



ACTIVELY MANAGING ISLAMIC INVESTMENTS

The Misnomer of “Passive” Islamic Investing

FROM THE

YARDARM

MARKET COMMENTARY & ANALYSIS

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About Saturna Capital

Saturna Capital, manager of the Amana, Saturna Sustainable, Sextant, and Idaho Tax-Exempt Funds, uses years of investment experience to aid investors in navigating today's volatile markets. Founded in 1989 by professionals with extensive experience, Saturna has helped individuals and institutions build wealth, earn income, and preserve capital.

We are long-term, values-based, and socially responsible investors. We view consideration of environmental, social, and governance (ESG) factors as essential in forming portfolios of high-quality companies that are better positioned to reduce risk and identify opportunities. We believe that companies proactively managing business risks related to ESG issues make better contributions to the global economy and are more resilient.

At Saturna, we believe in making your investment dollars work hard for you and that your interests always come first. Saturna strives to not only offer the best investment opportunities from mutual funds to IRAs, but to match those sound investments with superior customer service.

About Saturna Sdn Bhd

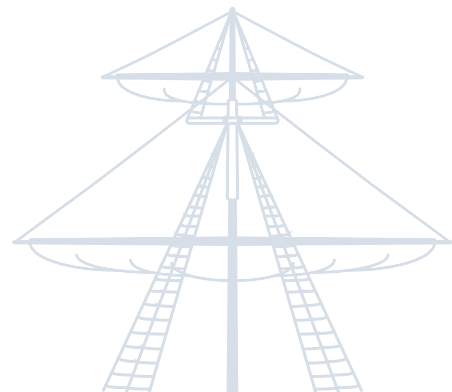
Saturna Sdn Bhd is the wholly-owned Malaysian subsidiary of Saturna Capital Corporation, resulting from the 2010 purchase by Saturna Capital of Alpha Asset Management located in Kuala Lumpur. Saturna Sdn Bhd holds an Islamic Fund Management Licence (IFML) with the Malaysian Securities Commission. Saturna is the first conventional asset manager to be converted to an Islamic asset manager.

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

The Amana, Sextant, Idaho Tax-Exempt, and Saturna Sustainable 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.

For years the flow of retail and institutional investment has migrated away from traditional, actively managed funds toward passive or index funds, driven by a combination of lower expenses for the passively managed vehicles and an unenviable history of underperformance among many actively managed funds.

For investors seeking broadly diversified exposure to an individual country or regional stock market, arguments against investing passively may fail to persuade. Passive investments, however, are not restricted to broad indices like the S&P 500. Many passive vehicles seek to provide more specific exposure to investing styles. Islamic (or *Shariah*-compliant) investing represents a case in point.



