# Crescent Investments Australasia

## Interview with Chaaban Omran, CEO

*Chaaban Omran is the former Managing Director of Muslim Community Co-operative Australia (MCCA). Chaaban was instrumental in demutualising the co-operative and in attaining Australia's first Financial Services License for a Shariah Compliant Retail Investment Fund. Also during his time at MCCA, Chaaban lectured and presented to the banking and services industry, both domestically and internationally, on Australia as an emerging market for Islamic Banking. Prior to MCCA where has been serving and is a director for nearly 4 years, Chaaban was Head of Business Systems for topASX200 company Australian Wealth Management (now known as IOOF Ltd). Chaaban has been in senior roles for 10 years also with Perpetual Investments, MLC and AMP. As a community volunteer, Chaaban was the former National President of the Federation of Australian Muslim Students & Youth (FAMSY). Chaaban has Bachelor of Commerce (Economics and Finance), Diploma in Business and a Certificate in Superannuation Management. Chaaban is a Fellow of the National Institute of Accountants and a Fellow of the Australian Institute of Management.*

**Q1. What are the main reasons to consider allocating into the Australian market? Is this rationale any different when being considered by conventional or Islamic investors?**

Australia is an attractive investment destination due to its strong economic fundamentals especially given its exposure to Asia (and in many respects China), has a well regulated and sophisticated financial markets and is surprisingly tax friendly for offshore investors.

Australia has a developed and well Regulated Financial Market

* Australian share market is developed and well regulated – Australian Securities and Investments Commission, Australian Prudential Regulatory Authority, Australian Stock Exchange
* 4th largest retirement savings market in the world estimated at over $AUD1 trillion
* All major custodians have operations here
* Banking sector escaped the contagion from the US property market

Australia has a Strong Domestic Economy

* Shallow downturn due to government stimulus and flow on from China
* Banking system resilient and well capitalised
* Abundant natural resources in Iron Ore, Coal and gas which China needs
* Investment in resource projects in LNG, Iron Ore, Coal and potentially Coal Seam gas to underpin strong domestic recovery.
* Government net debt negligible

Leveraged to China

* Australia's largest trading partner
* Exporter of resources to China, beneficiary of Chinese investment

* Listed equities biased towards resources
* Approximately 27% of the Top 100 index is resource companies
* Approximately 37% of the Small Ordinaries index is pure resource companies

Outlook

* Strong pickup in growth in CY10 driven by rising investment and domestic demand
* Improving Terms of Trade to drive income growth
* Unemployment has peaked and is declining
* AUD beneficiary of improving commodity demand and global growth

Australia remains a strong destination for conventional investors due to the abovementioned reasons. At the conventional level, financial services and banking stocks especially have faired extremely in comparison to the world during the Global Financial Crisis due to our strong regulatory framework – nonetheless the risk of investing in Riba-based stocks were still felt in our economy during that period. However for Islamic investors value can also be found in undervalued stocks and new upcoming innovative companies that meet the Shariah screening process. Australia is also a new market for Islamic investors that will allow them to exploit this new opportunity and add further diversification to their portfolio. There are vast opportunities and our appointed investment sub-advisor Sigma Funds Management believes there is significant upside in the next 12 months in our share markets.

**Q2. The Australian economy has at times behaved independently of the global markets (most notably during 2005), does this enhance diversification benefits for Islamic portfolios? Has this quality been persistent/sustained over the years?**

In Australia, Islamic portfolios are highly skewed towards resource stocks and in particular smaller companies with great upside opportunities. In general, The Australian market has reported record profits for many companies and for this reason our market has remained strong and resilient in comparison to global markets. Given we are en emerging market for Islamic portfolios we don't have any track-record going back to 2005. However, if we look at the performance of the Australian share market (ASX300) over the past 5, 10 and 15 years, Australia has consistently outperformed the Japan, FTSE and S&P500 indices. In over the 10 years to June 2010, the ASX300 produced a return of 30% whereas the other markets produced -46%, -22% and -29% respectively (source: Sigma Funds Management).

