Structuring *Sharia*-compliant Alternative Investments via Luxembourg: A Practitioner's View

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Recent years have seen a surge in Islamic investors carrying out business in a more Sharia-compliant manner. Banks and finance houses have had to develop products and services that meet this requirement. For practitioners who have not previously encountered Islamic finance, there might naturally be concerns in approaching this field. This article provides an overview of the fundamental elements of Islamic finance and analyses how Islamic Alternative Investments (in particular, real estate and private equity investments) may be structured via Luxembourg.

I. Introduction

The rules laid down in *Sharia* govern every aspect of a Muslim s life, including the way they conduct their business, the criteria for valid contracts and the prohibitions. The ethical framework of the *Sharia* recognizes that capital has a cost associated with it and is in favor of wealth generation. However, making money with money is deemed immoral, and wealth should be generated via trade or investments.

Therefore, financial transactions are strongly based on the sharing of risk and reward between the provider of funds (the investor) and the user of the funds (the entrepreneur). As a result of the prohibitions in *Sharia*, many conventional financial instruments are not suitable to Islamic finance in their existing form. Rather than lending money at interest, financial relationships between financiers and borrowers are governed by shared business risk (and returns) from investment in lawful activities (*halal*).

Islamic finance has gone through a period of exceptional growth. Given Luxembourg's position as one of the leading international financial centres, it is not surprising that part of this growth has taken place in Luxembourg which is now seen as a hub for Islamic finance in Europe. Notably, Luxembourg has been used by many Islamic investors including, in particular, sovereign wealth funds from countries in the Middle East[1], Islamic banks and high net worth individuals to structure their Alternative Investments in and through Europe.

II. Fundamentals of Islamic finance

1. Main principles

Islamic finance is finance under Islamic law (or *Sharia*) principles. The basic sources of *Sharia* are the *Quran* and the *Sunnah*, which are followed by the consensus of the jurists and interpreters of Islamic law. All contracts in the framework of Islamic finance have to comply with the rules of the *Sharia* that notably ban interest and speculation, and stipulate that income must be the fruit of shared business risk rather than guaranteed return. A contract is deemed *Sharia*-compliant if its terms and conditions are free of all prohibition.

The main principles of Islamic finance include:

- **The prohibition of the payment and receipt of interest (or *riba*):** The structure of Islamic finance revolves around the prohibition of all fixed return derived from a debt instrument (*riba*) and the lawfulness of profit deriving from investments. An Islamic finance investment must be part of 'real activity' and not a financial or monetary transaction through which the mere transfer of funds is sought. It follows that any predetermined fixed rate return on a debt-instrument, be it substantial or not, tied to its maturity, and whose principal amount is guaranteed regardless of the performance of the investment, is considered *riba* and prohibited by the *Quran*. Islam does require, however, that the lender -should he wish to take a share in the profit- also participate in possible losses proportionally to his capital in the business.
- **The prohibition on uncertainty (or *gharar*) about the subject-matter and terms of contract:** *Gharar* relates to the mere 'uncertainty' in the quantity, quality or existence of the subject-matter of a contract, and not to the risk as used in commercial terminology. Uncertainty and entitlement to profit in business go hand in hand in Islamic law. Contracts must therefore be drafted as clearly as possible so as to avoid *gharar*. In many cases, *gharar* can be effectively eliminated from a contract by carefully stating its object and price.
- **The prohibition on transactions involving speculation and gambling (or *masir*):** Attached to the prohibition on uncertainty is the prohibition on transactions involving *masir* that involve asymmetric information, excessive uncertainty, risk and lack of control. Incidentally, by prohibiting *gharar*, the *Sharia* also forbids trading *gharar*. Consequently, the current practices of conventional financial institutions and insurance companies in the futures and options markets are non-*Sharia*-compliant due to the features of *gharar*, interest, gambling, and so on. Gambling may be construed as a form of *gharar* since the gambler putting his money at stake is in no control of its result. Gambling is involved in a number of financial transactions and conventional banks' schemes/products, which Islamic companies and financial institutions are to avoid.
- **The prohibition on investments in undesirable businesses:** Irrespective of the form of investment used, investments in businesses dealing with activities that the *Sharia* considers unlawful are deemed prohibited, such as:
  - Alcoholic beverages and tobacco products;
  - Grocery stores dealing with *haram* goods;
  - Restaurants, casinos and hotels with bars for prohibited activities;
  - Amusement and recreational services likely to involve indecent activities;
  - Conventional financial institutions (primarily because of *riba* and/or *gharar* associated therewith); and
  - Adult entertainment.
- **Earnings through profit-sharing investments:** Islamic Finance techniques are merely asset-based and involve real economic activity and undertaking responsibility and liability. When loans are granted for business purposes, the lender –should he want to be entitled to a legitimate gain under the *Sharia*– should take part in the risk.
- **Asset-backing principle:** Of all the rules that govern the structure of Islamic finance instruments, the rule that transactions must be real asset-based is the most striking.

