

Diversifying in a Changing World

Investors should consider US dollar-denominated *sukuk* as the preferred gateway for global fixed income allocations.



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Investors are entering unfamiliar territory. As the Federal Reserve signals a pause – and potential reversal – in its historically aggressive rate hikes, investors face the reality of lower yields on US Treasuries and core domestic bonds. At the same time, recent US policies and an “America-first” investment approach have led some foreign investors and sovereign wealth funds to trim their exposure to US assets. Flows are shifting as global allocators increasingly look for stability and returns outside US borders.

For investors rooted in the US equity and fixed income markets, these trends should serve as a wake-up call: the old playbook may no longer provide portfolio safety or return potential. Instead, markets demand insight, agility, and – most of all – global diversification. In this environment, one lesser-known but highly effective tool stands out: US dollar-denominated *sukuk*.

What are *sukuk*, and why now?

Sukuk are income-producing instruments that adhere to Islamic tenants. These instruments function similarly to bonds and are often issued in US dollars by investment-grade sovereigns and large institutions in fast-growing economies such as those in the Gulf Cooperation Council (GCC)¹ and Southeast Asia.

While still underutilized in global portfolios, the US dollar-denominated *sukuk* market has more than doubled to

Key Takeaways

- 1 **Shifting market conditions require diversification.** With US Treasury yields falling and foreign investors reducing US exposure, traditional US-only portfolios may no longer provide the same safety or returns.
- 2 **US dollar-denominated *sukuk* stand out.** *Sukuk* offer low correlation to other fixed income assets, helping reduce portfolio volatility and improve risk-adjusted returns.
- 3 **They exhibit lower volatility than major benchmarks.** Historically, *sukuk* have shown significantly less volatility than both emerging market bonds and even US Treasuries, making them an attractive defensive allocation.

over \$270 billion in just six years, deepening liquidity for investors while the certificates remain rooted in tangible assets to adhere to Islamic principles. US dollar-denominated *sukuk* are a subset of a much larger global *sukuk* market. In fact, *sukuk* have been issued in [30 different currencies](#)² with an outstanding balance in excess of \$1 trillion at the end of the second quarter of 2025.

The key advantage of these securities isn't just religious compliance or regional exposure – it's their ability to change the risk/return shape of your entire portfolio. The benefits are compelling and hard to ignore.



Lower Correlation, More Diversification

Lower correlation is the engine of diversification. Markets do not reward investors merely for holding more assets – they reward them for holding assets that do different things at the same time. By combining assets that zig and zag differently, investors can reduce portfolio volatility and drawdowns while enhancing risk-adjusted returns.

Let's compare the correlation characteristics of the US dollar-denominated *sukuk* benchmark, the FTSE IdealRatings Sukuk Index (SUKUK) and the J.P. Morgan Emerging Market Bond Index (EMBI) Global Core to the MSCI All Country World Index (MSCI) – an international equity index that [tracks stocks from 23 developed and 24 emerging market countries](#)³ – and a US equity index, the S&P 500.

As shown in the accompanying table, the EMBI's correlation to the MSCI Index and S&P 500 Index over the five year period is 74.8% and 70.2%, respectively. For the same time period, the correlation of SUKUK with the MSCI Index is 37.7% and 31.4% with the S&P 500 Index. This means SUKUK has a significantly lower correlation with the MSCI Index and S&P 500 Index than that provided by the EMBI.

In fact, the correlation of SUKUK with the MSCI Index and S&P 500 Index is 49.5% and 55.3% lower, respectively. The 3-year period provides a similar outcome, though less pronounced. SUKUK's correlation with the MSCI Index and S&P 500 Index is 36.7% and 40.3% lower, respectively. The materially lower correlation imparts important and sought-after diversification benefits for investors.

	Correlation (5-year)		Correlation (3-year)	
	MSCI ACWI	S&P 500	MSCI ACWI	S&P 500
J.P. Morgan EMBI Global Core	74.8%	70.2%	60.0%	49.4%
FTSE Sukuk Benchmark	37.7%	31.4%	38.0%	29.5%
Correlation Reduction	-49.6%	-55.3%	-36.7%	-40.3%

Source: Bloomberg; 5-year period (June 30, 2020-June 30, 2025). 3-year (June 30, 2022-June 2025)

Lower Volatility, Less Risk

Examination of volatility is essential in obtaining a holistic perspective of the potential investment benefits. The investment community uses standard deviation to measure risk. Standard deviation measures the amount of variation, or dispersion, of a set of observed values and is commonly used to measure investment risk. In this case, the set of values comprises investment returns over time. The higher the standard deviation, the greater the dispersion of returns – both positive and negative. Greater return dispersion implies greater risk, while conversely, the lower the dispersion, the lower the risk. Standard deviation is best used in a relative framework to compare returns to other asset classes and therefore gain a sense of return variability.

