

2025 Sharia Portfolio Outlook: Navigating Growth and Challenges

In 2024, markets were defined by a potent mix of bullish momentum in equity markets, delicate central bank manoeuvres, geopolitical tensions, and a U.S. presidential election that rekindled debates on trade and regulatory policies. This confluence of factors underscored the resilience of global markets while exposing vulnerabilities particularly in regions outside the U.S.

Equity markets kept alive by the U.S.

Once again, U.S. equity markets had a stellar performance, buoyed by the unrelenting dominance of the so-called "Mag-7" stocks as artificial intelligence (AI) continued to dominate market narratives. A theme we have kept exposure to within our Sharia portfolios, helping drive performance in 2024. Despite some market wobbles in Q3 with stock valuations swelling and company profitability moderating slightly, we believe the U.S. can continue to provide a haven for global capital in 2025. Hopefully, with U.S. strength broadening out to other sectors as concentration risks raised eyebrows among investors this year.

Central banks continue walking the tightrope

Monetary policy remained at the forefront of market discourse, with central banks grappling with inflation that, while abating, remained a persistent concern. The Federal Reserve cut rates by 0.75%, signalling a cautious pivot towards monetary easing with much of this rhetoric benefiting rate sensitive stocks the Sharia portfolios are exposed to through growth tilted funds.

Europe faced its own challenges, balancing rate adjustments with fears of a stagnating economy, inducing further bouts of volatility in European equities. Hence, for the immediate-term we have dialled back our European exposure within Sharia.

Bond markets continued to react sharply to shifts in central bank moves and any policy missteps has remained a key risk. Despite our Sukuk holdings in Sharia outperforming the broader bond market in 2024, we have maintained a vigilant stance ensuring we're not overexposed to duration by leaning on our precious metals and multi-asset strategies for protection.

The U.S. election

The 2024 U.S. presidential election injected fresh dynamism into financial markets. Donald Trump's victory reignited debates on fiscal policies and deregulation, but with trade policies reemerging as a defining headwind for 2025. The U.S. administration hinted at reinstating tariffs on Chinese imports while considering new levies on European goods, particularly in industries like automotive and green technology. Moves that reflect broader protectionist tendencies aimed at safeguarding domestic industries and addressing perceived trade imbalances.

While some industries, such as U.S. manufacturing, stand to benefit from domestic-focused policies, we are positioning the Sharia portfolios for potential disruptions by pivoting towards sectors with less exposure to global trade flows.

Challenges ahead

Despite strong optimism around AI, monetary policy easing, and expectations for market breadth, challenges persist. Elevated valuations, particularly in U.S. technology stocks, have raised concerns about potential corrections. Geopolitical tensions, from ongoing U.S.-China rivalries to conflicts in Eastern Europe, continue to weigh on global sentiment. Meanwhile, uncertainty surrounding central bank policies and trade dynamics adds another layer of complexity.

These headwinds for 2025 could amplify market fragility in a downturn which is why we remain cautiously optimistic balancing our positioning in compelling themes with defensive and stable areas of the market.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has also been developing Shariah Standard No. 62 with updated guidance on Sukuk issuance placing a significant emphasis on true asset ownership. The standard might be finalised by early 2025, leading to a shift toward asset-backed Sukuk, ensuring that Sukuk holders have a genuine stake in the underlying asset, potentially

affecting overall issuance volumes. However, this mainly affects countries following AAOIFI standards, so countries like Malaysia, which use their own standards and lead in Sukuk issuance, will not be directly impacted.

Outlook for 2025

The year 2024 was one of extremes—marked by exuberance in equities, cautious optimism from policymakers, and the ever-present spectre of geopolitical and economic challenges. Investors largely shrugged off earlier predictions of a market downturn, with the S&P 500 rising nearly 30%. Optimism stemmed from the Federal Reserve's deft handling of inflation without triggering a recession, coupled with transformative innovations in AI and expectations of business-friendly policies under the new administration.

We expect U.S. exceptionalism to continue in 2025 but with more market breadth particularly in sectors such as energy, healthcare, and financials that already present compelling opportunities, supported by rate cuts and favourable valuations. As such, we aim to invest more with managers that are exposed to these sectors to take advantage of growth opportunities outside of the proven winners of 2024.

Despite evolving standards, the demand for Sukuk will continue to grow globally and we are confident in our manager's ability to adapt to the changing standards by leveraging innovative Sukuk structures to meet both regulatory requirements and investor expectations and diversify their portfolios across regions to overcome AAOIFI reliance.

With 2024 now in the rear view, and the presence of continued AI innovation, markets broadening, and less political uncertainty coupled with more Sharia focused funds entering the market, fuels our excitement looking ahead into 2025 and beyond.

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