

Amana Participation Fund

Halal Capital Preservation and Current Income

Investor Shares **AMAPX**
Institutional Shares: **AMIPX**



Amana Mutual Funds Trust



About Amana Mutual Funds Trust

At the Amana Mutual Funds Trust and Saturna Capital, we endeavor to align our investments with our principles.

The Amana Funds favor companies with low price-to-earnings multiples, strong balance sheets, and proven businesses. They follow a value-oriented approach consistent with Islamic finance principles. Generally, these principles require that investors avoid interest and investments in businesses such as liquor, pornography, gambling, and banks. The Funds avoid bonds and other conventional fixed-income securities.

Please consider an investment's objectives, risks, charges, and expenses carefully before investing. To obtain this and other important information about the Amana Mutual Funds in a current prospectus or summary prospectus, please visit www.amanafunds.com or call toll free 1-800-728-8762. Please read the prospectus or summary prospectus carefully before investing.

The Amana Mutual Funds are distributed by Saturna Brokerage Services, member FINRA / SIPC. Saturna Brokerage Services is a wholly-owned subsidiary of Saturna Capital Corporation, adviser to the Funds.

Filling a Need

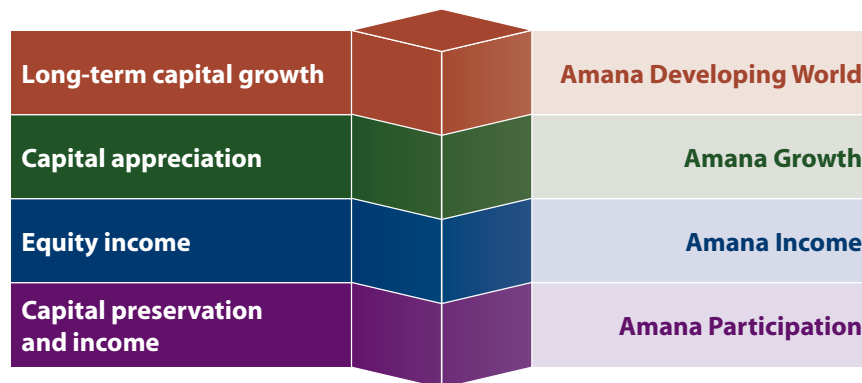
For more than 30 years, Amana Mutual Funds have provided professionally managed and diversified investment portfolios serving the needs of our clients. Building upon our history of *halal* investing expertise, the **Amana Participation Fund** is designed to help clients meet their long-term financial needs through an investment objective of capital preservation emphasizing current income consistent with Islamic principles.

Investors following Islamic principles traditionally have found their asset allocation options limited to equities and cash to meet their financial planning needs. To help investors diversify, we created the Amana Participation Fund, the first non-equity, *halal* income fund offered in the US. The Amana Participation Fund presents an opportunity to gain access to a third asset class: a non-equity, income-producing asset with historically lower volatility compared to equities.

The name, Participation, describes the characteristics of *sukuk* – investment certificates which are structured so that investors share in their economic profits and losses. *Sukuk* comprise a non-equity asset class only recently available to mainstream US investors, broadly serving the financial needs of the Muslim community and beyond.

The **Participation Fund** is not a cash alternative or deposit account and is best suited for investors with an investment time horizon of at least two or more years. Please carefully review the Fund's prospectus regarding risks and other disclosures, or consult your financial advisor, before investing.

The Amana Mutual Fund Family



The launch of the Participation Fund marks an important development for Muslim investors, broadening access to a third, essential leg of basic asset allocation: non-equity income.

One primary benefit of the **Participation Fund** is that formerly unproductive, uninvested cash can earn current income from a portfolio of investment securities that seeks to be more stable than investing for income from equities.

What are Sukuk?

Sukuk is the plural of *sak*, an Arabic word translated as deed, instrument, or legal document. *Sukuk* are financial certificates having characteristics similar to conventional bonds. Generally *sukuk*:

- have a stated maturity date;
- offer a stated annual investment income rate, similar to a coupon offered by a conventional bond; and
- may obtain a credit rating from well recognized credit rating agencies, such as Moody's and Standard & Poor's.

It is important to note that while *sukuk* may share similar features with conventional bonds, unlike conventional bonds, they typically reflect an undivided beneficial ownership interest in an underlying asset, similar to a stock. The returns of the underlying asset provide the investment return, and *sukuk* holders share in the underlying asset's profits as well as potential losses.

