PUBLIC WHITE PAPER

Halal Trading

An Introduction to Sharia-Compliant Investing

What it is, how the screen works, and how to get started

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INTRODUCTION

What is Halal Trading?

Halal Trading is investing in capital markets — equities, fixed income, real estate, and related instruments — within the rules of Islamic commercial law (Sharia). The discipline is older than modern finance, but the institutional infrastructure that makes it accessible at scale — published index methodologies, listed Sharia-compliant ETFs, a deep sukuk market, regulated Sharia advisory firms — is largely the work of the past three decades.

This short paper introduces the framework for a non-specialist audience. It is intended for investors, students, journalists, and advisors who want a working understanding of how Sharia-compliant portfolios are built, why the methodology produces the results it does, and where the practical entry points are. It is published under an open license so it can be reused, translated, or adapted.

Halal Trading is not the absence of investment. It is investment with a different definition of what counts as productive capital.

How this paper is organized

Section 1 introduces the three foundational principles. Section 2 walks through the two-tier screening methodology — the operational core of the discipline. Section 3 covers the main asset classes. Section 4 summarizes performance and risks. Section 5 sets out a starter framework for individual investors. A short glossary is included at the end.

1. The Three Foundational Principles

Three Quranic prohibitions form the boundary of the framework. Each translates directly into a portfolio rule:

Riba — no interest

Riba prohibits any predetermined excess paid for the use of money over time without a corresponding transfer of risk or productive economic activity. In practice, that excludes conventional fixed-coupon bonds, money-market deposits paying a contractual rate, and most forms of margin lending. Sharia-compliant alternatives — sukuk, profit-sharing deposits, Murabaha-based money market funds — are built around real assets and shared commercial risk rather than the simple loan-of-money model.

Gharar — no excessive uncertainty

Gharar prohibits contracts containing ambiguity about subject matter, price, or delivery sufficient to make the transaction closer to a wager than a commercial agreement. Modest commercial uncertainty is permitted; structural ambiguity is not. This is the principle that rules out most conventional derivatives, contracts-for-difference, and certain structured products.

Maysir — no gambling

Maysir prohibits zero-sum wagers without underlying productive activity. The line between maysir and ordinary investment risk is drawn by underlying economic substance. Buying a share in a productive enterprise is investment; betting on a price level with no link to a real asset is not.

What this leaves

Taken together, the three principles push portfolios toward instruments with a real-asset link, transparent terms, and shared commercial risk. That is why Sharia-compliant portfolios skew toward operating-business equities, asset-backed sukuk, real estate, commodities, and private equity in real-economy ventures — and away from leverage-funded speculation, conventional fixed income, and pure-derivatives strategies.

2. How the Screen Works

The Sharia-compliant universe is produced by applying a two-tier filter to a parent benchmark such as the S&P 500 or MSCI World. Both tiers are applied at every quarterly rebalance, and names enter and exit the eligible set continuously.

Tier 1 — Business activity

Companies whose primary revenue comes from impermissible activities are excluded. The standard categorical exclusions are:

- Conventional banking, insurance, and other interest-based financial services
- Alcohol, tobacco, and pork-related production or distribution
- Gambling, casinos, and pornography
- Weapons (with scholarly variation on dual-use names)