2. Islamic Finance techniques

The Islamic economic system has a set of interest-free core models that serve as a basis for the design of more sophisticated and complex financial instruments. The most relevant Islamic modes of financing may be categorised into equity- and debt-related techniques:

2.1. Equity-related techniques

- Mudaraba (Profit sharing agreement): The mudaraba is a profit sharing arrangement with one party providing capital and the other party (mudarib) providing entrepreneurial skills. While losses accrued are borne by the provider of capital, profits are shared by both parties in accordance with a predetermined ratio.
- **Musharaka (Joint-venture):** The *musharaka* is a partnership between two parties that both provide capital in agreed measures. The partnership clearly sets out arrangements for the sharing of both profits and losses in the venture.
- **Diminishing musharaka (Declining balance partnership):** The *diminishing musharaka* involves the shared ownership of an asset which one party gradually buys from the other, thus incrementally increasing its share until the full ownership of the asset is transferred to one party. This variant is solely feasible in respect of fixed assets or other assets that can be leased or given for use to the other party.

2.2. Debt-related techniques

- **Murabaha (Forward sale):** The *murabaha* involves a contract between two parties for the sale of goods at a price that includes an agreed profit margin. It results in debt amounting to the cost, plus a profit margin. The debt has to be paid back irrespective of the profit or loss incurred by the purchaser (client). Modern *murabaha* transactions generally take the form of '*murabaha* to Purchase Order', characterised by the bank purchasing an asset from a third party at the client's request, and selling it to the client on a deferred payment basis.
- **Commodity murabaha (or 'tawarruq'):** The *commodity murabaha* avoids *riba* and involves a contract in which a commodity (gold, platinum, etc.) is purchased on credit and immediately sold at spot value with the objective of receiving cash. The commodity as such is not required by the buyer; rather, the buyer simply needs liquidity which he receives via the purchase of a commodity on credit and its immediate sale against cash.
- **Salam (Spot sale):** *Salam* involves a forward sales contract which enables a commodity to be bought with immediate payment but future delivery. This type of contract exemplifies the concept of time value of money through the pricing of goods. The fundamental element of *salam* is that the price paid in advance is lower than the cash and carry price at the time of delivery. *Salam* provides the buyer with a hedge against possible future price increases, and the seller with immediate cash injection.
- **Istisna'a (Commissioned manufacture):** Whereas the principle of *gharar* prevents the sale of an asset one does not own, the techniques of *istisna'a* and *salam* have been developed as exceptions to this. *istisna'a* is a sales contract applicable to assets to be manufactured (e.g. real estate development project) that are identified by specifications, and not by designation. This contract is valid only for those assets that have to be manufactured or built. Both unique and homogeneous assets are covered under *istisna'a* provided their specifications are agreed at the time of the agreement.
- **Qard Hasan (interest-free loan):** The *qard hasan* is a loan agreement characterised by a guarantee for repayment in full by the end of a predetermined period without any further return (or share in the profit/loss of the business) to the creditor. A modest service charge is, however, permissible.
- **Ijara (leasing):** The *ijara* involves the lease of particular assets for a specific period of time in exchange for predetermined rental payments. Following the finalisation of the agreement, the lessor cannot increase the rent unilaterally. However, in case of long duration lease, the increase of rental payments may be based on any agreed benchmark during the lease period (inflation rate, interest-based rate such as EURIBOR…). For the period the asset is leased, the lessor remains the owner of the asset and bears its ownership risks. All liabilities emerging from the ownership are borne by the lessor, but the liabilities relating to the use of the property by the lessee.
- **Sukuk (*Sharia*-compliant securities):** *Sukuk* represent the proportional ownership of the holders in underlying assets that may be issued by governments or private companies. While *riba* is prohibited, the *Sharia* accepts the validity of financial assets that derive their return from the performance of a real asset. *Sukuk* may be based on all *Sharia*-compliant financing. However, most *sukuk* currently issued are based on underlying *ijara* transactions whereby the stream of income generated from the sale-and-lease-back of real property asset (e.g. airports, buildings, schools and hospitals) funds the payment to the *sukuk* holders.

