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Matching perception with the reality-Performance of Islamic equity investments
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Abstract
The systematic failure of the global equity markets during the recent financial crisis made investors re-evaluate their portfolio constituents. It is argued that equities that comply with the Islamic investment principles perform better than conventional equities during the declining phase of capital markets. The better performance of Islamic investments can be attributed to the Shari'ah based screening criteria that specifically forbids investment in shares of those companies that are excessively leveraged and/or engaged in lending activities. This study investigates the extent to which this claim is valid by comparing the performance of global and regional Islamic equity indices (IEIs) with conventional equity indices during the past decade. The equity indices for such analysis are preferred since it does not account for transaction costs or management skills. A logistic smooth transition autoregressive (LSTAR) model is used to investigate whether the 'down market' performance of IEIs differs from conventional indices. The LSTAR is superior to conventional ordinary least squares models since this allows for a smooth transition from the 'down market' to the 'up market' rather than an abrupt change. The empirical results indicate that IEIs, in general, perform better than conventional indices during the period 2000 to 2012. We do not find any abnormal returns associated with Islamic equity indices on a global basis, however, there is evidence of positive abnormal returns in the case of regional indices from Europe and Asia. Overall, IEIs exhibit lower systematic risk as compared with their benchmark suggesting that any excess performance from Islamic investments stems from the systematic risk that each investment assumes with respect to their benchmark during the declining phase of capital markets. The findings of this study are of interest to both academics and the general investing public since it provides evidence that IEIs are comparatively less risky than their conventional counterpart and thus provide hedging opportunities during the downfall of capital markets. © 2013 Elsevier B.V.

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