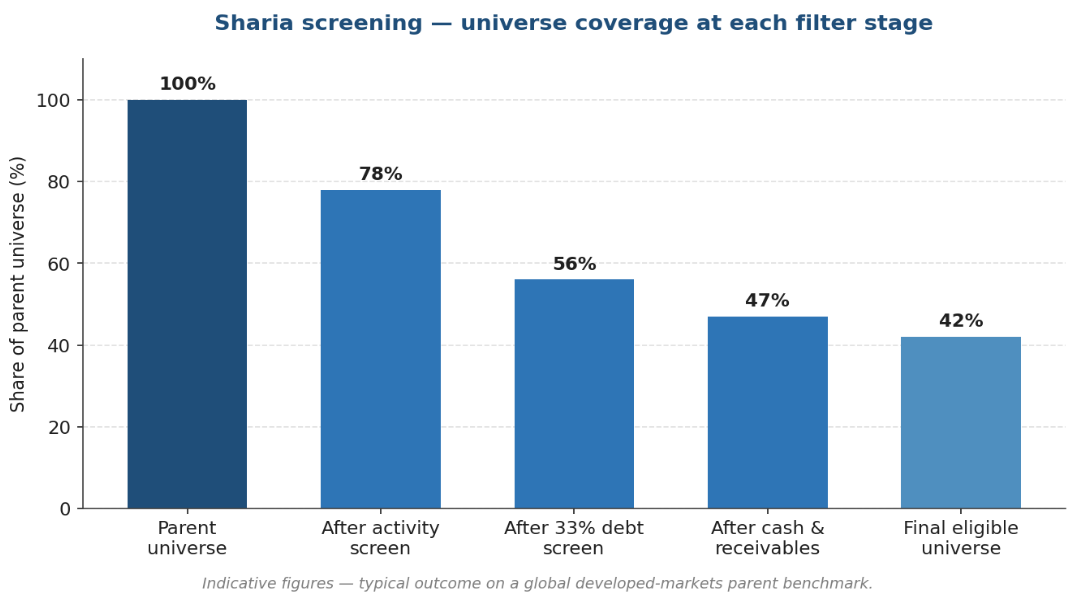
A small de-minimis allowance — typically 5% of total revenue — lets companies with minor incidental impure income remain in the universe, provided the residual income is purified (more on that below).

Tier 2 — Financial ratios

Companies that pass the activity screen still face a balance-sheet test. Three ratios are universally applied:

- Total interest-bearing debt as a proportion of total assets or trailing-average market cap — must be below roughly 33%
- Cash plus interest-bearing securities as a proportion of total assets or market cap — same threshold
- Accounts receivable as a proportion of total assets — typically below 49–50% (with stricter readings at 33%)

Major index providers — AAOIFI, S&P Shariah, MSCI Islamic, FTSE Sharia, Dow Jones Islamic Market — all use variations of these three ratios. The differences between them are technical (which denominator, which exact threshold) but real, and they show up in the resulting portfolios.



Universe coverage at each filter stage on a global developed-markets parent benchmark (indicative).

Purification — the cleanup step

Even fully compliant portfolios contain a small residue of impermissible income — corporate interest on operating cash, the small impure-revenue lines tolerated under the 5% allowance. Purification (tazkiyah) is the process by which that residue is identified, calculated, and donated, so no investor benefits economically from prohibited income. Index providers publish the purification ratio for each constituent annually; the AAOIFI formula multiplies that ratio by dividends received to give the amount that should be donated to charity.

3. The Main Asset Classes

Equity

Sharia-compliant equity is the largest segment by AUM. Once the two-tier screen is applied to a global developed-markets parent index, the eligible universe typically retains 40–55% of the original constituents — enough breadth for diversified portfolio construction. Sector composition is materially different: technology, healthcare, materials, and energy are over-weighted; financials, real estate, and utilities are under-weighted.

For most individual investors, the practical entry point is a Sharia-compliant ETF tracking a major index family. Listed products on US and European exchanges cover global, US, emerging-markets, and REIT exposures, with all-in expense ratios in the 25–55 basis-point range.

Sukuk — the fixed-income substitute

Sukuk are trust certificates representing proportional ownership in tangible assets, projects, or contractual cash flows. They are sometimes called "Islamic bonds", but the legal form is fundamentally different — sukuk holders are co-owners of an asset-backed structure, not creditors entitled to a fixed coupon as a matter of right.

The global sukuk market passed $900 billion of outstanding paper in 2024 and continues to grow. Issuance is led by sovereigns from Saudi Arabia, Malaysia, the United Arab Emirates, and Indonesia, with growing corporate issuance and a small but established presence from European and US issuers. Investment-grade sukuk typically trade within 10–30 basis points of comparable conventional bonds.