Notwithstanding the elements deemed undesirable and prohibited by the *Sharia*, debt plays a vital role in Islamic finance. Islamic financial institutions regularly create debt by providing financial facilities in trading activities. Thus, *Sharia* compliance certainly does not revolve around putting debt and equity in opposition, but rather emphasizing on equity and subjecting debt to the principle that once created, it should not increase on a conventional opportunity-cost theory basis.

III. The role of the *Sharia* board

One distinct feature of the modern Islamic finance movement is the role of the *Sharia* board which monitors the operations of the Islamic banking institution and plays a central role in transactions. The Sharia board provides guidance on what is an acceptable investment under Islamic law and what is prohibited and clarifies elements that are doubtful from a *Sharia* perspective in the form of legal opinions (*fatwa*).

Noteworthy, the *Sharia* is open to interpretation and *Sharia* boards often have divergent views even on key *Sharia* issues. In this regard, there is no practical guide but for the general guiding principles outlined above. Any particular Islamic finance transaction therefore needs to be vetted by Islamic scholars to ensure compliance with *Sharia* rules. While a specific instrument or investment structure may be accepted by one *Sharia* board, it may equally be rejected by another.

IV. Structuring *Sharia*-compliant Alternative Investments in practice

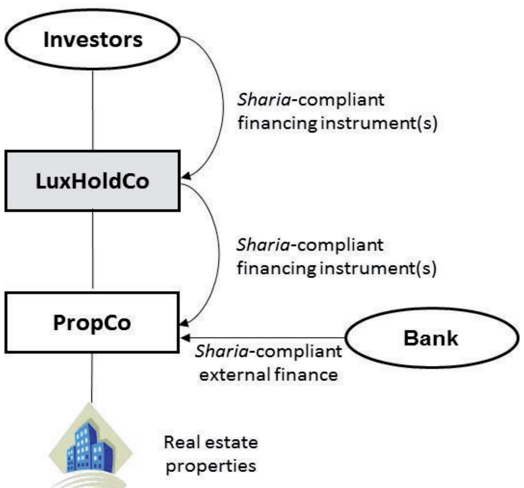
1. Opening comments

Structuring *Sharia*-compliant Alternative Investments via Luxembourg is a challenging exercise because all transactions[2] must adhere to the principles set out under Islamic law[3]. Great care must be taken in structuring the investment vehicles, the financial transactions and the legal documentation (for example, the purchase agreement or lease agreements[4]) so as to ensure that they operate in compliance with *Sharia* precepts. Although the selection of the optimal investment structure depends on several factors, tax efficiency is usually a key consideration.

2. Typical Sharia-compliant investment structures via Luxembourg

Sharia-compliant real estate and private equity investments have in common that investors usually structure their investments either directly or indirectly[5] via one or more Luxembourg holding companies into the target (for example, a company or real properties)[6]. The chart below indicates a simplified real estate structure where *Sharia*-sensitive investors structure their investment via a Luxembourg holding company and a (Luxembourg or local) property company into foreign real estate. Both the Luxembourg holding company and the property company are financed with *Sharia*-compliant financing instruments. Furthermore, the property company is financed with *Sharia*-compliant external finance (for example, *commodity murabaha*).

Chart: Simplified real estate investment structure



3. Considering the specific requirements set-out by the Sharia Board

As a principle, everything that is not explicitly prohibited by the *Sharia* is permissible for Muslim investors. The *Sharia* is, however, open to interpretation. When structuring investments in the past, we experienced significant differences in the requirements set out by different *Sharia* boards. For example, while some *Sharia* boards oppose the financing of companies down the chain with standard interest-bearing loans (in view of the prohibition on *riba* [interest]), others do not mind such financing (based on the argument that it is a loan to oneself)[7].

