

WHY SUKUK COULD BE A VIBRANT INVESTMENT OPPORTUNITY FOR ALL

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Seven years since it made history as the first non-Islamic economy to issue a sovereign sukuk, the UK issued its second offering on 25th March this year for £500 Million – more than double the size of the first issuance. The Chancellor of the Exchequer Rishi Sunak said, “We've set out ambitious plans to make the UK the most open and dynamic financial centre in the world. Strong investor demand for this Sukuk meant we achieved a good price for the taxpayer and will help us develop our relationships with Islamic economies around the world.”¹ This five-year maturity issuance increases the supply of high-quality Shariah compliant, liquid assets to the market and saw a strong demand from investors in the Middle East, Asia, and the UK. In this blog, we outline the three key reasons why sukuk is an attractive investment option for investors.

WHAT IS ISLAMIC FINANCE?

Islamic finance refers to financial business that adhere to the tenets of Islamic law or Shariah, which advocates preservation of equality in transactions. It works on the principles of profit and risk sharing and prohibits the practice of lending to generate interest income.

5 CORE PRINCIPLES OF ISLAMIC FINANCE

01

ETHICAL

No investments are permitted in forbidden industry's 'HARAM' – alcohol, gambling, pornography and weapons.

02

JUST

No speculative exploitation from legal uncertainty or abuse of unfair advantages.

03

CERTAINTY

There can be no elements of uncertainty in asset quality, price or delivery.

04

RIBA

'Interest' is not permitted to be paid or received.

05

TANGIBLE

All financial products must be tangible or asset-backed.

1. <https://www.gov.uk/government/news/uk-bolsters-islamic-finance-offering-with-second-sukuk>

WHAT IS SUKUK?

Sukuk are a form of bonds accepted by Islamic finance issuers and investors alike and comply with the principles of Shariah. As charging 'interest' is prohibited under Shariah (known as Riba), conventional bonds are not permitted under Islamic finance. Issuers that raise capital using sukuk invest in assets that investors have direct ownership interest in. Furthermore, the assets created must also align with the ethical principles of Shariah and the capital should not be invested in forbidden industries like alcohol, gambling, etc.

So, what makes sukuk an attractive investment option?

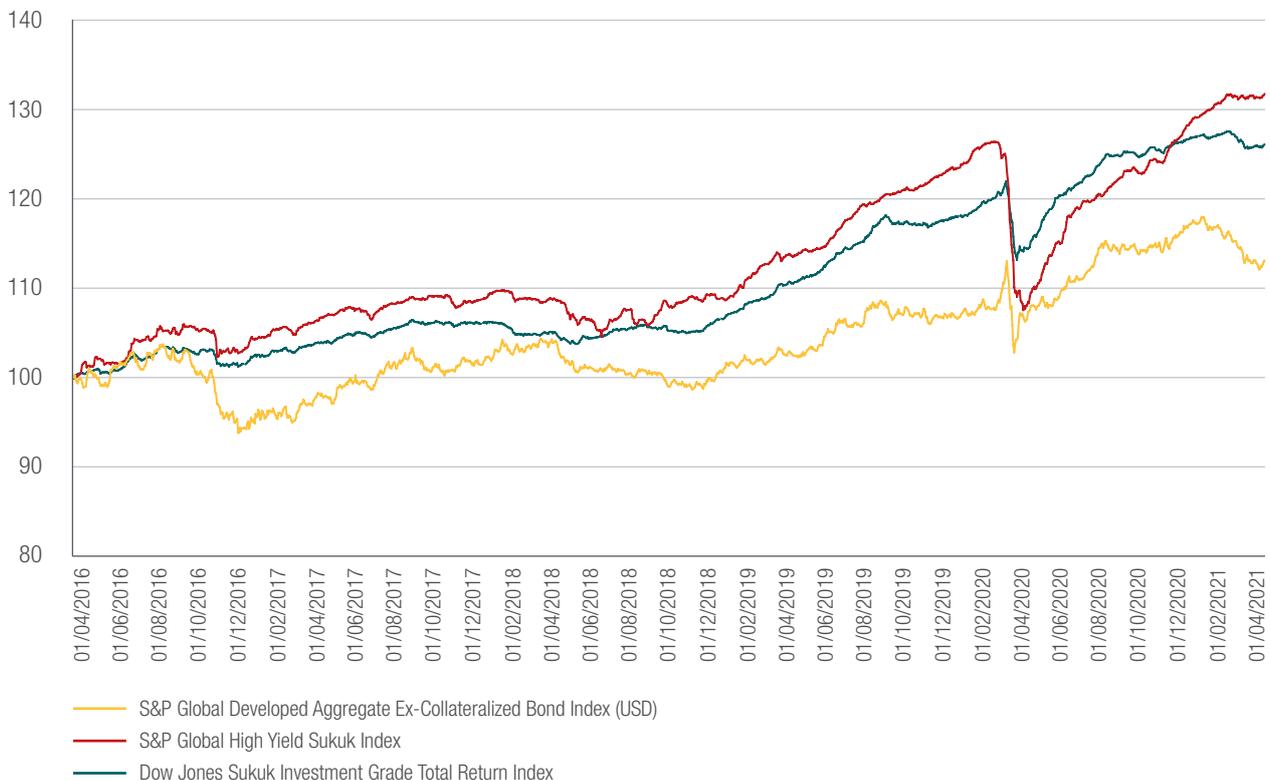
1. **Alternative to conventional bonds:** Sukuk bonds offer both Muslim and non-Muslim investors an excellent opportunity to invest in instruments that follow Shariah principles. As opposed to conventional bonds that are interest bearing debt instruments, sukuk bonds offer investors a stake in the underlying assets – ownership in underlying projects, properties, or investment. Due to

