Resilience of Islamic Finance During Credit Crunch – Empirical Evidence from European Market

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Islamic Finance is based on the Islamic Jurisprudence as prescribed by the Shariah, and has witnessed significant growth and development in the recent decades. During the period of economic slowdown and following Financial Crisis during FY 2007-2009, it was claimed that this financial system seemed to be better in coping with such economic slowdowns. The paper analyses whether the same holds true for Shariah compliant equities in the market i.e. whether Shariah compliant equities perform better in the market as compared to general market. Three portfolios are constructed based on the constituents of S&P Europe 350 to represent overall market, the market without the financial firms and the market of Shariah compliant equities. It is found that the portfolio of Shariah Compliant equities outperforms the other two portfolios in all aspects of analysis. However it slightly underperforms the market portfolio when there is upward growth trend in the economy. The findings of this paper is very relevant for policy makers, investors and fund managers to determine the policy matters, deciding investment and marketing strategy for Islamic capital market products. This paper also highlights the significance of Islamic finance to withstand turbulent financial crisis.

Key Terms: Islamic Finance, Shariah compliant equities, capital market, financial crisis

Introduction to Islamic Finance

The teachings and guidelines in Islam encompass all aspects of human life. It governs all the daily activity of an individual. The Islamic Law or Shariah as it has been derived from the Quran[1], Fiqh[2] and Sunnah[3] governs all aspects of life and activities thereon of Muslims. It includes everything related Social, spiritual, ethical, economic or any other aspect of life.

The Islamic financial framework, as we see it today, has been developed from this all-encompassing aspect of Shariah. According to Ainley et al [4] following principles form the core of Islamic Financial System.

First, at a broader level, the Islamic model aims for social justice and economic prosperity of the whole community. This is evident from the fact that the *Shariah* Rulings try to reduce concentration of wealth in a few hands, and also provide relief for poor. Second, Islam does not forbid the motivation to make profit, Rather it encourages to get into business or other productive activities and make profit out of these. However a clear distinction has been made between what activities are permitted and what are not. Third, the Islamic economic model is based on risk and profit sharing, and not on interest. Interest or *Riba* has been forbidden.

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Finally, *Shariah* provides a comprehensive regulation for contracts. These rules ensure that all the parties make well-informed decisions and there should be no uncertainty or ambiguity.

Development of Islamic Stock Index

Islamic Banking started with a focus to serve members of a particular religion. However today it is serving a multicultural client base through a wide range of Shariah Compliant products and services.

This sector has also witnessed development of Islamic mutual funds, which has been the largest and the most rapidly growing sub-sector. According to a study by Abdurrazak [5] there were only 29 Islamic Mutual funds in 1996, which grew to more than two hundred by the end of 2007. Also the funds managed rose from $ 20 billion in 2003 to $44 billion in Q1 2009. At the same time number of funds rose from 400 in 2003 to 700 in Q1 2009 [32].

With the emergence of Islamic Finance and Islamic Equity Funds, it was needed to measure their performance according to a suitable benchmark. As a result FTSE launched FTSE Global Islamic Index along with Dow Jones Islamic Fund Index in year 2002. Later on S&P launched a series of index, which measure performance of Islamic Equities across industries, countries and geographical regions.

Today, Islamic Finance has seen development of Banks, Home Finance Institutions, Project financing and retail banking products which follow the guidelines of Shariah and have been witnessing substantial growth since last ten years. Now there are efforts being made to establish an Islamic Capital market and Stock exchange [6, 29, 31].

Traditional Financial System and Islamic Finance

In conventional financial system, accounting numbers act as a measure to carry information from business to other stakeholders. The seminal study of Ball and Brown [7] provided empirical evidence that only a little more than half of the total information content is incorporated in annual accounting numbers.

Conventional accounting numbers have also been criticized for completely ignoring the social and economic impact of a business on the society. To fill this gap, the concept of triple bottom line reporting has emerged in the academic circles, which also considers the Social/Environmental impact as an essential unit of measurement for defining business efficiency and sustainability. The emergence of Socially Responsible Investment (SRI), its growth and growing importance can be associated with the same [8].
The economic downturn in mid-2007, and the subsequent upheaval in the financial markets of the world is blamed on, to a certain extent, this inability of the accounting system in general, and the “fair value accounting system” in particular, to convey the relevant information related to business entity to investors and regulators for decision making. It is suggested that as the information based on such accounting numbers were incomplete the investment and regulatory decisions, based on this incomplete information, were destined to be flawed resulting in the systematic failure of the entire system in the long run.