Sukuk are a distinct asset class.¹

Sukuk vs. Conventional Bonds

	Sukuk	Conventional Bonds
Underlying Asset	Proof of ownership in an asset	Debt obligation
Legal Structure	Holders each hold an undivided beneficial ownership in underlying assets	Issuer has a contractual obligation to pay bond holders interest and principal on certain specified dates
Halal considerations	The underlying assets are <i>halal</i>	n/a
Pricing	Pricing based upon value of underlying assets	Pricing based on credit rating of issue and issuer
Valuation	Buyers purchase assets that have value	Buyers act as creditors in implicit loan agreement
Investment rewards and risks	Holders receive a share of profits from the underlying assets (and accept a share of any loss incurred)	Holders receive regularly scheduled interest payment for the life of the bond, and the principal is returned at the bond's maturity date

What makes *Sukuk* *halal*?

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), a not-for-profit Bahrain-based Islamic financial standards organization, defines *sukuk* as “certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity.” *Sukuk* may invest in a broad range of tangible assets including facilities, equipment, operating businesses, and real estate that generate a return (or a loss) from those assets. This contrasts with conventional bonds where the investor holds a debt instrument that generates income from the payment of interest (*riba*).

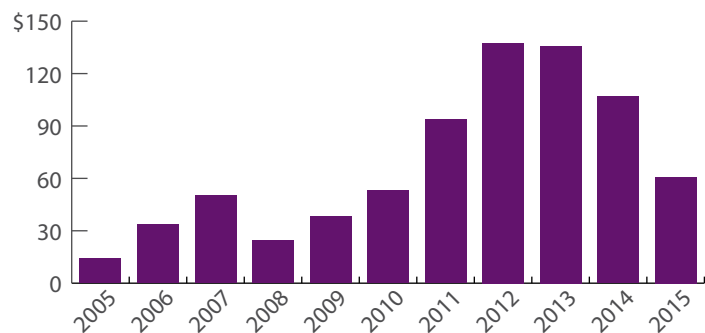
Islamic investing generally prohibits earnings from *riba*.²

All aspects of *sukuk* are subject to review by appointed Islamic scholars who provide a *fatwa* that forms the basis for claims of compliance with Islamic tenets.³

A Condensed History of the *Sukuk* Markets

While *sukuk* have gained broader acceptance among investors over the past few decades, they are not new. Some of the earliest forms of *sukuk* date as far back as 634 CE. In 1988, the International Islamic Fiqh Academy (a university in Jeddah, Saudi Arabia) of the Organisation of Islamic Conference helped to modernize *sukuk* by issuing a widely accepted framework.⁴ One of the first *sukuk* issued under the new framework came a few years later in 1990 from the Malaysian subsidiary of Shell Oil Company.⁵ The Government of Bahrain issued the first sovereign *sukuk* in September 2001.⁶

Global *Sukuk* Issuance (Jan 2005 - Dec 2015), USD Billions



Source: International Islamic Finance Market (IIFM)

At the end of 2015, there were US\$281 billion of *sukuk* outstanding.⁷

Annual *sukuk* issuance grew at a compound annual growth rate (CAGR) of 33% between 2001 and 2013,⁸ and more than US\$60 billion of new *sukuk* were issued globally in 2015.⁹ Although this represents a slowdown from previous years (likely due in part to a drop in oil and other commodity prices), issuers include a wide array of industries and countries.

Types of Sukuk

In a typical structure, investors buy *sukuk* certificates from an issuer who then forms a special purpose vehicle (“SPV”) to manage the assets, any counterparties, and the beneficiary or lessee (sometimes referred to as the “originator”) who will use the assets. While this is not a complete list of the types of *sukuk*, we have provided brief descriptions of some commonly used structures.

Ijara / Lease

Sukuk al-ijara is similar to a lease program and is one of the most prevalent forms of *sukuk*. With this arrangement, investors finance the purchase of fixed assets (such as real estate or airplanes) in exchange for an amount of income generated by the business activities in which the assets are used. At the end of the agreement, the lessee has the option to buy the assets from the SPV.

Istisna’a / Exception

Sukuk al-istisna’a is a contract to financing an industrial development project (i.e., construction or manufacturing). It differs from *ijara* in that the assets are not yet created and the developer agrees to deliver the assets by a certain date.