In light of the above, when structuring Alternative Investments in practice it generally makes sense to start with a conventional investment structure and to carefully analyse which elements may be prohibited under *Sharia*. These prohibited elements need to be replaced by transactions and agreements that are permissible for Muslim investors (after consultation with the *Sharia* board).

At the same time, it needs to be ensured that the investment remains tax efficient (considering a conventional investment structure as benchmark) and easy to manage. In some case, it may however not be possible to simply replace certain unacceptable elements of the structure (either because of the requirements set out by the *Sharia* Board or the preferences of the investor). Here, more complex Islamic modes of finance may have to be implemented.

4. Permissible investments in real properties

Real estate covers a wide range of assets including, *inter alia*, residential properties, office buildings, warehouses, shopping centres, hospitals and various types of infrastructure projects[8]. The challenges faced when selecting real estate assets for investments should in principle be no different from those faced in conventional finance i.e. maximizing the return and reducing the portfolio risk through a diversification strategy (for example, through investing into different real estate sectors and geographical areas). In addition to the concerns involved in the asset selection of conventional investors, Islamic investors must screen the use of the properties by their tenants before any investment takes place in order to ensure compliance with *Sharia* principles. Notably, as long as the property itself is used for *halal* (permissible) business activities, it has the potential to form part of a *Sharia*-compliant structure[9].

5. Permissible Islamic Private Equity investments

In regard to Islamic Private Equity investments, it is crucial that the business activities performed by the target entity are not prohibited under Islamic law (prohibited sectors include, for example, gambling, pork trading, weapons, alcohol) and that certain financial ratios are met (for example, the funding with conventional debt and the investment in debt instruments). Where the financial prohibitions are not respected at the moment of the investment, it may still be possible to restructure the business in a *Sharia*-compliant manner (for example, the refinancing of conventional debt with *Sharia*-compliant debt). It may further be possible to separate the non-*Sharia*-compliant part of the business from the permissible part of the business[10].

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6. Financing of investments

In Luxembourg, it is possible to structure financing instruments that bear mere variable yield depending on the performance of an underlying asset. Such variable yield may, however, not necessarily be deductible for foreign tax purposes (for example, where a Luxembourg property company owning foreign real properties is financed)[11]. Therefore, KPMG Luxembourg developed a tailor-made *Sharia*-compliant financing instrument for the financing of property companies and foreign businesses that generates tax deductible expenses (in most of the common target jurisdictions). The financing instrument bears mere variable yield depending on the income stream derived from the real property or the profit generated by a business and provides for a yield cap. The management of this instrument is, however, more straight forward than other Islamic modes of finance.

7. Limitations in the availability of Sharia-compliant external funding

A particular issue when it comes to structuring Islamic finance investments is linked to the limited availability of *Sharia*-compliant external bank financing in Western countries. Thus, it may be possible that banks are not ready to finance holding companies or property companies in a *Sharia*-compliant manner (for example, with a *commodity murabaha*).

Thus, the direct investment into the shares of such companies as well as the financing with asset-linked or profit participating modes of finance may not be permissible from a *Sharia* perspective due to the unacceptable levels of conventional debt funding. In these circumstances, a disconnection of the Islamic investors from the non-*Sharia*-compliant investments through the implementation of specific *Sharia*-compliant modes of finance has proven to be an efficient solution that has been accepted by *Sharia* boards.

8. Limitations regarding purchase price adjustments

The principal transaction terms must be sufficiently known and properly defined in the purchase agreement in order to be *Sharia*-compliant. While this seems to be a given also for conventional investments, the common practice of agreeing on purchase price adjustments (if certain conditions are met after the closing of a transaction) may imply that the purchase price is not known by the parties at the time of the purchase (and transfer of title) so that the transaction may be deemed to be invalid on grounds of *gharar* (uncertainty). As such the parties must use alternative means and structures to arrange for such payments.

V. Conclusion

Since many years, *Sharia*-sensitive investors[12] have been quite active in structuring their investments via Luxembourg. Here, the compatibility of the Luxembourg legal framework (providing for the principle of contractual freedom) with Islamic finance requirements and the possibility to structure Islamic finance investments in a tax efficient manner is of major importance.

