

# Expanding the Faithful Frontier:

## Shariah Multi-Asset Retirement Solutions

**For Professional Clients only**

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### Summary

- ◆ Shariah-compliant multi-asset solutions are essential for faith-based investors seeking improved retirement outcomes and financial security.
- ◆ Low-cost, diversified asset-class-level exposures, often through passive strategies, are crucial for achieving broad diversification and long-term sustainability.
- ◆ Effective Shariah-compliant investments require oversight from a Shariah supervisory board and dividend purification.
- ◆ Equities drive growth, Sukuk provide defensive stability, supported by gold and property for added diversification and flexibility.

Providing meaningful investment and retirement solutions for Shariah-compliant investors is crucial in helping faith-based investors achieve improved retirement outcomes, long-term financial security, and reduced reliance on the state. Yet, despite growth in demand, Shariah-compliant investment options remain limited. As a result, some Muslim investors may have been forced to choose between hybrid portfolios that mix Shariah-compliant and conventional holdings, overly risky concentrated strategies, or—in many cases—choosing not to invest at all.

This landscape is now changing rapidly. Major providers such as HSBC Asset Management are bringing new Shariah-compliant products to market at pace, helping to close the gap and enabling faith-based investors to access retirement solutions that mirror the outcomes available from more established products. Interestingly, there is considerable overlap between faith-based investment screening and responsible or ethical investment approaches, given the focus on excluding harmful industries and prioritising cleaner balance sheets.



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A defining feature of a good Shariah-compliant investment solution is rigorous oversight from a recognised Shariah supervisory board, something providers must treat as central rather than optional. Dividend purification is equally essential; without applying purification across all funds, an investment cannot be considered fully Shariah-compliant.

As with any robust multi-asset solution, the foundation lies in the quality and cost-efficiency of the building blocks used. Low-cost, asset-class-level exposures—possibly delivered through passive strategies—play a vital role in helping Shariah-compliant portfolios achieve broad diversification, appropriate risk management, and long-term sustainability.

## **Equities: The growth engine**

Equities are typically the cornerstone of the growth component in any multi-asset portfolio, and this remains true in a Shariah-compliant context. A global equity allocation usually forms the backbone of the equity sleeve, providing diversified exposure across regions, sectors, and economic cycles. For investors seeking long-term capital appreciation, Shariah-compliant equities therefore represent one of the most important building blocks.

Shariah screening for equities involves a dual process designed to ensure alignment with Islamic ethical and financial principles. The first part is business activity screening, which excludes companies generating significant revenue from non-permissible activities such as alcohol, tobacco, gambling, pork products, adult entertainment, and conventional financial services, among others. This is closely aligned with many ethical or ESG-driven exclusions, highlighting the natural overlap between Shariah investment principles and broader responsible-investment practices.

The second part of the screening is financial ratio screening, where companies with excessive leverage or interest-based income are removed. Standards such as those issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) set quantitative thresholds, typically limiting total debt, cash, and interest-bearing instruments to specific proportions of a company's market capitalisation. This ensures that investors are not exposed to businesses that rely heavily on interest-based financing, which is prohibited under Islamic law.

Although the screening process is robust, many companies still derive small, incidental amounts of income from non-permissible sources. This makes dividend purification essential. Purification involves identifying the portion of dividend income attributable to non-halal activities and donating that portion to charity. Without this step, portfolios may comply with screening criteria but fall short of being fully Shariah-compliant.

Shariah-compliant equity indices and passive strategies built upon them therefore offer a cost-effective, diversified, and principled means of accessing global equity markets while aligning with Islamic values. Their role in driving long-term growth makes them essential for multi-asset Shariah portfolios.

## **Sukuk: the defensive anchor**

While equities provide growth, multi-asset portfolios also require defensive assets to help manage volatility and deliver stability through market cycles. In Shariah-compliant portfolios, this defensive allocation is achieved primarily through Sukuk, the Islamic alternative to conventional fixed income. Passive Sukuk exposures at the broad asset-class level are often the most efficient way to access this market, offering diversification, transparency, and lower costs.

Sukuk share similarities with conventional bonds in terms of providing periodic cash flows and returning principal at maturity, but they differ fundamentally in structure. Sukuk must represent partial ownership of an underlying tangible asset or a pool of assets, avoiding interest-bearing debt relationships. Their contractual frameworks are therefore asset-backed or asset-based, ensuring compliance with Islamic principles that prohibit *riba* (interest). Despite these structural differences, Sukuk still provide exposure to the global duration factor, meaning they respond to interest-rate movements in a way that is broadly comparable to traditional fixed income.

