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# Do constraints on financial and operating leverage affect the performance of Islamic Equity portfolios?

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## Abstract

The Islamic equity screening standards specifically forbid investment in equities of companies with high financial leverage and a low fraction of investment in real assets. We investigate how these constraints on financial leverage and higher investment in real assets (operating leverage) affect the performance of Islamic equity portfolios (IEPs). The empirical findings suggest that investors sacrifice potential returns by holding constrained portfolios but also avoid some of the risk. The exact effect on portfolio performance is largely dependent of the actual screening standard used, either book-value based (MSCI) or market-value based (AAOIFI). These results have clear implications for both investors and policy makers.

**Keywords:** *Islamic equity investments; Leverage, Investment in real assets, Portfolio management.*

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