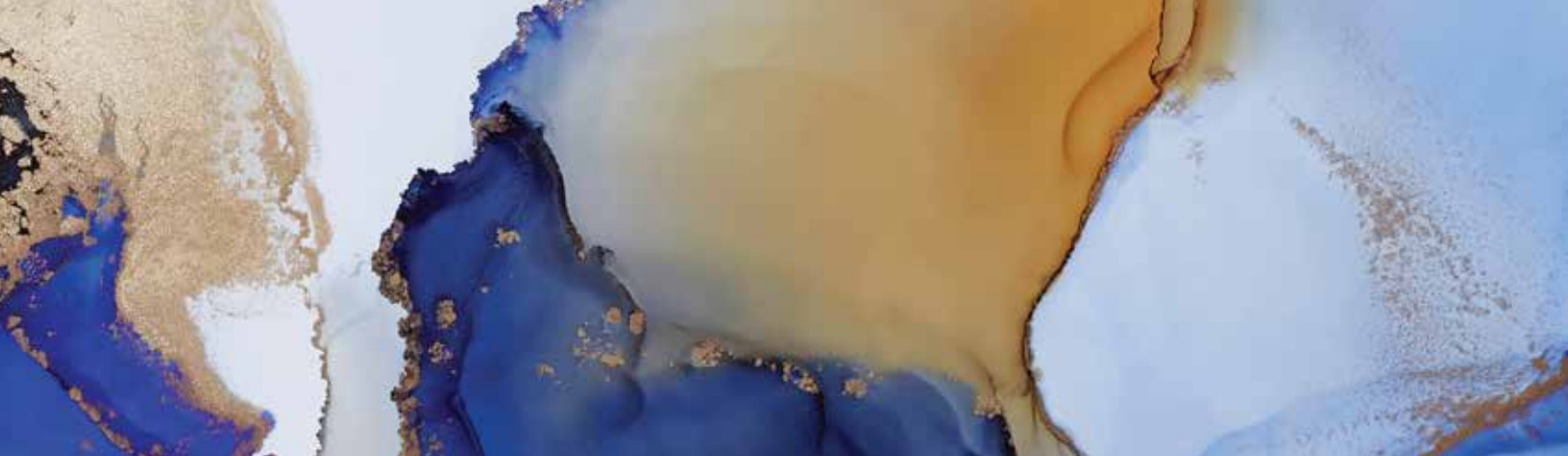


The index provider plays the role of the investment manager . . .

As the largest manager of Islamic investments in the United States, we believe that in the realm of Islamic investing, a truly passive option doesn't exist. Instead, we ask where the active decisions are being made; in the choices of which screening methods are used to design the index, or in the implementation of screening methods in the actual investment portfolio?

A passive Islamic fund outsources active decisions on how to screen the investment universe and weight the factors to the index provider, of which there are several, including Dow Jones with their Islamic Market Developed Markets Index and MSCI with their World Islamic Index. In this sense, the index provider plays the role of the investment manager, while the passive fund becomes a vehicle to implement those benchmark investment decisions. But how much does the typical passive investor know about the active decisions taken by the benchmark provider? In reviewing the 10 largest holdings of the two indices referenced above, we find that only two stocks appear in common. Further, we discover that the two indices have widely differing sector allocations, with the gaps most conspicuous in Technology, Health Care, and Energy. Finally, country allocations diverge greatly with one index weighting the United States nearly 40% higher than the other.

Benchmark providers do not have a fiduciary obligation to investors. There can be some avoidance of liability in construction and maintenance of the benchmark, particularly regarding compliance with Islamic guidelines, that may not be in the best interests of investors. For example, a key element of Islamic investing is the prohibition of speculation. The Dow Jones Islamic Market Developed Markets Index mentioned above includes Tesla among its 10 largest holdings. According to consensus estimates, in early April Tesla traded at a 2022 price to earnings ratio of approximately 94x. Even accepting the aggressive forward earnings estimates, Tesla was trading at 57x 2026 earnings. Ford, on the other hand, was trading at 7x this year's earnings. From mid-May through early November of 2021, Tesla shares more than doubled to \$1,229.91, but then skidded -38% to \$766.37 as of March



14, 2022, before rebounding into early April, peaking at roughly \$1,148 then tumbling 45% over the next seven weeks. Tesla deserves credit for almost single-handedly initiating the transition to electric vehicles (EVs) but considering the share price volatility, the valuation, and the aggressive investments in EVs being made by every major automotive company in the world, the shares appear to represent the very definition of speculation.

In contrast to passive approaches within constrained universes like Islamic investing, the active manager can take the role of both designer and maintainer of the screens that define the universe, as well as the role of director of how those screens are implemented. The benefit of this approach is that the active manager can weigh tradeoffs between how the universe is constrained and how those constraints are handled with respect to the broader universe and global economy.

For example, the effect of a screen may be to underweight or avoid an economic sector with a significant weight in the broader universe due to Islamic considerations. An active manager could choose to mitigate the deviations from broad sector weights by using a factor analysis in portfolio construction, or they could focus on fundamental factors of stock selection when choosing the companies from a sector. Neither of these possibilities are likely to be relevant to a benchmark provider, but they may be important components of a holistic Islamic investment strategy.

