

The Growth of Passive Investments in Islamic Finance: Trends and Implications

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Introduction

Islamic indices provide market participants with a comprehensive set of Shariah-compliant benchmarks for equities and sukuk, offering a diverse range of strategies tailored to various investment goals. These have been developed to cater to the unique needs of the Islamic financial ecosystem, reflecting the evolving dynamics of the global market. Historically, Islamic investing has been predominantly actively managed; however, a recent shift toward passive investing is evident, especially as Shariah investors see the benefits of ETFs—including transparency and cost-efficiency—over active funds. In the predominantly Muslim Middle East and North Africa (MENA) region, the benefits of passive investments are especially pronounced. According to the S&P Indices Versus Active (SPIVA[®]) MENA Mid-Year 2023 Scorecard, 85%-88% of equity funds in the region underperformed their benchmarks and only 42% survived over the past decade.¹

This article was first published in [IFN Guide 2024](#).

¹ Lazzara, Craig, Di Gioia, Davide and Stoddart, Grace. SPIVA MENA Mid-Year 2023 Scorecard. Data as of June 30, 2023. S&P Dow Jones Indices. <https://www.spglobal.com/spdji/en/documents/spiva/spiva-mena-mid-year-2023.pdf>

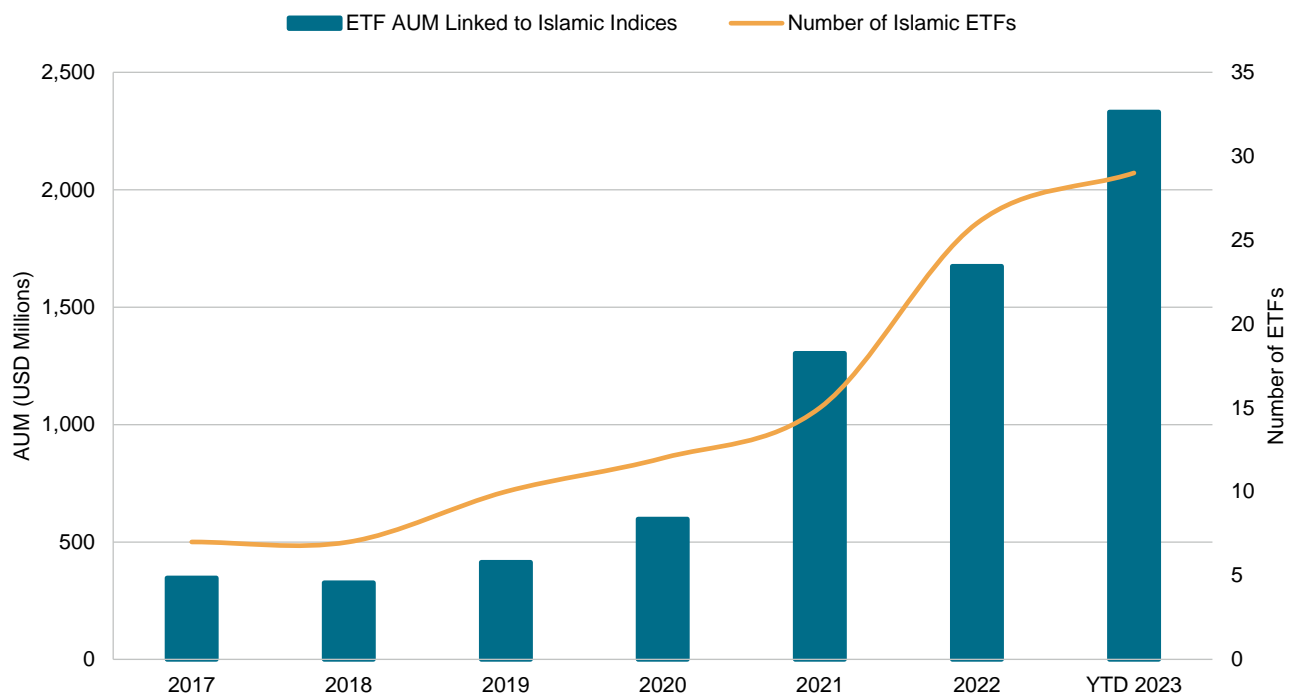
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Review of 2023

Global Islamic indices dropped by over 20% in 2022, paving the way for a 2023 resurgence.² During the first nine months of 2023, the [S&P Global BMI Shariah](#) and [Dow Jones Islamic Market World Index](#) increased by approximately 12.3% and 13.0%, respectively.³ Over the past 10 years, the S&P Global BMI Shariah outperformed its conventional benchmark in five-year rolling returns nearly 75% of the time.

The asset landscape mirrored this upward trend. By Sept. 30, 2023, there were 29 Islamic ETFs with a combined AUM of USD 2.33 billion—a significant jump from 2022's 26 ETFs and USD 1.67 billion AUM. Looking back five years, the growth has been even more remarkable: from 7 ETFs and an AUM of USD 326 million in 2018.

Exhibit 1: ETF AUM and Number of Funds Linked to Islamic Indices



Source: FactSet. Data as of Sept. 30, 2023. Chart is provided for illustrative purposes.

