

July 2010

Invest in an Islamic finance pioneer

This Spring the ArabianMoney.net website reported on the latest progress in the marketing of the first-ever Islamic hedge fund of funds to banks across the Gulf States by Shariah Capital (SCAP:LN). There is a fairly high initial entry fee of \$5 million to this fund, so it is not going to be every reader of this newsletter who wants to be an investor in a commodity based hedge fund that is also Shariah compliant.

Yet there is no doubting the performance of the DSAM Kauthar Commodity Fund launched at the start of 2009 and its impressive 41 per cent annual return. The fund is after all an average of four funds operated by the most blue chip of Wall Street managers: BlackRock, Tocqueville Asset Management, Lucas Capital Management and Zweig-DiMenna International Managers.

The DSAM Kauthar fund holds particular appeal for Muslim investors because of its compliance with Shariah law. There is no investment in any company involved with gambling or alcohol. The fund avoids companies with large debts or income from loan interest. And it avoids all direct short selling. It sticks to commodity related investments.

DSAM is 51 per cent owned by the state-owned Dubai Multi Commodities Center and 49 per cent by Shariah Capital, a Connecticut-based firm founded by Eric Meyer, a former technology hedge fund manager who has also specialized in ethically based investment funds.

Its product is clearly unique and funds run on Islamic principles seem to have a good future, particularly of course in the Middle East. There are practical as well as religious reasons. For a start in a world where debts are becoming more and more of a headache for governments, companies and individuals – and interest rates are so low that they will eventually have to go up – so it makes sense to avoid investments that expose you to debt risk.

It is also a simple fact of life that in boom periods companies carrying high debt tend to outperform their rivals, but conversely in a downturn it is the conservatively financed groups that come out on top and their indebted rivals perish. So if you think the trading years ahead are not likely to return to the pre-crisis boom levels for business then going for low-debt investments makes sense.

ArabianMoney would therefore recommend the DSAM Kauthar Commodity Fund to extremely wealthy investors looking to diversify their portfolios according to Islamic principles. We also have an idea for readers who cannot think in terms of \$5 million as a relatively small investment, and that is to buy shares in Shariah Capital quoted on the AIM in London.

It is hard not to admire Mr. Meyer's success in putting this fund together, and engaging top Wall Street firms to manage it for him. He also managed to get the Dubai Multi Commodities Center to invest \$200 million in seed capital into the four funds. Luckily he got this investment just before the global financial crisis in September 2008 that sent Dubai into a deep recession last year. Indeed, the DMCC must be proud of its investment that is now worth \$260 million.

The DMCC is a part of Dubai World, the conglomerate whose real estate subsidiaries Nakheel and Limitless have recently been much in the news for their debt rescheduling plans. Last year many Dubai World investments – from property in New York to the former cruise liner the Queen Elizabeth II – tanked in value. Not so its hedge fund of funds.

Mr. Meyer got his luck in securing DMCC funds before the crisis by the way that most good luck comes, through exceedingly hard work. ArabianMoney editor Peter Cooper first met him three years ago when he was just a man with a plan. It then looked very ambitious. How could an American catholic set up an Islamic hedge fund to interest Gulf investors? Well, he has done it, and the Kauthar Commodity Fund scooped all the top prizes at this year's Dubai Hedge Funds World conference.

Now having created his unique product and proven its performance DSAM is taking it to the market, and looks to be sticking to its blue chip strategy. First, blue chip US fund managers; Second, a blue chip regional investor; Third, blue chip institutional and family investors.

But Mr Meyer knows how to run a business. He kept his initial expenses low, and fund management fees on the start-up capital already make the business profitable. His tie up with Barclays Capital in September 2007 to create a Shariah-compliant investment platform was an early breakthrough but he has come an awful long way since then.

It is always risky to invest in a small company, and ArabianMoney would always counsel diversification in any portfolio. But what is so nice about Shariah Capital, apart from the always personable and highly reputable Mr Meyer is that it has already passed the due diligence of blue chip financial institutions in its start-up phase, so you are not investing in some unproven local enterprise with largely unknown investors as it often the case with UAE based investment funds.

Investment in the Middle East has its pitfalls, like anywhere else actually. You have to judge start-ups by the company they keep and the past record of their directors. Even then it is best to come in at a stage when the product is proven and the growth prospects look best. It could still then take longer than expected or be disappointing at first. There is also the possibility of further turbulence in global markets that may set back expansion plans as investors choose to sit on their money. Shariah Capital could be a volatile stock at such times, although its share chart shows a very comfortable passage through the recent global financial crisis.



The opportunity to buy shares in a financial services company with a unique product tailored for the Gulf States is surely not one that comes along very often. And at a time when many regional investment companies and local financial institutions are still sorting out their balance sheets from the crash of 2009, Shariah Capital is just starting a major marketing push in the region unburdened by past mistakes.

As Mr Meyer tells ArabianMoney: 'The commodity stocks have been backing and filling for the last six months and I believe our funds are very well positioned for the next 12 to 24 months. I see our funds as a perfect hedge against the madness of paper money. If the free world somehow makes it through the financial storm I see our funds as a perfect cyclical bet on an eventual rebound of the world economy.'

But don't just buy the funds; buy the fund manager!