An active manager can also make fundamental decisions regarding the acceptability of any investment from an Islamic perspective, rather than relying on automated word searches for prohibited activities together with a handful of financial ratios. For example, nowhere in Pepsi's business description does it mention alcoholic beverages, and one would be hard-pressed to find mention of such on the investor relations website. Nonetheless, in 2022 Pepsi began selling an alcoholic version of Mountain Dew,¹ rendering it inappropriate for Islamic portfolios.

The marketplace has rendered its verdict regarding passive investment vehicles, and they have become an integral part of the investment landscape. For investors seeking broad country or even sector exposure, that may be appropriate. Investors seeking to express their beliefs, however, may be better served by actively managed funds that provide clarity and transparency regarding the investment process. 🌱

About The Authors



Scott Klimo CFA®
Vice President & Chief Investment Officer, Saturna Capital
Portfolio Manager Amana Growth Fund, Sextant Growth Fund

Scott Klimo, Vice President & Chief Investment Officer, joined Saturna Capital in May 2012. He received his BA in Asian Studies from Hamilton College in Clinton, NY and also attended the Chinese University of Hong Kong and the Mandarin Training Center in Taipei, Taiwan. Mr. Klimo has over 30 years experience in the financial industry with the first several years of his career spent living and working in a variety of Asian countries and the past 20 years working as a senior analyst, research director and portfolio manager covering global equities. Mr. Klimo is a Chartered Financial Analyst (CFA) charterholder and an avid cyclist. He is a supporter of various environmental organizations and served for several years on the Board of Directors of the Marin County Bicycle Coalition.



Bryce Fegley MS, CFA®, CIPM®
Senior Investment Analyst & Portfolio Manager, Saturna Capital
Deputy Portfolio Manager Amana Income Fund

Bryce Fegley, Senior Investment Analyst & Portfolio Manager, joined Saturna Capital in 2001 and worked in brokerage/trading and later as an investment analyst. Beginning in 2010, he spent two years as President of our Malaysian subsidiary, Saturna Sdn Bhd, directing its research and fund management operations. In 2012 he returned to Saturna Capital headquarters. Prior to joining Saturna, Mr. Fegley worked in brokerage operations in Seattle from 1997-2000. Originally from upstate New York, he studied at the University of Colorado at Boulder earning his BA in English Literature. Mr. Fegley earned an MS in Computational Finance and Risk Management from the University of Washington in December 2017. His volunteer activities include a board role with the Whatcom Family YMCA.

More by Scott Klimo

The Case for Active Management in ESG



How do investors make sense of quantitative ranking systems that retain “black box” elements? In the quest to find top-tier firms that seek to reduce risk through industry best practices, an active approach to investing can help investors identify risks that a passive approach may miss.

More by Bryce Fegley

How Long Is Your Bond?



Understanding bond investing terminology can help you select a bond fund or an asset allocation that is right for you. Saturna Capital explains credit risk, maturity, duration, interest rate sensitivity, weighted-average, convexity, and more.

Available at www.saturna.com

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Footnote

¹ Hard Mountain Dew. <https://hardmountaindew.com/>

Ownership of Securities Mentioned

As of March 31, 2022, no fund advised by Saturna Capital owned any securities of Tesla and PepsiCo comprised 1.08% of Sextant Core Fund's portfolio.

Index Definitions

The MSCI World Islamic Index reflects Islamic investment principles and is designed to measure the performance of the large and mid-cap segments of 23 developed markets countries that are relevant for Islamic investors. The Index, with 350 constituents applies stringent screens to exclude securities based on two types of criteria: business activities and financial ratios derived from total assets.

The Dow Jones Islamic Market Developed Markets Index measures the performance of stocks traded globally that pass rules-based screens for adherence to Islamic investment guidelines.



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