overlaps in ethos, sukuk bonds should appeal to ethically minded investors interested in ESG (Environmental, Social & Governance) alternatives.

2. **Diversification:** Sukuk securities are an excellent choice for portfolio diversification. Due to its low correlation with other fixed income products. Additionally, sukuk allows investors to invest in Southeast Asia and GCC (Gulf Cooperation Council); these are some of the fastest-growing regions of the world, which are often less-represented in many traditional bond indexes and funds.

3. **Stability:** A dedicated investor base of Islamic banks and institutions have supported the global sukuk market that has insulated the asset class against market volatility. Thanks to the buy-and-hold nature of the investors intending to hold the certificates till maturity, performance of Sukuk bonds on secondary markets have been relatively stable, despite the wider economic instability.

PERFORMANCE COMPARISON



Though sukuk issuances saw its first drop in 2020 after four consecutive years of stellar growth on account of the COVID-19 pandemic, the supply is expected to stay relatively stable in 2021 and beyond supported by low interest rates and abundant liquidity. Just like other investment opportunities, sukuk also comes with its share of inherent risks, but these Shariah-compliant bonds have consistently seen some of the best performance of fixed income asset classes over the past five years.

The Dow Jones Sukuk Total Return Index and S&P Global High Yield Sukuk Index has had 5Y annualised returns of 4.74% and 5.67% respectively, compared to 2.48% of S&P Global Developed Aggregate Ex-Collateralized Bond Index (USD) which tracks the performance of investment-grade debt publicly issued by sovereign, quasi-government, and investment-grade corporate entities, excluding collateralized/securitized bonds.²

More than three quarters of sukuk issuances in 2020 were rated investment grade and as sovereign nations, supranationals, and other government bodies are major issuers, their robust credit standings should provide confidence to the investors looking to invest in sukuk bonds.

In summary, sukuk can enable investors to achieve stability in returns and diversification of their portfolios whilst allowing them to have direct ownership of underlying assets. The sukuk market is still in the nascent stages and a few challenges do need to be addressed, such as standardizing the issuance process and developing secondary markets. That said, the popularity of this fixed income asset class as an attractive investment option is growing across regions with a broad range of new issuers looking to tap into the market. Investors should take advantage of the safe and stable sukuk ecosystem and consider adding them to their investment portfolios.

2. <https://www.spglobal.com/spdji/en/indices/fixed-income/sp-global-developed-aggregate-ex-collateralized-bond-index/#overview>

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