

Business

Islamic investing

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Last month, Eric Meyer was at a hedge fund conference in Dubai, speaking to a room filled with asset managers -- about half from the United States and a good number from lower Fairfield County.

"What is your strategy in the Middle East?" Meyer asked the audience rhetorically.

It's a logical query, considering that the Middle East is estimated to be a \$250 billion to \$500 billion investment market -- and virtually untapped by the burgeoning American hedge fund community.

Meyer wasn't surprised that, despite the liquidity in the Middle East, driven primarily by high oil prices, American and European hedge funds don't have a go-to strategy for the region.

The reason: Accessing the Islamic investor market is a formidable challenge.

No one knows that better than Meyer, who has spent the past five years traveling from his New Canaan office to the Middle East and Europe, laboring with Islamic Shariah scholars, as well as Western financial and legal experts, to achieve what many thought impossible -- creating risk management tools that enable observant Islamic investors to participate in an alternative investment world.

In a pioneering effort, Meyer's New Canaan firm, Shariah Capital, a division of Meyer Fund Management, has developed Shariah-compliant alternative investment products, as well as the first Shariah-compliant fund of funds.

Shariah and a fatwa

Those in the Arab world, and Islamic institutional investors in particular, are becoming increasingly interested in adding hedge funds to their portfolios, but religious law often prohibits them from doing so. The inherent risk and speculation that goes with

conventional hedge fund strategies violates the Koranic law known as Shariah, Meyer said.

The Koran doesn't allow a person to sell something he doesn't own, which rules out short-selling -- a widely used strategy that enables hedge funds to post high returns even in bear markets.

Undue risk and speculation is forbidden, as is the concept of interest.

The complexity of creating a hedge fund strategy acceptable to Islamic investors is a pie in the sky dream for many American investment managers.

"You can't simply look in the Yellow Pages for Shariah certification," Meyer said. "I think for a large hedge fund in Fairfield County, it would take years and millions of dollars to do."

But thanks to Meyer's dedication, fund managers who are interested in the Middle East have access to Shariah-compliant investment vehicles that provide an equivalent to short selling and options trading.

The firm has received a fatwa, or a religious blessing, on a proprietary real-time screening process that uses data-mining software to screen thousands of publicly traded companies in seconds. It can monitor listed companies for Shariah compliance in 52 different securities' markets around the world.

About 5,500 stocks are approved by the screening process, Meyer said.

Now, Islamic investors have the opportunity to invest in long/short and market-neutral hedge funds, he said.

Equally important, Meyer said, long/short and market-neutral equity hedge fund managers can manage their portfolios within Shariah guidelines without fundamentally changing their strategies.

Using these tools, Shariah Capital is poised to launch its own Shariah Long/Short Master Fund and Shariah Market Neutral Master Fund, the first Shariah-compliant fund of funds in the market.

A breakthrough

What Meyer has accomplished is a breakthrough, said Bill Scholz, president of Gabelli Asset Management's alternative investments group and a Gamco Investors Inc. managing director.

Rye, N.Y.-based Gamco, which has been interested in gaining entry into the Middle Eastern market for several years, has agreed to become part of Shariah Capital's fund of

funds, subadvising the merger arbitrage fund on Shariah Capital's market neutral platform.

A number of people from Gamco have visited the Middle East in an effort to sell the firm's long-only investment product, but without much success, Scholz said.

"I realized our long-only product was a commodity there," he said.

What is not a commodity in the Middle East investing is hedge fund products. That's why Gabelli saw such an opportunity with Shariah Capital -- particularly because it is a natural extension to the several socially responsible screened funds the firm already runs.

Scholz has taken two trips to the Middle East with Meyer and Gau in what he describes as a fast and furious road show.

"There is little downtime, they hit the ground running," Scholz said.

Their list of contacts is impressive and extensive, he said. For example, Scholz described meeting with the Abu Dhabi Investment Authority. One of the biggest government investment authorities in the world, it is responsible for investing all of the Abu Dhabi government's oil revenues and assets.

The ADIA, with investments totaling \$500 billion, is one of the most influential and wealthy players in the global market.

"Everybody wants to get to see them. They are deviously hard to get in to see," Scholz said. The first time Scholz went to Abu Dhabi with Meyer, he met with the investment authority twice.