As part of its strategy to diversify the financial centre, the Luxembourg government is keen to place Luxembourg as a partner of choice for Islamic finance transactions in Europe. The contemplated issuance of the first sovereign *sukuk* in a non-Muslim country by the Grand-Duchy of Luxembourg will be a strong signal to Islamic investors and definitely not miss its desired marketing effect.

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** The authors wish to thank Nada SHALL for her assistance.*

1) Many sovereign wealth funds from Middle East countries invest, however, in a conventional manner.
2) This includes in particular the financing instruments, the purchase agreements, rental agreements and agreements determining the management of the entities involved.
3) Sharia compliance is not only to be considered upon implementation but has to be ensured over the entire lifetime of the investment.
4) A lease agreement, in order to be Sharia-compliant, has to adhere to a number of rules regarding leases (ijara).
5) For example, investors may indirectly invest via a Luxembourg or foreign fund vehicle, or foreign holding companies.
6) In the case of real estate investments, investments are generally held via property companies, partnerships owning real properties or Real Estate Investment Trusts.
7) In contrast, the financing with interest-free loans (qard hasan) is uncontroversial.
8) For example, solar power plants and wind parks.
9) The properties should not be used for haram (unlawful) activities such as liquor production, conventional banking or casinos.
10) Most Sharia scholars take the view that such restructuring should be implemented within a three-year period.
11) The deductibility of expenses for foreign tax purposes is an important feature of a tax-efficient real estate investment structure
12) In particular, sovereign wealth funds from Middle East countries, Islamic investment banks and high net worth individuals.

Time to look at European value

By Jens MOESTRUP RASMUSSEN, Head of Equity Investment, Sparinvest

Investment houses are required by law to remind investors that the price of shares can go down as well as up. But it could be argued that investors sometimes need reminding that price volatility is as much an opportunity for profit as for loss: because –even though sometimes it appears that the world is about to end – shares can go up as well as down.

After the financial crisis of 2008, the bourses of Europe were hit very hard and the Eurozone region was one of the worst affected in terms of investor confidence. The media was full of headlines about bank insolvency, high unemployment and the possibility of a 'Grexit' causing 'Eurogeddon' – a breakdown of the single currency.

Companies with global operations but whose headquarters were in 'Postcode Europe' were universally punished as a result of poor sentiment. Even as recently as one year ago, the greatest concern amongst investors was that global recovery could still be derailed by the Eurozone sovereign debt crisis.

Today, however, it's a much different story. Sentiment towards the Eurozone is improving. The ECB seems to have the debt crisis under control, the weakest countries are nursing themselves back to international competitiveness, the recession appears to be largely over, and economic growth is expected to resume this year. More importantly for investors, European stock markets are performing strongly. Last year ended with many pan-European indices having climbed the 'wall of worry' to end at their highest levels since early 2008, as the MSCI Europe Index produced a total return of 19.8% in Euro terms in 2013.

So, does this mean that investors who have been steering clear of European equities have already missed the chance to benefit from regional recovery? To answer this, we need to look at what has been driving stock market returns and examine the interesting valuation gap that has opened up between Europe's most expensive and cheapest stocks.

Paying a premium for 'safety'

In the absence of any meaningful returns from risk-free assets, investors seeking positive returns over the past 5 years have been forced onto a diet of higher risk. Their strategy with equity investment has been to herd into the 'so-called' defensive stocks; those offering a stable return, high yields and operating in defensive sectors such as pharmaceuticals and consumer stables which can traditionally weather recessions.

When we see five years' worth of investors herding into the same narrow space, we naturally start to worry about the price implications for these popular stocks. Stocks that start out expensive because of their defensive qualities – and which continue to be popular with investors for an extended period of time – simply become more expensive.

At the other end of the spectrum, Europe's cheapest companies – the ones hardest hit by the recession – have remained unpopular. 'Value investing' – the investment strategy which aims to buy stocks in undervalued, quality companies at rock-bottom prices during periods when markets are reacting to bad news – has underperformed for the past five years. This is not because of a lack of bad news – quite the contrary – it's because there has been so much bad news that people almost gave up hope of Europe ever emerging from recession or of its cyclical companies being able to generate profits again. Investors have been reacting mainly to the macro-economic headlines and not to the annual results posted by individual companies (the true indication of their financial health.)