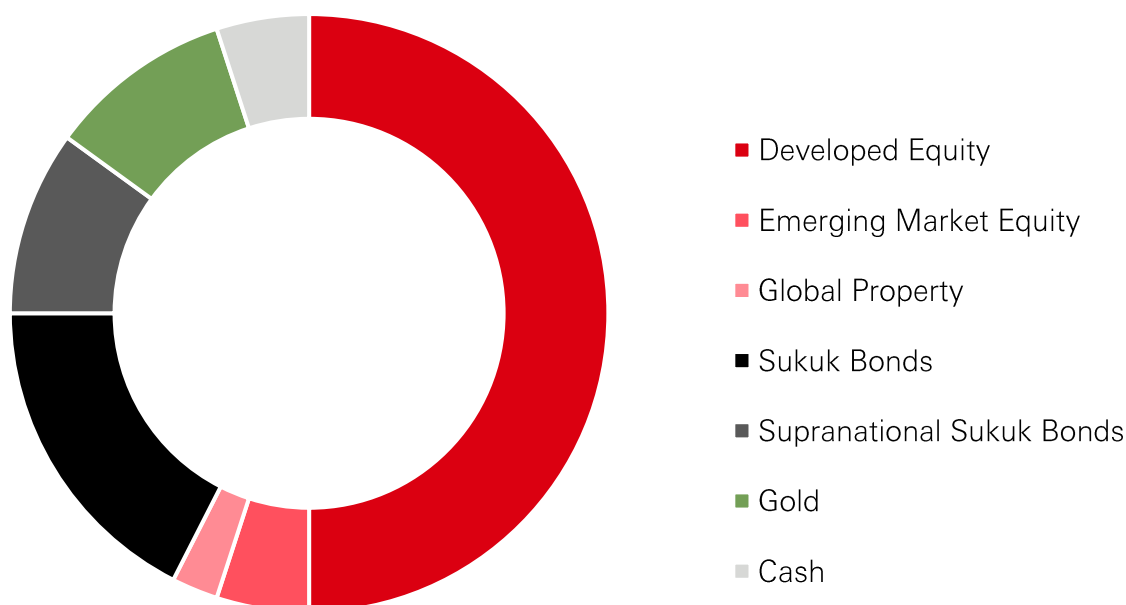
Another important characteristic of Sukuk markets is their issuer base. Sukuk are predominantly issued by sovereigns, quasi-sovereigns, and corporates from the Middle East and parts of Asia. As a result, Sukuk benchmarks often exhibit characteristics reminiscent of emerging-market income, including higher yields, exposure to faster-growing economies, and sometimes elevated geopolitical or credit considerations.

This means building the defensive sleeve of a Shariah-compliant multi-asset portfolio requires careful thought. While Sukuk provide diversification and stability, investors must be aware of the regional concentration and the risk profile embedded within the asset class. Nonetheless, when used in combination with global Shariah-compliant equities and other permissible assets, Sukuk play a crucial role in delivering balanced, risk-managed retirement solutions.

## **Bringing it all together**

As the Islamic investment ecosystem matures, a logical next step has been the development of fully diversified multi-asset portfolios that bridge the risk spectrum between equities and bonds. This evolution is especially relevant for defined contribution (DC) schemes, offering a smoother investment journey without compromising on Shariah principles. This ensures investors can stay on track throughout their retirement lifecycle – while also providing additional self-selection options that align more closely with individual risk preferences.

## Typical Shariah Multi-Asset Balanced Portfolio



The construction of Shariah-compliant multi-asset portfolio begins with careful evaluation of the available universe. Key building blocks include Islamic equities, screened property exposures, Sukuk bonds and physical gold. Each plays a distinct role in achieving diversification and risk control. While many portfolios rely heavily on developed market sovereign bonds for stability, Shariah portfolios must look to alternatives like Sukuk and gold to fulfil similar functions – despite their differing risk-return characteristics.

From a multi-asset standpoint, government bonds play four important roles in portfolio construction: they provide liquidity, safe haven properties, diversification, and lower volatility than their equity counterparts. However, the emerging market nature of Sukuk, albeit investment grade, means its volatility profile is almost twice as volatile as global government bonds, implying the de-risking impact is less effective. Correlation is also higher between Sukuk and equity markets, while liquidity is more constrained within Sukuk bonds.

Therefore, we need to look broader to fully embed defensiveness into the portfolio. As such, gold becomes a valuable diversifier. While gold has a relatively high volatility profile, it exhibits low correlation to equities and therefore contributes to volatility smoothing when combined with both equity and fixed income assets.

Additionally, investors can also expand their toolkit within the fixed income market. Instruments such as International Islamic Liquidity Management (IILM) certificates, which are sub-12-month maturity, sit outside of the traditional Sukuk benchmark. Including them in the portfolio offers shorter duration exposure, improving portfolio flexibility through the ability to respond more nimbly to market shifts while also offering attractive carry properties.

The expansion of Shariah-compliant investment tools marks another step forward in accessing diversified, risk-managed portfolios without compromising faith. As the market continues to deepen and new asset classes are formed, Islamic multi-asset portfolios will become even more sophisticated, while remaining firmly rooted in Shariah values.

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