Real estate, commodities, alternatives

Real estate is among the most natural fits for Sharia-compliant investing — asset-backed, generating income from real economic use, easily compatible with leasing-based structures. Sharia-compliant REITs are now available across most major markets. Direct exposure to permissible commodities (energy, metals, agricultural products excluding pork and alcohol) is allowed, typically through physical-backed structures or specific Sharia-compliant contracts. Private equity in real-economy ventures fits naturally; hedge funds employing significant short selling or leverage usually do not.

4. Performance and Risks

Long-run performance

Empirical work over the past two decades has tended to find that Sharia-compliant equity benchmarks deliver returns broadly comparable to their parent universes, with measurably different risk characteristics. In bull markets led by technology and growth, the Sharia-compliant version typically over-performs because of its structural over-weight in those sectors. In market environments led by financials or value rotations, the relationship reverses.

The most striking pattern is in drawdown behavior. During the 2008 global financial crisis, Sharia-compliant indices outperformed parent benchmarks materially — drawdowns roughly five percentage points smaller — because conventional financial-sector exposure was already absent. During energy-led corrections (such as 2014–2015), the relationship reversed.

Risks to be aware of

- Sector concentration. A 30%+ technology weight is typical and produces real idiosyncratic exposure to that sector.
- Tracking error. Returns will diverge from a conventional parent benchmark by 3–6% annualized over rolling five-year windows. This is structural, not a sign of poor implementation.
- Liquidity. Sukuk secondary markets are thinner than equivalent conventional bond markets. Smaller Sharia equity ETFs can see wider bid-ask spreads under stress.
- Methodology variation. Different index providers use slightly different rules. A portfolio compliant under one methodology may not be under another.

5. How to Get Started

For an individual investor or small institution evaluating an entry into Halal Trading, a structured five-step approach works for most cases:

- Clarify the rationale. Is the allocation driven by religious alignment, structural diversification, both, or neither? The answer shapes everything downstream.
- Decide on a benchmark. Common choices include the MSCI World Islamic, S&P Global 1200 Shariah, or Dow Jones Islamic Market World for equity, and the Dow Jones Sukuk index for fixed income.
- Choose an implementation. For most individuals, a small portfolio of listed Sharia-compliant ETFs covering global equity and global sukuk is the simplest and most cost-effective approach. For larger allocations, a separately managed account becomes economically rational once the dedicated sleeve exceeds roughly $100 million.
- Confirm the operational details. Does the chosen vehicle handle dividend purification at the fund level, or is it left to the holder? What is the Sharia governance arrangement? How frequently is the screening refreshed?
- Build a monitoring habit. Quarterly reporting that includes eligible-universe summary, any forced sales, and purification calculations should be your standard expectation from any Sharia-compliant manager.

A note on advice

This paper is informational. Specific investment decisions should be taken with appropriately qualified investment, legal, tax, and Sharia advisors. Doctrinal questions where Islamic schools differ are settled by your appointed Sharia supervisor, not by this document.

Glossary

Term	Meaning
AAOIFI	Standard-setter for Islamic financial institutions; its Sharia Standards are the most widely adopted technical reference.
Gharar	Excessive uncertainty in a contract; one of the three core prohibitions.
Halal / Haram	Permissible / prohibited under Islamic law.
Ijarah	A lease-based contract; common sukuk structure.
Maysir	Gambling or zero-sum wagering without productive activity; one of the three core prohibitions.
Mudaraba	A profit-sharing partnership.
Murabaha	A cost-plus sale contract; common in trade finance.
Riba	Interest or any predetermined return on money over time; one of the three core prohibitions.
Sukuk	Trust certificates representing ownership in tangible assets, projects, or contractual cash flows.
Tazkiyah	Purification — the process of identifying and donating impure income from a compliant portfolio.
Wakala	An agency contract; common sukuk and asset-management structure.
Zakat	An obligatory annual giving on eligible Muslim wealth; doctrinally distinct from purification.

How to cite

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About this paper

This is a short, public-facing companion to a longer institutional white paper aimed at investment committees. The institutional version covers the same topics in greater technical depth, with extended performance analysis, operational checklists, and an implementation decision matrix. Contact the publisher for the full document.

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