The return of the cyclicals

Confidence levels about the prospects for Europe amongst institutional investors have risen significantly. The rally seen in the markets in 2013 was all about an expansion in price/earnings multiples with people showing their willingness to pay a high price for potential future earnings power. But increasingly, investors will want to see those prices justified by a real improvement in earnings and this is what we expect to drive the next stage of market performance – particularly in Europe – during 2014.

During 2013, we began to see clear outperformance of some of Europe's cyclical sectors. This suggests both that recovery is underway and that stock-picking attention will now return to cyclical beneficiaries, with the judgement being about price in relation to quality.

Because of the extreme valuation gap caused by five years' worth of poor sentiment and investor herding, it is still possible to find good companies available at great prices. 'Good companies', means companies with high potential because they have a proven track record of generating good returns over complete economic cycles. Perhaps they don't do so well during periods of recession, but as confidence picks up, so does demand for their goods and services. Their profitability returns, the markets notice, and their share prices rise. Europe's most undervalued companies still have huge potential to generate gains in the process of 'reversion to mean'.

There are strong signs that the recovery in Europe is underway and gaining traction. We believe that, as confidence returns, Europe's strongly discounted companies will become a natural target for M&A activity, which will quickly focus investors' attention on the true value – not only of the companies involved in such deals, but also of those operating in the same sectors, thereby creating a positive ripple effect.

"Buy when there is blood in the streets" is a well-known phrase in the investment world. Professional investors know that the best time to buy is when the outlook is bleakest - because that's when prices are cheap. Value investors, sometimes called the "bottom-feeders" of the investment world, are happy to buy selectively when bad macro-economic news causes prices to decline steeply.

This is because they are able to differentiate between low quality shares that are being punished for a reason and high quality shares that are being punished for no reason other than poor general sentiment. The bargain hunters know that, under the law of "reversion to mean", knocked down company share prices will eventually rise to reflect the true value of the issuing company – based on company fundamentals rather than macro-economic conditions. As markets return to a focus on fundamentals, the stage is set for outperformance from active value strategies.

Interwiew with Gui VERHAEGEN, Lead Fund manager Tareno Value-Opportunity Equities fund, Partner Tareno (Luxembourg) S.A.

Tareno launched the Value-Opportunity Equities Fund

Why has Tareno (Luxembourg) S.A. launched another fund, the Value-Opportunity Equities Fund?

We are asset managers for institutional and private investors and as part of this activity we have been offering index enhanced funds since 2005. Notwithstanding, many clients wanted us to do stock-picking for their managed portfolios. In order to verify if we could offer added value in this perspective, we have monitored our stock-picking for the last five years and we observed positively that we managed to beat the MSCI World and MSCI Europe indices by a nice margin during the past year, as well as over a three and five year period.

Here are the results:

	Stock-picking	MSCI World	MSCI Europe
One year: 2013	38.59%	21.54%	20.16%
Three years: 2011 - 2013	33.60%	34.08%	28.89%
Five years: 2009 - 2013	114.7%	103.45%	89.17%

Furthermore, we identified that we even could have done better, if we would have had a particular fund (SICAV) at our disposal for the "stock-picking" investments.

In what respect?

The recent creation of Tareno Value-Opportunity Equities fund provides three distinct advantages compared to direct investments in stocks: Firstly, it will give access to very interesting markets like Malaysia, India, South-Korea etc. which are not accessible to individual accounts. Secondly, the fund permits us - in a well diversified way - to invest in niche markets or sectors like e.g. Greece that offered a terrific opportunity a while ago, something that was impossible to do with direct investments. These transactions would have been too small and too many in one single portfolio. And thirdly, we gain a tremendous amount of time when we buy a stock in a fund which is part of the client's portfolio rather than buying or selling stocks in each individual account that we manage at different banks and in different countries. Besides that, the fund establishes an official track-record which could be used as a sign board to attract third parties like institutional investors, financial intermediaries etc. for whom this fund could be a solution for a part of their investments.

What about the additional expenses by investing through a fund?

The transaction fees and management fee in the fund are very low, and there are no upfront and exit fees. You also have a small tax benefit. So costs are really no issue.