In an another attempt by researchers operating from a critical perspective is that accounting far from being a practice that provides neutral or unbiased representation of underlying economic facts, actually provides the means of maintaining the powerful positions of some

sectors of the community (those currently in power and with wealth) whilst holding back the position and interests of those without wealth.' [9]. In this regard, Islamic Finance can be contrasted with School of Normative Accounting Theory implying Deductive approach of theory building. This provides an altogether new conceptual framework based on the rules and regulations of Shariah.

Objectives of the Study

The equities, which are traded under such Shariah based system, are compatible with Islamic Principle of Shariah and meet Islamic jurisprudence criteria. It is now being reported that the Shariah based financial products have remained relatively insulated from the Financial Crisis as they do not invest in intangible assets and derivatives and therefore were relatively de-linked from the sub-prime market. It is claimed [30] that due to this fact the Financial Crisis has not affected the equities under Islamic Investments as badly as other equities in general.
A statistical investigation of performance of Islamic Equities in European market, which is not only one of the most developed financial markets in the world, but is also one of the most highly affected economies by the Financial Crisis; will give us an empirical evidence of validity of these claims. If the performance of Islamic Equities is significantly different than that of conventional equities we may conclude that these claims hold ground. This would demand further investigation into the specific reasons for the same to find out if the difference is due to the specific characteristics demanded by the Islamic Jurisprudence criteria. On the other hand if the performance of Islamic Equities is parallel to or less than the conventional equities we may conclude either that such claims do not hold ground and a more detailed investigation is needed to examine the claims made by the proponents of Islamic Finance.

Literature Review

The following literature review will look at the academic work focused on SRI and then will try to analyze the concept of social factors as determinants of financial performance. It will also look at the development of various Indices related to Islamic Finance, and their methodology to define Islamic Equities or *Shariah* Compliant Equities. The next section of literature review will outline the proposed linkages between *Shariah* Compliant Equities and their performance and a statistical approach will be developed based on these proposed linkages to find out any departure in the performance of Islamic Equities from the conventional equities.

SRI, Islamic MFs and Islamic Equities

Before getting into the proposed characteristics of Islamic Equities and their performance we will have a look at the research conducted to measure or evaluate the performance of Socially Responsible Investments or SRI. The research to analyze the performance of SRI started in as early as 1970s and extant literature in this area suggests that this issue was initially raised by Moscowitz [10]. Moscowitz's article merely suggested that social issues could be considered as a criterion. Hamilton et al [11] empirically supported the view that the performance of SRI is not statistically different from the performance of conventional mutual funds. However their analysis was limited to analyzing the returns of the funds. In order to take account of factors other than performance, Bello [12] used a sample of SRI funds and examined the same in contrast with randomly selected conventional funds of similar net assets and found

that socially responsible funds do not differ from conventional funds in asset characteristics, degree of portfolio diversification or long run investment performance.

Looking at this issue from another angle, Bauer et al [13] studied the Canadian mutual fund market. The study concluded that there is no significant difference between the financial performance of SRI and conventional funds. Elfakhani and Hassan [14] created eight mutual fund categories of Islamic mutual funds on regional basis and then compared their performance with respective benchmark indices for the respective region. They found that no statistically significant difference exists in the performance. However, the results showed that the performance of Islamic Equity funds was better in the second period dominated by recession than the first period dominated by boom, and it was suggested that Islamic Mutual Funds might be a good hedging investment against market downturn.

Barnett et al [15] examined 61 SRI funds to measure the linkage between financial performance and social performance. They found a curvilinear relation exist between the two. As more and more social screens are applied the financial performance declines first but then improves as the number on screens used reaches to maximum. They also find that the financial performance also depends upon the type of social screens used. The study concluded that the 'financial cost' of poor diversification is offset with the increase in social screens used as only more stable firms are selected into the portfolio.

Areal et al. [16] analyzed the performance of a sample of socially responsible mutual funds taken from seven European Countries, which were investing globally and/or in European Market. They found that the SRI funds show neutral performance and indicated that investors (European) can add social screens to their investments without sacrificing on their return. However the opinion about performance of SRI has not been always been inconclusive or positive. Renneboog et al [17] found that SRI funds in many European, North American and Asia-Pacific countries strongly underperform domestic benchmark portfolio. However the number of scholars who opine that SRI underperforms conventional funds is drastically limited and we can safely accept, in the light of the research done till now that the performance of SRI and conventional funds does not differ.