Mudaraba / Profit Sharing

Sukuk al-mudaraba are similar to business loans, but instead of a business paying interest on its loan, it pays a pre-determined percentage of its profits. In the case of loss (i.e., an unprofitable business), the losses are born solely by the provider of the funds.

Murabaha / Cost-Plus-Financing

Sukuk al-murabaha could also be described as a cost-plus-financing model. The issuer buys a particular asset or commodity at market value and sells it to the originator (who will use the asset). This structure is a common method of financing home loans, but typically the certificates are not traded because of the prohibition on trading in debt.

Musharaka / Participation

Sukuk al-musharaka are similar to *mudaraba* except that the repayment terms are flexible and both the originator and the issuer contribute funds, and consequently both would participate in any losses.

Wakala / Agency

Sukuk al-wakala share characteristics of *mudaraba* and *musharaka*, with a twist: the investors agree to a pre-determined ratio of profit, but should the profit exceed the agreed to amount, the issuer may keep the excess.



Making a Mindful Investment

The **Amana Participation Fund** aims to offer broader diversification opportunities for investors seeking capital preservation and current income consistent with Islamic principles. It is important to note that while the *sukuk* market has experienced favorable growth and broader acceptance among the investment community, it is still viewed as a newly developing and nascent market. As a result, these securities can be adversely affected by unexpected risks and as such, require a careful review of the prospectus.

About The Author



Patrick Drum MBA, CFA, CFP®
Amana Participation Fund Portfolio Manager

Patrick T. Drum, Research Analyst and Portfolio Manager, joined Saturna Capital in October 2014.

He is a select member of the United Nations Principles for Responsible Investment (UNPRI) Fixed Income Outreach Subcommittee and an adjunct professor of finance at Pinchot University, formerly known as Bainbridge Graduate Institute (BGI). Mr. Drum has nearly ten years of experience integrating ESG considerations into fixed income portfolio management.

He holds a BA in economics from Western Washington University and an MBA from Seattle University Albers School of Business. He is a Chartered Financial Analyst Charterholder (CFA) and a Certified Financial Planner®. Mr. Drum has more than twenty years of investment experience in serving institutions and private clients.

Footnotes:

¹ International Monetary Fund (IMF), *The IMF and Islamic Finance*, March 2015.

² Bhandari, Sunil. *Islamic Finance*, Association of Chartered Certified Accountants (ACCA), August 8, 2015.

³ Ali, Rahail and Lovelis, Hogan. *Sukuk and Islamic Capital Markets: A Practical Guide*, Globe Law and Business, March 2011.

⁴ International Islamic Financial Market (IIFM), *Sukuk Report*, 1st Edition, 2010. Page 7.

⁵ IIFM, *Sukuk Report*, 1st Edition, 2010. Page 7.

⁶ IIFM, *Sukuk Report*, 1st Edition, 2010. Page 8.

⁷ RAM Rating Services Berhad, *Sukuk Snapshot (as at end of December 2015)*, February 10, 2016.

⁸ Augustine, Babu Das. *Global sukuk issuance to gain momentum in 2015*, Gulf News, March 15, 2015.

⁹ Tan, CK. *Global sukuk issuance slides 43% in 2015*, Nikkei Asian Review, April 6, 2016.

The value of the shares of the Amana Participation Fund rises and falls as the value of the securities in which the Fund invests go up and down. The Fund limits the securities it purchases to those consistent with Islamic principles. This limits opportunities and may affect performance. The Fund may invest in securities that are not traded in the United States. Investments in the securities of foreign issuers may involve risks in addition to those normally associated with investments in the securities of US issuers. These risks include currency and market fluctuations, and political or social instability. The risks of foreign investing are generally magnified in the smaller and more volatile securities markets of the developing world.

While the Participation Fund does not invest in conventional bonds, risks similar to those of conventional nondiversified

fixed-income funds apply. These include: diversification and concentration risk, liquidity risk, interest rate risk, credit risk, and high-yield risk. The Participation Fund also includes risks specific to investments in Islamic fixed-income instruments. The structural complexity of sukuk, along with the weak infrastructure of the sukuk market, increases risk. Compared to rights of conventional bondholders, holders of sukuk may have limited ability to pursue legal recourse to enforce the terms of the sukuk or to restructure the sukuk in order to seek recovery of principal. Sukuk are also subject to the risk that some Islamic scholars may deem certain sukuk as not meeting Islamic investment principles subsequent to the sukuk being issued.

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