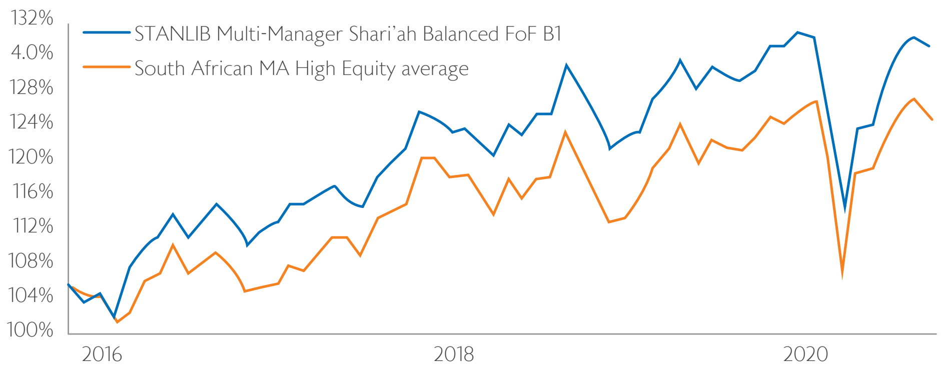
Shari’ah investing does not mean giving up on returns

Shari’ah investing in South Africa has been around since the 1990s, serving a community of investors looking to fulfil their ethical requirements. It is a common concern that – given the cost of compliance and the limited investment universe – when investing in shari’ah products, achieving investment goals comes at the expense of returns.

At STANLIB Multi-Manager we believe this does not have to be the case. By way of example, and while appreciating that alpha is cyclical, the STANLIB Multi-Manager Shari’ah Balanced FoF has generated top quartile returns over the past five years in the ASISA Multi Asset High Equity category. This means it has beaten most conventional funds in the category.

Figure 1: STANLIB Multi-Manager Shari’ah Balanced FoF vs ASISA MA High Equity average

Cumulative nominal returns from October 2015 to September 2020



Source: Morningstar, STANLIB Multi-Manager

The notion that shari’ah investing is disadvantageous stems from the fact that the shari’ah market is a subset of the overall market. Shares that do not meet shari’ah guidelines are excluded – companies that engage in interest, insurance, gambling, liquor, weapons and pork products. By default, this therefore excludes the bulk of the financial sector which is approximately 15% of the JSE. Overall the JSE Shari’ah All Share Index has just over 60 shares compared to more than 160 shares in the JSE All Share Index.

Furthermore, shari’ah investing imposes restrictions on permissible companies whereby the total debt of the company cannot be more than one third of the company’s value, as measured by either market capitalisation or total assets. Cash and interest-bearing instruments are also monitored and cannot make up more than one third of the company value. In addition, the overall net interest income of the company cannot exceed 5%. With these restrictions, the use of gearing becomes an issue, which further limits the investible universe.

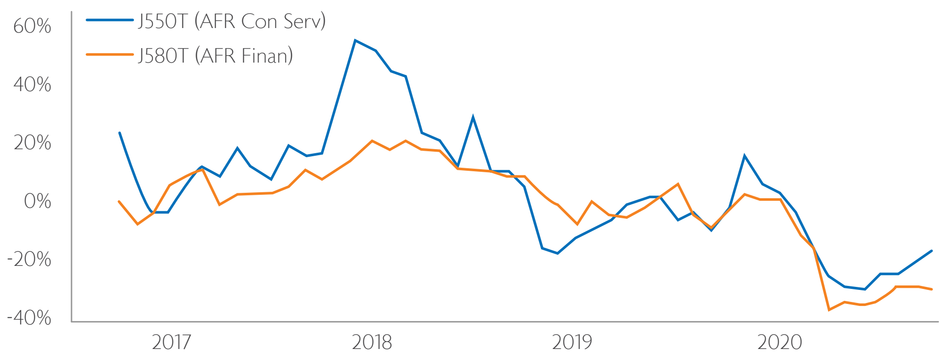
Looking at the local market, the JSE Shari’ah All Share Index is heavily weighted to resources with an exposure of more than 70%. Furthermore, Richemont makes up approximately 15% of the index. This seemingly leaves little room to create a well-balanced portfolio with the benchmark in mind.

Although all these restrictions apply to shari’ah investing, astute fund managers can build portfolios that are diverse and competitive. To diversify, fund managers look to global markets to fill the gaps in the local shari’ah market. Global markets offer a wider variety of sectors and stocks that can be invested in from a shari'ah point of view and additionally, offer protection from potential rand depreciation. The underlying managers of the STANLIB Multi-Manager Shari'ah Balanced FoF – Visio, Kagiso and Old Mutual – all allocate a portion of their assets to global markets. By adding global securities to the fund, exposure is gained to stocks such as Apple and Mastercard which are not available locally but fill the gaps in local sectors where the diversity of local technology or financial services companies is much lower.