² Olazabal, Eduardo, "Global Islamic Indices Declined Over 20% YTD, Underperforming Conventional Benchmarks in 2022," Jan. 18, 2023, Indexology® Blog. <https://www.indexologyblog.com/2023/01/18/global-islamic-indices-declined-over-20-ytd-underperforming-conventional-benchmarks-in-2022/>

³ Data as of Sept. 30, 2023.

In response to the surging interest in Shariah-compliant investing, especially among Australia's growing Muslim community, S&P Dow Jones Indices (S&P DJI) collaborated with Australia Securities Exchange (ASX) to introduce its first Shariah-compliant series of benchmarks to the Australian market, the S&P/ASX Shariah Indices, in March 2023. With the launches of the [S&P/ASX 200 Shariah](#) and [S&P/ASX 300 Shariah](#), the renowned S&P/ASX Indices now complement other globally recognized Shariah-compliant equity benchmarks, including the [S&P 500[®] Shariah](#), [S&P/TOPIX 150 Shariah](#) and [S&P/TSX 60 Shariah](#).⁴

In parallel to equity indices, sukuk listings increased significantly over the past decade. Conventional and Shariah-compliant bonds increased notably to USD 180 billion in outstanding debt, with sukuk representing a substantial portion, at USD 77 billion. Among the notable listings are the U.A.E. Ministry of Finance sukuk and the debut of ESG sukuk, with the total ESG sukuk reaching approximately USD 18 billion. Concurrently, in Saudi Arabia, the domestic government sukuk market, as represented by the [iBoxx Tadawul SAR Government Sukuk Index](#), flourished between 2019 and 2022, establishing Saudi Arabia as the premier global sovereign sukuk issuer. Since the index's inception (June 30, 2019), the sukuk count rose from 29 to 50, with the total notional outstanding advancing from about USD 40 billion to USD 115 billion.

The past few years have witnessed a significant pivot from predominantly active Shariah-compliant mutual funds to passive index-based investing. Notably, nearly two-thirds of Islamic index funds launched post-2017 have extended their influence beyond traditional Islamic centers such as Malaysia and Saudi Arabia to North America and Europe.⁴ This evolution is underscored by the listing of Shariah-compliant ETFs on major platforms, like the London Stock Exchange, New York Stock Exchange and elsewhere, signifying the increased value of these offerings.⁵

Looking Ahead

Islamic indexing and passive investing trends align with the global momentum toward sustainable and diversified portfolios. The Islamic finance sector, currently holding assets worth approximately USD 2.2 trillion, is projected to skyrocket to almost USD 4.94 trillion by 2025.⁶ Increasingly, the Islamic finance sector is embracing diverse asset classes, including asset leasing, real estate, commodities trading and sukuk (Islamic fixed-income securities).

⁴ Olazabal, Eduardo, The Growth of Islamic Index-Based Strategies, S&P Dow Jones Indices, December 2022. <https://www.spglobal.com/spdji/en/commentary/article/the-growth-of-islamic-index-based-strategies/>

⁵ "London Stock Exchange Welcomes HSBC Asset Management and Its Islamic ESG ETF Range," Dec. 1, 2022, London Stock Exchange. <https://www.londonstockexchange.com/london-stock-exchange-welcomes-hsbc-asset-management-and-its-islamic-esg-etf-range>

⁶ "Islamic finance and the securities market outlook for 2023," Standard Chartered, April 17, 2023. <https://www.sc.com/en/feature/islamic-finance-securities-market-outlook-2023/>

This expansion signals a commitment to a more resilient and varied Islamic financial ecosystem.⁷

The global trend toward sustainability investments is also evident in Islamic finance. The overlap of Islamic finance principles with sustainability criteria has spurred the emergence of Shariah-compliant ESG ETFs. For instance, the Wahed Dow Jones Islamic World ETF, known for its sustainability focus, exemplifies the melding of Shariah principles with ESG criteria, ushering in a fresh era of ethical Islamic passive investment offerings.⁸

These developments depict an evolving Islamic finance industry, increasingly aligned with global passive investment trends and tailored to the intricate requirements of Muslim investors. The convergence of Islamic finance, passive investing and sustainability principles not only broadens the Islamic finance product suite but increasingly promotes a global transition toward ethical investment methods.

Conclusion

The ascent of passive investments in Islamic finance underscores the adaptability and resilience of Shariah-aligned financial strategies. Given the challenges that many active Islamic funds face in consistently outperforming their benchmarks, the increasing rise of transparent, cost-effective passive alternatives is readily apparent. The positive trend in AUM growth observed in 2023 reflects the expanding availability and wider acceptance of Islamic passive investments. As the Islamic financial market continues to mature and innovate, passive strategies are poised to assume an increasingly central role, providing investors with a well-rounded approach that seamlessly combines Shariah compliance, performance and cost-efficiency.

⁷ "Wealth and investments: Islamic finance," Mercer. <https://www.mercer.com/en-om/solutions/investments/sharia-compliant-investing/>

⁸ Jamall, Ashruff and Osman, Shereen, "Islamic Finance & ESG investing: Ready for convergence?" PwC, August 2022. <https://www.pwc.com/m1/en/publications/documents/islamic-finance-and-esg-investing.pdf>

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