Research was also conducted to find out whether the SRI actually invests differently in different stocks. Karen et al. [18] analyzed whether the SRI fund managers pick different stocks for their portfolio than conventional investment managers by choosing different portfolio compositions. Their study found that there are "differences between the weights invested among different industries among SRI and conventional funds". Although the differences were not seen as consistent, and moreover they tended to change over time. This research paper showed that despite performing at par with conventional investment, SRI has different industry exposure.

In another empirical analysis, Kempf and Osthoff [19] analyzed whether the SRI invest according to social and ethical standard or they are just another mutual fund with a fancy name. They created an ethical ranking of US funds using empirical techniques and found that SRI funds have ranked above the conventional funds.

Recent studies have also tried to investigate consumer behavior behind SRI investments. Nilsson [20] analyzed the final consumer of SRI to find out why investors choose to invest in SRI. It was found that it is not only the pro-social or pro-ethical mindset of the investors

which draws them towards SRI, but a significant proportion of SRI investor also chose the same in anticipation of better financial performance.

Along with academicians, the practitioners also believe that social issues will become more and more important decision factors in coming times. An increasing number of fund managers are finding environmental, social and corporate governance issues as prime criterion for projecting performance and investment quality [21]. According to a Mercer Investment Consultancy Survey, 65% of managers worldwide consider Globalization and 62% consider corporate governance as very important factors in typical investment analysis [21].

The emergence of SRI and their continuous growth has attracted academicians and it continues to do so. The research in SRI, as has been outlined above has brought out a few conclusions:

a) Theoretically it is expected that SRI should underperform conventional funds, but in practice the empirical evidence suggest that SRI funds perform at par with the conventional funds. This suggests that social screening does not affect financial returns to investors.
b) The SRI generates similar returns, but by investing in a different set of stocks in a different composition of industry. The underlying stocks also differ significantly on social variables like corporate governance, environmental aspects, Employee relations, Alcohol and/or armament production etc.

c) The SRI investors not only invest for social reason but a large proportion of SRI investors also invest in anticipation of better return.

d) There have been an increasing number of practitioners (Managers) who incorporate social and ethical factors in their investment analysis. In fact, today it is difficult to find any credit rating model or system, which does not, gives consideration to social and ethical factors in addition to financial performance while determining investment worthiness of a company.

Extending the same logic to Islamic Equities, it can be deduced that the concept of Islamic Finance already encompasses all these factors in addition to others, since the very beginning as a very important criterion for investment decision-making.

Research Objectives

The performance of SRI in general and Islamic Finance (Investment) in particular has been a subject of interest among scholars and has resulted in many academicians analyzing the same in different markets, time settings and aspects. However, most of this research has been limited on performance of SRI mutual fund and/or Islamic Mutual funds. However as per the definition there has always been a separate class of equities existing in the market, which have been Shariah compliant. Mutual funds pick the equities from this sub set of the market. The performance of such mutual funds does not reflect the performance of overall ‘market’ of Islamic Equities.

This study attempts to fill this gap by measuring the performance of overall market of Islamic Equities and not only the Islamic Equity Funds. It is further argued that performance of

Mutual Funds is also dependent upon the ability of fund managers to a very large extent and may not represent the performance of entire market of Islamic equities. To overcome this gap, in this study, we are analyzing the performance of Islamic equities and not mutual funds.

In the light of Financial Crisis and economic downturn as happened during the period of 2008-2009, it has been claimed that Islamic Finance is better equipped to face and avert an economic downturn than conventional finance. In brief, the major reason for the recent Financial Crisis was extensive subprime lending and creation of complicated financial instrument to change the portfolio structure instead of taking care of loans at the ground level to make the portfolio profitable. Islamic Finance does not allow this kind of adjustments, which may be harmful in the long run. Also it does not allow capital to flow into certain sectors and deferred payment instruments (derivatives). Due to these factors it claimed to be having immunity from any such Financial Crisis.

Extending the same logic of activity, leverage, profitability and liquidity Shariah Methodology selects equities, which are permissible for Shariah compliant investing. In addition to industry screens, the accounting screens are expected to provide immunity from the market fallback caused by excessive leverage and deferred payment instruments. It is claimed that equities, which are compatible as per the Shariah guidelines, will be relatively immune from the Financial Crisis.