As alluded to above, one of the major sector exclusions in shari'ah investing is financials. In order to get a similar exposure, however, our managers consider stocks that are sensitive to the same factors as financials. For example, Kagiso invests in interest rate sensitive stocks such as consumer cyclicals to align with the interest rate cycle (see figure 2). Thus, even though there are sectoral limitations in the shari'ah universe, we are still able to construct a well-balanced portfolio.

Figure 2: JSE consumer services vs JSE financial indices

12-month annualised rolling nominal returns from October 2015 to September 2020

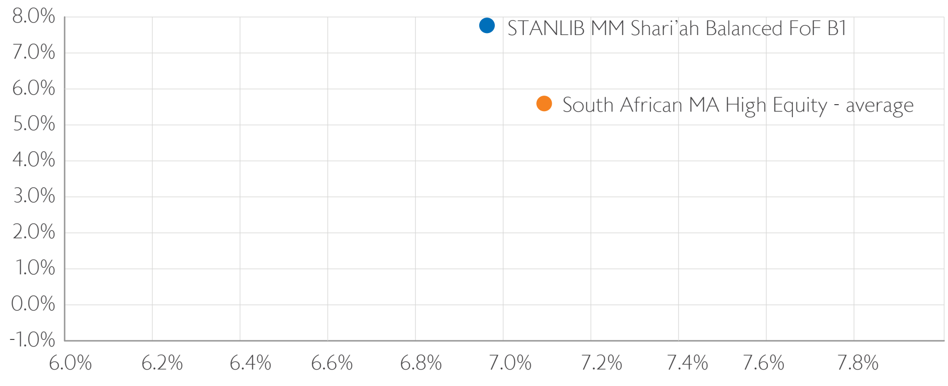


Source: Morningstar, STANLIB Multi-Manager

From a risk point of view fund managers do not need to increase the risk of a fund given the constraints of the shari'ah universe. For example, Old Mutual looks at volatility when it comes to portfolio construction, relative to the overall market. In doing so their quantitative models allow portfolio managers to construct portfolios within a certain volatility band. This process manages the risk of the portfolio relative to the overall market with the ability to change the volatility based on the market outlook. The benefit of this to the STANLIB Multi-Manager Shari'ah FoF is illustrated in figure 3 and demonstrates that it achieved a superior return to the ASISA MA High Equity peer average at a lower level of volatility.

Figure 3: risk vs return

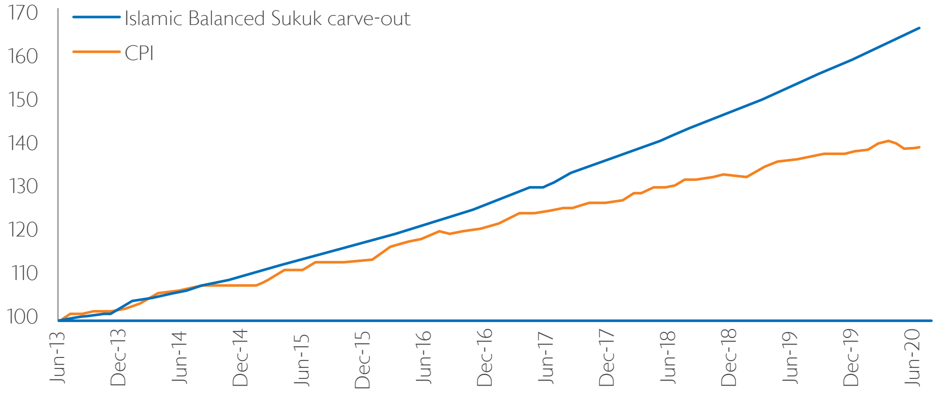
Annualised nominal risk/return (3 years rolling) from October 2015 to September 2020



Source: Morningstar, STANLIB Multi-Manager

The shari'ah universe has some benefits that can be seen as adding some stability to a portfolio. Highly leveraged and generally volatile companies are excluded after screening. Shari'ah income investments are structured in such a way that the cash flows, the assets backing the instrument and the profit sharing are agreed upfront. Hence there is no volatility in these instruments as can be seen in figure 4 which illustrates Kagiso's sukuk carve out.

Figure 4: Kagiso Islamic Balanced Sukuk carve-out vs CPI



Source: Morningstar, STANLIB Multi-Manager

Investing in a shari'ah product therefore does not mean that investors must give up competitive returns in order to achieve their ethical investment goals. The key is to choose a fund manager that can construct a portfolio that achieves both the return and ethical objectives. In employing a multi managed approach investors benefit from the skills of STANLIB Multi-Manager in choosing the best available managers that can achieve these objectives and appropriately blending them into a diversified and compliant portfolio.

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