

Halal investing during unexpected downturns



THE US

By Aliredha Walji

News of COVID-19 spreading worldwide has affected the markets. With market fluctuations like what we have been seeing over the past few weeks, the field of Islamic finance has not been exempted from the downturn. However, it has been protected from larger drops due to the avoidance in Halal investing of overly leveraged industries.

Still, in order to try and protect themselves further, some individuals may be inclined toward the possibility of timing the market. While this has its merits — it would be great if everyone could sell their holdings when the market is at its peak, and deploy cash reserves when markets hit bottom — it is actually very difficult, perhaps impossible, to time the market correctly each and every time.

The best we can do is guess, which is why some people equate timing the market with speculating, which is not Halal.

So what are other ways for Muslim investors to protect themselves during the downturn?

Experts recommend creating a balance between equities and fixed income (for Muslim investors Sukuk is a good option) and those who are younger and have a longer time horizon they can allocate a higher percentage into equities and also create diversification within the equity portfolio among various sectors and have a portion allocated to emerging or developing markets.

Allocating to precious metals such as gold can be a good strategy as well and also ‘cash is king’.

Another option, which should be done in tandem with diversification, is to monitor financial ratios to determine where we are and if a sector/stock is undervalued enough to allow us to buy in. These include the Shiller CAPE ratio, TMC/ GNP and the S&P 500 to Gold ratio.

The Shiller CAPE ratio computes the price-earnings (P/E) ratio in a way that

smooths out the impact of economic cycles. Comparing the average CAPE ratio with the current P/E ratio can help investors assess whether prices are over-, under- or fairly valued.

Currently, the CAPE ratio is 24.83. In January 2020, it was 31. The average is around 16.7, with minimums and maximums at 4.78 (from December 1920) and 44.19 (from December 1999) respectively.

The TMC/GNP is an indicator which Warren Buffett calls “probably the best single measure of where valuations stand at any given moment”. According to this measure, we are currently sitting at 121.4% as of the 27th March 2020. The lowest point this measure ever reached was about 35% in 1982, while the highest point was about 148% during the tech bubble of 2000.

Lastly, the S&P 500 to Gold ratio tells you how many ounces of gold it would take to buy the S&P 500 on any given month. It was slightly above two in January and is currently at 1.62. In 2009, this ratio was below one, which signaled it was a good time to buy.

VIX, a measure of stock market volatility, is also a good indicator of buying opportunities in the market. It typically spikes during periods of market declines and is currently at a very high level.

All of these should be examined carefully as each has its own story to tell and can provide certain clues about the market.

In the end, it is important to ground ourselves and think clearly about personal goals. Working with a professional can also help you to manage risk appropriately.

Although the past few weeks have been stressful, those who have been in the markets long enough will tell you not to worry about the down days and instead to see them as opportunities for growth in your investments in the future. ☺

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