Scholz tells another anecdote to show just how well-connected Meyer is in the Gulf.

A few months ago, Gabelli had gotten a redemption from a large bank in the Middle East without explanation.

Soon after, Scholz got a call from Meyer, who said he had heard about the redemption.

"How would you know that?" Scholz asked.

"I'm on the phone with the bank's chairman," said Meyer, who went on to explain that the redemption was solely because the bank had just received a top-down mandate to be Shariah-compliant by the end of the year.

"That is the type of contacts these guys have, they go to the top of the food chain," Scholz said.

Arab introduction

For the first 17 years of his professional life, Meyer focused solely on Western finance. "My understanding of the Middle East was what I read in the newspapers," Meyer said.

He began his career in institutional sales at Oppenheimer & Co. and made his way into the hedge fund world. He spent several years working for a hedge fund and then became director of research for a Forbes 400 family fund.

In 1993, Meyer launched his own long/short equity hedge fund, which focused on technology and small caps. That fund generated returns of more than 33 percent per year from 1995 to 2000.

But Meyer's life changed in 1999 when a member of the Bear Sterns' capital introduction team connected him with the Kuwait Fund for Arab Economic Development, a multibillion organization that invests money for Arab economic development throughout the globe. Meyer became friendly with the organization's hedge fund allocation portfolio manager, who urged Meyer to visit Kuwait.

In 2000, Meyer took up the invitation.

"I was introduced to a very different but fascinating culture and a very different but fascinating business environment, he said.

It was during that Kuwait trip that Meyer met with the chief executive officer of the first Islamic investment houses. He challenged Meyer to develop Shariah-compliant investment alternatives for the Arab marketplace.

At that point, the only westernized investment option acceptable to many Islamic investors was long-only mutual funds -- which suffered terribly during the 2000-02 bear market.

"It really resonated with me when he said more Westerners should take our investment needs seriously," Meyer said. "That's how I was introduced to the world of the Middle East and to this intriguing world of Shariah."

The barriers were daunting, he said, but when there is an estimated \$250 billion marketplace interested in diversifying its investment vehicles, the idea of being first to market with alternatives was attractive, he said.

Trimming the hedge

So in 2000, Meyer gave back \$300 million to his hedge fund investors and focused solely on his newest venture, Shariah Capital.

"He's like a force of nature," Scholz said. "For a hedge fund manager to give back \$300 million is really something -- \$300 million is hard to raise."

But, Meyer said, it wasn't just the idea that he could be first to market that persuaded him to chase his Shariah dream. It was also the promise of a great intellectual challenge -- a challenge that he admits he underestimated.

"It's been a long, humbling road," he said.

The first, and perhaps largest obstacle, was finding prominent Shariah scholars to work with. Without them, there is no chance of obtaining Shariah compliance.

Fatwas can be issued by a number of different scholars from a number of different schools of Islamic learning. Meyer had to find scholars who were not only respected, but who read and spoke English well.

The challenge was to take Western financial rules and regulations and apply them to historical rules that date to 632 A.D., the time of the prophet Muhammad, he said.

"They had to understand our rules, I had to understand their rules, before we could offer a solution," said Meyer, who quickly realized that there were only a handful of Islamic scholars who fit the bill.

Shariah dream team

Meyer eventually found Sheikh Yusuf Talal DeLorenzo, the chair man of the Dow Jones Islamic Index, who is based in Washington, D.C. DeLorenzo then introduced Meyer to two other scholars, one from Bahrain and one from Malaysia.

"He's tied up the dream team of Islamic scholars," Scholz said.

Meyer retained the trio, and over the next several years the group would meet for days on end, usually in London, poring over Islamic historical documents and U.S. regulatory provisions.

Another key player in the process was Britain's Barclays Bank, which worked alongside Meyer and the scholars to handwrite a Shariah-compliant prime broker document, removing the words "interest" and "guarantee."

Interest is illegal under Islamic law and only Allah can offer a guarantee. There were more than 500 references to the two words that had to be removed.

"I have to say Barclays took a real leap of faith when I first approached them. They had to devote time, diligence and effort to this project, with no guarantee of success," Meyer said.

Kieran McCann, director of Barclays Capital Prime Services, said the firm was interested in working with Meyer because many of the larger funds Barclays services are looking to

diversify their investor base.

