
Professional Certificate in Islamic Funds and Asset Management

Islamic Portfolio Management and Performance Measurement

In this explanation, we will discuss key terms and vocabulary related to Islamic Portfolio Management and Performance Measurement in the context of the Professional Certificate in Islamic Funds and Asset Management. This explanation will provide a detailed and comprehensive understanding of these concepts, along with examples, practical applications, and challenges.

Islamic Portfolio Management:

Islamic Portfolio Management refers to the management of investment portfolios in accordance with the principles of Islamic law, known as Shariah. These principles include the prohibition of interest (riba), uncertainty (gharar), unethical investments (haram), and the requirement for fairness and transparency.

Key terms and vocabulary related to Islamic Portfolio Management include:

1. Shariah Supervisory Board (SSB): A committee of Islamic scholars who oversee the compliance of the investment portfolio with Shariah principles.
2. Mudarabah: A profit-sharing agreement between the investor (rab-ul-mal) and the portfolio manager (mudarib), where the manager invests the capital and manages the portfolio, while the investor provides the capital.
3. Wakalah: An agency agreement between the investor and the portfolio manager, where the manager acts as an agent on behalf of the investor and manages the portfolio in accordance with the investor's instructions.
4. Murabahah: A cost-plus-profit agreement, where the portfolio manager purchases an asset at a cost and sells it to the investor at a profit.
5. Ijara: A leasing agreement, where the portfolio manager purchases an asset and leases it to the investor for a fixed period.
6. Musharakah: A partnership agreement, where the portfolio manager and the investor contribute capital and share the profits and losses in proportion to their contribution.
7. Income screening: The process of screening the portfolio for investments that generate interest or other forms of non-Shariah compliant income.
8. Asset screening: The process of screening the portfolio for assets that are not Shariah compliant, such as pork, alcohol, gambling, and weapons.

Islamic Performance Measurement:

Islamic Performance Measurement refers to the evaluation of the performance of an Islamic portfolio, taking into account the unique characteristics of Islamic finance. These characteristics include the prohibition of interest, uncertainty, and unethical investments, and the requirement for fairness and transparency.

Key terms and vocabulary related to Islamic Performance Measurement include:

1. Sharpe Ratio: A ratio that measures the risk-adjusted return of an investment, calculated as the excess return over the risk-free rate divided by the standard deviation of the return. In the context of Islamic finance, the Sharpe Ratio can be adjusted to exclude interest-based returns from the calculation.
2. Sortino Ratio: A ratio that measures the risk-adjusted return of an investment, calculated as the excess return over a minimum acceptable return (MAR) divided by the downside deviation of the return. In the context of Islamic finance, the Sortino Ratio can be adjusted to exclude interest-based returns from the calculation.
3. KLD Social Rating: A rating that measures the social performance of an investment, based on environmental, social, and governance (ESG) factors. In the context of Islamic finance, the KLD Social Rating can be used to evaluate the Shariah compliance of an investment.
4. Dow Jones Islamic Market Index (DJIMI): An index that measures the performance of Islamic stocks, based on Shariah screening criteria.
5. Islamic Global Equity Index: An index that measures the performance of global equities, based on Shariah screening criteria.
6. Sukuk: An Islamic bond that complies with Shariah principles, where the issuer raises capital through the sale of assets or services, rather than through the issuance of debt.
7. Zakat: An Islamic charity tax, calculated as 2.5% of the net assets of an individual or institution, and paid to the poor and needy.

Examples and Practical Applications:

- * A portfolio manager may use Mudarabah or Wakalah agreements to manage an Islamic portfolio, where the profits are shared between the manager and the investor, while the losses are borne solely by the investor.
- * A bank may use Murabahah or Ijara agreements to provide financing to customers, where the bank purchases an asset and sells it to the customer at a profit, or leases it to the customer for a fixed period.
- * A company may use Musharakah agreements to raise capital, where the company and the investors contribute capital and share the profits and losses in proportion to their contribution.
- * A fund manager may use income and asset screening to ensure that the portfolio is Shariah compliant, by excluding investments that generate interest or other forms of non-Shariah compliant income, and assets that are not Shariah compliant, such as pork, alcohol, gambling, and weapons.
- * An investor may use the Sharpe Ratio or Sortino Ratio to evaluate the risk-adjusted return of an Islamic portfolio, and the KLD Social Rating to evaluate the social performance of the portfolio.
- * An investor may invest in the Dow Jones Islamic Market Index or the Islamic Global Equity Index to gain exposure to Islamic stocks, or in Sukuk to gain exposure to Islamic bonds.
- * An individual or institution may calculate and pay Zakat to fulfill their Islamic charity tax obligations.

Challenges:

- * The lack of standardization in the application of Shariah principles can lead to differences in the interpretation and implementation of Islamic finance principles.

- * The limited availability of Shariah-compliant assets and instruments can limit the investment opportunities for Islamic portfolios.
- * The lack of transparency and disclosure in the financial statements of some Islamic financial institutions can make it difficult to evaluate their performance and compliance with Shariah principles.
- * The regulatory and legal framework for Islamic finance can vary across jurisdictions, which can create challenges in the cross-border flow of Islamic finance instruments.

Conclusion:

In conclusion, this explanation has provided a detailed and comprehensive understanding of the key terms and vocabulary related to Islamic Portfolio Management and Performance Measurement in the context of the Professional Certificate in Islamic Funds and Asset Management. By understanding these concepts, individuals and institutions can effectively manage and evaluate Islamic portfolios, and ensure compliance with Shariah principles. However, it is important to note the challenges that exist in the application and implementation of Islamic finance principles, and the need for continued development and standardization in this field.