Australian Equities-Cumulative Returns in Local Currency Till Jun-10

Source: Sigma Funds Management

**Q3. This economic resilience has been partly driven by the resources sector (which accounts for well over 20% of the Australian share market), does this overshadow other sectors and/or investment opportunities?**

The resource sector has been the engine of growth in Australia for the last 5 years but these benefits flow into other sectors as well. Increased investment has flowed into full employment which should be positive for consumption and housing. The higher terms of trade should lead to higher national income and hence consumption and government expenditure.

A strong domestic economy leads to investment opportunities in other sectors, hence the benefits of a strong resources sector become more widely spread.

**Q4. With $1.65 trillion, the ASX represents the second largest stock market in Asia-Pacific after Japan, nevertheless there are very few Shariah-compliant products offering exposure to this market. What are some of the reasons for such a lack of product?**

Up until now, Australia has not seen Shariah-compliant products as an alternative innovative investment class. The recent traction for the financial services industry to take not of these products has come about due to the strong performance of such products in the US and the UK-both from an Islamic Finance and from an Islamic Investments Funds point of view. Further the ethical investments concept in market over the past 15 years seems to be waning and it's most likely that if marketed correctly and strongly to wider Australians that Shariah-compliant products will be a more attractive investment class than ethical investments.

The lack of product in this market is an opportunity. Australia does not have a large number of muslims as in some other South East Asian markets which may be one of the key reasons it gets overlooked. Unfortunately the domestic funds management industry is not focused on developing product for this market in Australia as it is seen as a niche.

The other constraint is the lack of local Islamic scholars who are well versed in financial matters who can help develop the industry locally. Also the lack of Islamic financial practitioners also acts as a handbrake.
Nevertheless it can be a profitable niche for a first mover given the latent demand of Australia's 400k odd muslims via superannuation or as a retail product offering.

**Q5. Data from the Australian Bureau of Statistics shows that 40% of listed equities are owned by overseas investors, what are some of the factors that have facilitated access to the Australian marketplace?**

Australia is an economy that is open to offshore capital flows which helps facilitate foreign investment. A well regulated share market also gives foreign investors confidence to invest in Australia. Finally the attractive economic outlook and investment opportunities that are available has also been a driver of foreign investment into Australia.

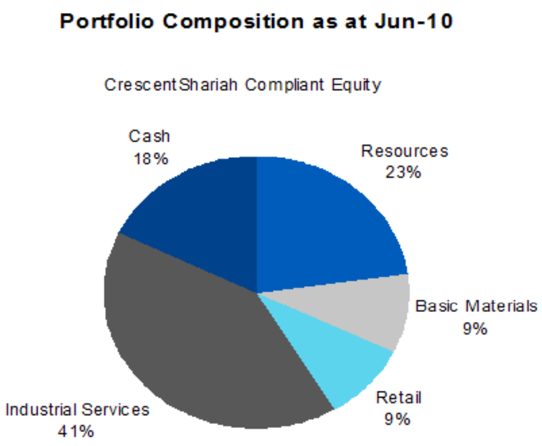
**Q6. What are the implications for overseas investors considering recent legislation surrounding Managed Investment Trusts (MITs)?**

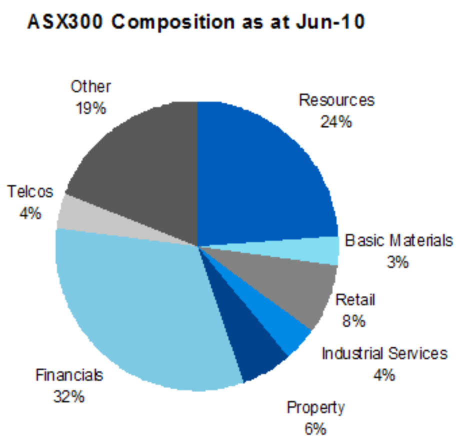
Recent proposed changes relating to Managed Investments Schemes centre around the need to ensure that clients are getting the right financial advice and simplifying fees and offer documents. For example the proposed regulations prescribe that a Product Disclosure Statement (PDS) must be no longer than six A4 pages – a significant shift from the current regime, which does not prescribe any PDS length. In addition to prescribing PDS length, the Regulations mandate the content to be included in the PDS.