How do you explain the excellent results in the individual stock-picking?

All credit goes to Benjamin Graham & David Dodd and their well known disciples (Warren Buffet, Charlie Munger, William Ruane, David Tisch and many others who laid out the principles of Value Investing. In short, they instructed the basis of "how to acquire more than you are paying for". We try to apply this and I quote Charles Munger again by trying to be consistently not stupid instead of trying to be very intelligent. I call it provocatively the "smart dummy way".

Explain yourself.

Less is more. We are aware of our limitations. Nobody can (should) make market forecasts. Nobody can systematically do a great job by market timing. That fact is frustrating to mankind and probably the reason why still so many desperately try to do it. On the other hand, if we do stock pickings, who are we? We are no insiders, we are generalists, which means that we need to be very prudent in our approach to have an edge.

So what is your investment process?

To start with, we are only interested in companies that have a sound balance sheet, offer products/services for a possible growing demand, be led by a reliable management and present a consistency in its results. Next, we look at the price. This price should be so cheap that it gives us a comfortable margin of error. It means that when some things go wrong, we still could get an acceptable return on investments. All this sounds rather easy, but I can assure you that finding the necessary 50 to 100 stocks worldwide in order to have a broad diversification are currently very hard to find. This proves that the criteria are very strict and the actual market situation is pretty "efficient". Since the price you pay is of uttermost importance for the return you will get, we try to buy as cheap as possible.

When do you consider a stock as being cheap and interesting?

We do not have a magic coca cola formula. Generally, we are looking at about 25 ratios to put the pricing in perspective. It is pretty down to earth, nothing sophisticated. Minimalism is key to mastery. We also keep in mind that a terrific company at a reasonable price will bring a better return than an average company at a cheap price.

Is that not in contradiction with the efficient market theorists? The notion "cheap" will not be of any relevance to them.

You are probably right. So what? There are all kinds of investors. Value investors will often share the idea with them that a broad diversification can be used as a safety net and that stocks are most of the time "correctly" priced. We even agree that it is very difficult to offer added value towards index funds but we are in disagreement that the stock-market is a place where everything can be mathematized. We do not share the idea neither that if some value-investors outperform in the long run, statistically it just comes down to being lucky.

If not everything can be mathematized what else is of importance?

The psychological, emotional part of the equation. Look at crowd herding, the importance of marketing in daily life, this is not about rational individuals or groups. This means that due to irrational behavior a market can be cheap, normally priced and overpriced. It is important to buy undervalued and try to sell overvalued. David Graham refers to it as Mister Market who is constantly offering you to buy or sell stocks. Sometimes he is euphoric, than it is time to sell to him, he will feel happy and sometimes he is depressed, so you buy from him and he feels better again. Any value investor is aware of this and equally struggles not to become a victim and part of the same "mass perception". He should be self-conscious and empathic to understand what emotionally is going on in the market.

In this same context, he should also put his personal money where his mouth is, it will keep him focused and he will feel the same "pain" as his clients when things seem to go in the wrong financial direction. Also personal traits like passion, patience and "flexible stubbornness" play their part. Being eager to keep on learning and searching, disciplined to wait, imperturbable, and on the contrary being humble enough to change your opinion when you are wrong. Experience is precious. After 30 years in the stock-markets, I have been faced with several financial scars, but I still learn from these mistakes every day. Only in this place age looks sexy. Another important item is the size of the fund. A smaller fund can still load up a lot of clients and maneuver comfortably in and out of investments.

The fact that we are not benchmarked gives us more freedom in our value-opportunistic yet disciplined and diversified approach, compared to many other fund managers who stay glued to their benchmark. And last but not least, short decision lines permit to be able to decide very fast and act swiftly if necessary. At Tareno (Luxembourg) S.A. the leading fund manager has the final word. So being a rather small asset management company does not necessarily mean you have the odds against you, on the contrary.

To whom the fund is accessible?

We have an institutional and a retail share class. It is a UCITS IV fund and we are registered for sale in Belgium, Luxemburg, Germany and Switzerland.

Tareno Value-Opportunity Equities Fund
ISIN Institutional Share Class: LU096 491 5226
ISIN Retail Share Class: LU096 491 5655

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