"That's why we thought it was a good business opportunity for us to dedicate legal time and resources," McCann said.

It took years, but Meyer got the fatwas he needed to move forward.

"To get all of this done has just been Herculean efforts," he said.

Why Meyer?

"The reaction I've been seeing from Middle Eastern institutions is, 'Why are we doing this with a sandy-haired, blue-eyed guy from Connecticut. Why don't we have it here?' " Scholz said.

"That's been the negative. They can't believe it wasn't developed there," said Scholz, adding that the fatwa Meyer received on the short-sell equivalent is causing the most ruckus.

"This has the financial institutions in the Middle East all tied up in knots, because they want this technology," he said.

Shariah Capital has successfully positioned itself to not just work with Western financial institutions and fund managers, but also with Middle Eastern banks, which are increasing leaning toward providing Shariah investment products to their clientele.

For example, Saudi Arabia's National Commercial Bank and National Bank of Dubai recently mandated that their investments can be made only in Shariah-compliant vehicles.

Last week, the National Bank of Abu Dhabi, the largest bank in the United Arab Emirates, announced the formation of an Islamic banking division.

The initiative sets up a separately branded Islamic banking subsidiary to serve customers wanting Shariah-compliant products and services.

"Clearly, they will need a range of Shariah-compliant products, not all of which they have the resources to build internally. That's where Shariah Funds could play a role," said Joseph Gau, Shariah Capital's managing director, who spent 13 years heading the Middle East and Africa division for the Citibank Private Bank in New York.

"NBAD is a perfect target market client for the Shariah-compliant products we've developed," he said.

'Coming of age'

Anticipating the bank moving in this direction, Gau said he and Meyer introduced Gabelli

Asset Management and Boston-based GRT Capital, two of Shariah Funds underlying hedge fund managers, to Michael Tomalin, chief executive at the National Bank of Abu Dhabi.

The bank's ambitious plan to offer Shariah solutions to its customers "is indicative that Islamic finance is really coming of age in the Gulf, because you are seeing conventional banks getting involved in Islamic finance in a very big way," Meyer said.

Meyer predicts that the large European and American banks will eventually follow suit, offering similar Shariah investment options -- opening even more opportunities for Shariah Capital.

Further, he said, the Middle Eastern stock markets, which have performed tremendously over the past three years, are significantly cooling off. That will cause Islamic investors to take an even harder look at hedge fund strategies.

"This is a prime opportunity for Western hedge fund managers," Meyer said. "I see a very big shift to alternative investment markets."

The interest of hedge funds in the United States has been piqued by the incredible amount of wealth in the Middle East, achieved on the back of high oil prices, as well as real estate and other investments, said Chris Wolfe, director of research at Dover Management LLC, a Greenwich investment adviser whose investment strategies hinge on social and corporate responsibility.

"This, to most Westerners, looks like a very new, very robust pool of wealth," he said. "Great wealth attracts great managers of great wealth."

And the market opportunity for Shariah products is big, not only because of Middle Eastern riches, but also from a geo-political sense, said Shabu Qureshi, a director at Emerging Markets Partnership, a Washington, D.C.-based private equity firm that focuses on emerging markets.

Muslims live throughout the world, and Shariah is part of the identity they want to assert, said Qureshi, whose firm has a Bahrain office that manages an infrastructure fund sponsored by the Islamic Development Bank.

The demand for Shariah products is particularly strong in Saudi Arabia, which is the most conservative of Gulf countries, as well as the wealthiest.

Muslim investors, particularly family groups, are looking for Shariah products, and, he said, there is more demand than supply.

"There is a tremendous amount of potential there," Scholz said. "The trick is converting potential into sales."

"It is not going to happen overnight . . . (but) I am absolutely confident the payoff will come," he said.

Meyer may be the first to the Shariah market, but he won't be alone much longer, Scholz predicts. "I'd say he's probably one to two years ahead of the competition," Scholz said.

Though the competition will come fast, until last year it was a tremendous uphill battle to get fund managers interested in looking at Gulf investors, Meyer said. Westerners just have not spent a lot of time thinking about financial opportunities in region.

"It is really such an unknown frontier," he said.

This year, Meyer has seen a paradigm shift, with fund managers suddenly seeking Shariah Capital's help.

"After a long drought for four or five years, suddenly I'm getting an immense amount of incoming calls," Meyer said.

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