As shown in the accompanying table, the 5-year standard deviation for the EMBI was 8.34% and SUKUK was 3.34%. Additional benchmarks, Bloomberg Barclays US Aggregate Total Return (USAGG) comes in at 6.80%, while the Bloomberg Global Aggregate Index (GLOBE) comes in at 6.25%. The Bloomberg Barclays US Treasury Index (TREAS) was 5.34%.

It's worth noting that SUKUK's standard deviation is materially lower over both observed periods when compared to the selected fixed income benchmarks. In fact, its standard deviation is nearly 60% lower than that EMBI over the past five years. This means volatility of SUKUK is nearly 60% and 56% lower than EMBI over the past five and three years, respectively.

Selected Benchmarks	5-year	Reduction in Volatility	3-year	Reduction in Volatility
J.P. Morgan EMBI Global Core (EMBI)	8.34%	-59.9%	8.59%	-56.1%
Bloomberg US Agg Total Return (USAGG)	6.80%	-50.9%	7.60%	-50.4%
Bloomberg Global Agg Index (GLOBE)	6.25%	-46.6%	7.01%	-46.2%
Bloomberg US Treasury Index (TREAS)	5.34%	-37.4%	5.92%	-36.3%
FTSE Sukuk Benchmark (SUKUK)	3.34%		3.77%	

Source: Bloomberg: 5-year period (June 30, 2020–June 30, 2025). 3-year (June 30, 2022–June 2025)

There is also a stark difference in standard deviation between the TREAS and SUKUK benchmarks. SUKUK experienced more than one-third less volatility when compared to a US Treasury over both periods. This tends to surprise most investors as very few fixed-income benchmarks tend to demonstrate lower volatility than US government Treasuries.

Most assume the lower volatility would be attributed to duration. However, that is not the case. The effective duration difference between TREAS and SUKUK is only one year and a reporting duration of 5.76 years and 4.78 years for the first half of 2025, respectively. The fact that the underlying return characteristics of US dollar-denominated *sukuk* are tethered to assets rather than debt commitments is one of the many variables that contribute to its low volatility profile.



Performance Returns

Finally, let's examine investment performance. As can be observed in the accompanying table over the 5-year, 3-year, and 1-year periods, the EMBI posted an annualized return of 1.53%, 8.61%, and 9.77%, respectively. SUKUK also demonstrated favorable annualized returns with the 5-year coming in at 2.09%, 3-year at 4.26%, and the trailing 12 months ending the

second quarter of 2025 coming in at 6.95%. Other benchmarks referred in the volatility segment are also included to offer a holistic comparison.

When comparing fixed income benchmark performance across the index complex, we find that SUKUK offers investors an additional compelling business case.

Annualized Returns: Selected Fixed-Income Benchmarks

Benchmark	5-year	3-year	1-year
J.P. Morgan EMBI Global Core (EMBI)	1.53%	8.61%	9.77%
FTSE Sukuk Benchmark (SUKUK)	2.09%	4.26%	6.95%
Bloomberg Global Agg Index (GLOBE)	-1.16%	2.74%	8.86%
Bloomberg US Agg Total Return (USAGG)	-0.73%	2.55%	6.04%
Bloomberg US Treasury Index (TREAS)	-1.60%	1.53%	5.27%

Source: Bloomberg: 5-year period (June 30, 2020-June 30, 2025). 3-year (June 30, 2022-June 2025). 1-year (June 30, 2024-June 30, 2025)

Closing Perspective

Sukuk have progressed beyond just a religiously focused allocation to a strategic building block for global fixed-income portfolios. Their structurally lower correlations with major equity indices, markedly subdued volatility, and compelling investment performance create a rare combination. Taken together, these three

attributes reposition sukuk from being merely "another diversifier" to serving as a gateway allocation – one that broadens geographic exposure, upgrades risk-adjusted performance, and aligns portfolios with the backing of real assets.

Endnotes

¹The region known as the Gulf Cooperation Council (GCC) is a political and economic alliance of six countries in the Arabian Peninsula. Its members are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

²International Islamic Financial Market. IIFM Sukuk Report, 13th Edition. Page 80. 2024. <https://www.iifm.net/frontend/general-documents/61b62b8779cbce687eac670ce915a3b31732169124.pdf>

³MSCI ACWI Index (USD) Factsheet. MSCI. July 31, 2025. <https://www.msci.com/documents/10199/8d97d244-4685-4200-a24c-3e2942e3adeb>