Nonetheless leaving these positive changes aside, the taxation benefits for Managed Investment Schemes are surprisingly attractive for overseas investors. Overseas investors have the perception that Australia levies far too much tax on them – this is not the case. Taxation in a managed investment scheme is minimal.

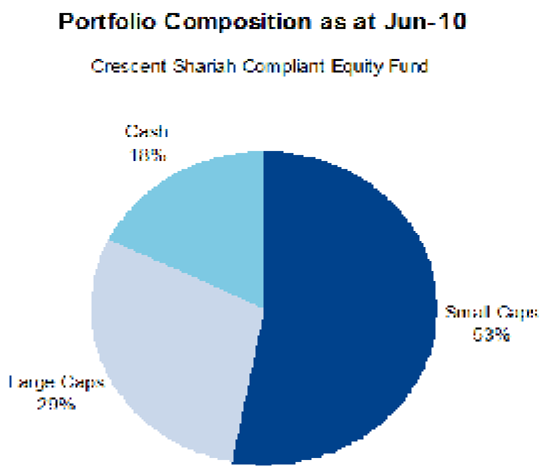
**Q7. Does the screening preclude your ability to have exposure to any specific market sector (i.e. retail, mining, etc) or segment (i.e. large caps)?**
**The screening precludes Crescent from investing in Financials which make up 33% of the market cap of the ASX300. The screen is also biased towards resource stocks and small caps in particular. This also makes it difficult for mainstream fund managers to offer a shariah based product given the mix of skills required to manage the fund.**

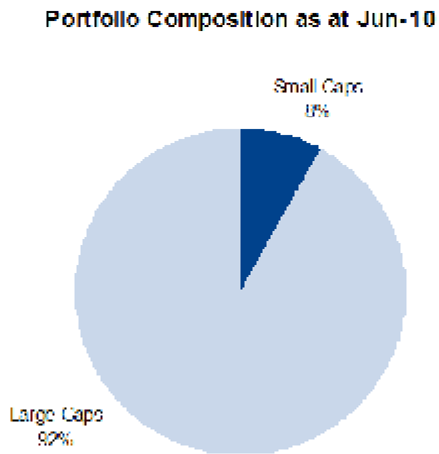
Below is a graph that shows the sector make up for the Crescent Shariah Compliant Australian Equity Fund which shows that we do not invest in the Financial and Property sectors due to their Riba and gearing exposure. The ASX300 Index is the conventional index.



In terms of the segment, we find that our Shariah Compliant Australian Equity Fund is highly skewed towards smaller companies as can be seen by these illustrations:

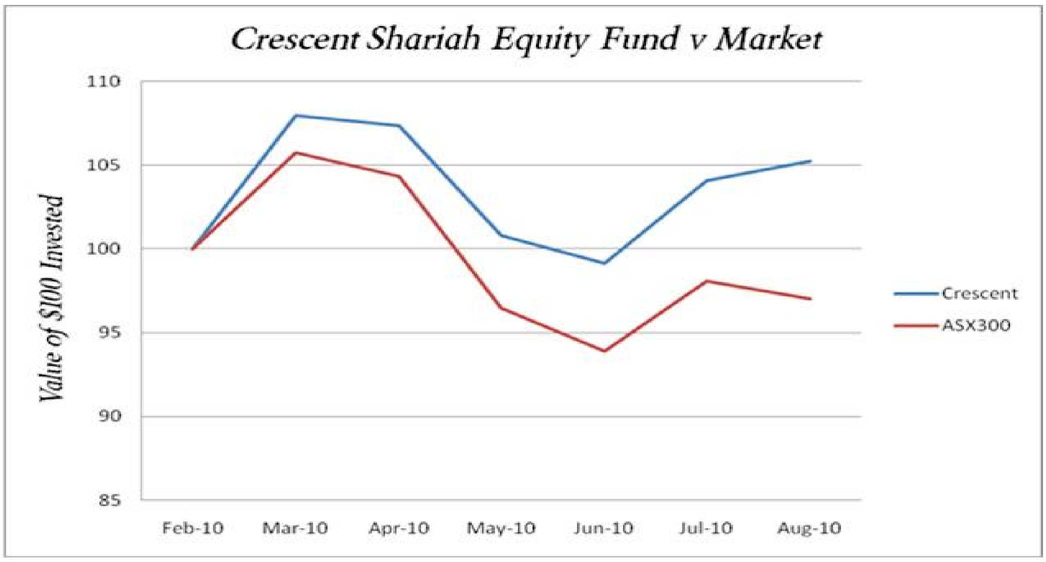



### Q8. While there are more than 2,000 companies listed in the ASX, what is the impact on this universe after applying a Shariah screening methodology?

Depending upon the method used to screen the ASX the shariah screen reduces the number of stocks to invest in from 2000 to approximately 230-300. Crescent uses the AAOIFI method as we believe this is the method that blends a strict application of financial screens and wide market recognition.

As a matter of fact, when you take the differences between the Shariah compliant portfolio and the conventional index you will see that our fund has outperformed the conventional index in the past seven months as shown below:



### Q9. Taking into account the absence of a readily available Islamic index, what are the most appropriate benchmarking options available?

That is a difficult issue to address, and Crescent is advocating the creation of such an index by the mainstream index providers. In Australia that is S&P which owns the rights to the S&P/ASX indices. We are also investigating the provision of a custom index by other reputable providers for eg Dow Jones.

For the moment and for comparison purposes we use the S&P/ASX300 (see above sector allocations) as a guide to how the fund is performing. Our aim is to achieve comparable returns to the market despite the obvious index composition issues. This we believe can be delivered by stock selection and risk management within portfolio construction.

We also benchmark on an absolute return basis given that investors want to achieve positive absolute returns and are less concerned with relative returns.

### Q10. The Australian dollar remains one of the strongest (and most traded) currencies today, how would this impact an allocation decision? Considering the link to commodities, is this appealing for institutions with significant exposure to oil revenues?

Obviously the Australian dollar is highly correlated to commodity prices given that the exports of such commodities are a significant part of the Australian economy. A strong domestic outlook for Australia and the bias towards rising interest rates suggests that the fundamentals point towards further appreciation of the currency. This adds to performance when measured in USD, and given oil is traded in USD this would be particularly attractive to institutions in oil producing countries. Both from an investment return enhancer as well as for diversification purposes.

### Q11. Considering its dynamic investment fund community and vast superannuation industry, what are the necessary steps to position Australia as an Islamic asset management hub?

Australia has a competitive advantage in terms of the sophistication, maturity and regulation of its investment fund industry given how long we have had superannuation. So the skills exist to manage and service the Islamic asset management industry. We need to lift the awareness of shariah compliant investing and the issues that this raises in terms of investing. We also need more Islamic scholars being available to help with the constitution of shariah advisory boards. Local Fund managers also need to invest the time and money in developing products that can meet the needs of the domestic market before it would be taken seriously by offshore Islamic investors. The fact that the domestic market is underserviced is the real opportunity, 400k muslims with superannuation assets are seeking such alternatives but to date other than the efforts of Crescent Investments little has been accomplished. Getting the government to support the development of the industry by seeding some of these funds would lift the profile and awareness of such products as well as highlight the supportive intentions of the government towards shariah compliant investing. This is something that we can learn from the Malaysian government in terms of nurturing the expertise and development of the industry.

Your feedback and comments are very important to us, please feel free to contact the author via email.