Considering this proposed relationship between the performance of a firm and the screening used by Shariah methodology, we can assume that a portfolio consisting of Shariah compliant equities should outperform the market during the period of economic downturn. To test our assumptions we can thus derive research question as follows-

"Whether the Islamic equities have performed better than the other equities in the European market during Financial Crisis?"

To answer this question we propose our Research hypotheses as below-

H_0: Return on Islamic Equities is not different from average return of the market.
H_1: Return on Islamic Equities is different from average return of the market.

Based on the research hypotheses we will develop our methodology to test the same.

Methodology

Various studies have been done to analyze the performance of Islamic Mutual funds in various markets, time periods and contexts [33-35]. However research analyzing Islamic equities is limited. One of the studies in this area is by Sadeghi [22] who has analyzed the effect of declaration, for equity, as being Shariah compliant, on its stock market performance. The study is focused on Malaysian market and has used event study to measure the performance of equities around the event date. This empirical research conducted in Malaysia using event study methodology, shows that the inclusion of a particular equity as an Islamic Equity has positive effect on the financial performance of the included shares [22]. However it does not gives any hint about the long-term performance of such equities.

Europe has been chosen as the focus market for this study as such study has not been conducted for this region. Also the same has been done keeping in mind the availability of

data and other information for the purpose of research. For our analysis of performance of Islamic Equities in European market, we have considered S&P Europe 350 [23] as standard representative of our focus market for the purpose of our research. We have assumed that the equities in S&P 350 Europe provide a comprehensive, if not complete, representation of European market which is our focus market for the purpose of our study and will provide reliability to our test results and conclusions drawn on the basis of the same. Further, S&P also provides S&P Europe 350 Shariah Index [24], where all the Shariah Compliant equities form the constituent of the original index becomes the constituent of the Shariah Index and can be taken as approximate representative for the Islamic Equities market in the Europe.

For our analysis, we have formed three portfolios with the help of the constituents of these indices.

i. The first portfolio consists of all the constituents of S&P Europe 350 Index as on 25th July 2009. This portfolio has been taken as a representative of the market.
ii. The second portfolio consists of all the constituents of the S&P Europe 350 Shariah Index on the same date and has been taken as the representative of Islamic Equities market.
iii. The third portfolio consists of all the equities of the Index except the equities related to financial sector. As the effect of economic downturn was more for financial institutions, it was felt that the study will become measurement of performance of Financial firms Vs. performance of non-financial firms given the fact that 77 out of 350 firms in the index belong to financial sector. Therefore this third portfolio was also created to have an understanding of effects due to performance of financial firms.

To reiterate, the three portfolios created are as follows:

1. Market portfolio (S&P 350)
2. Market except financial firms' portfolio (S&P – Fin)
3. Islamic Equities portfolio (Shariah)

The notation(s) in the brackets has been used throughout the discussion to denote the respective portfolio.

It has been assumed that equal amount of money has been invested in each of the equity included in the respective portfolio. This has been done to avoid any size effect arising due to different market capitalization of the firms. Also for the same reason we have avoided using the original index closing values as the market return as the same gives weightage to market capitalization of the firm and is expected to be biased for the purpose of our study.

The return for a given period (taken on a week in the present study) has been calculated as follows:

$$\textit{Weekly Return} = \{(P_1 - P_0) + Di\} / P_0$$

Where P_1 is the closing price for a given week, P_0 is the opening price for the same week or the closing price for the last week and Di is the dividend paid during the week. After calculating the returns, the following statistical measures has been used to evaluate performance-

A. Sharpe Ratio – This statistical test gives a comparison of risk-adjusted return for portfolio in a given market. Originally developed to measure performance of mutual funds, this statistical tool is also useful for analyzing performance of any given portfolio in a market or for making comparison between two portfolios. According to Sharpe [25] this ratio is designed to measure the expected return per unit of risk for a zero-investment strategy. This has been used to find how well the return on Islamic Equities compensates the investor for the risk taken specifically in the sense that going for Islamic Equities has restricted their diversification. We have used the revised equation provided by Sharpe [25] for the purpose of our calculation, as has been depicted below:

$$\textbf{Sharpe Ratio} = \frac{\overline{r_j} - \overline{r_f}}{\sigma}$$

Where r_j is average return of the fund for a given period, r_f is the average risk free return for the same period and the σ is risk of a fund measured in terms of standard deviation of the return of the fund for the same period.

B. Jensen's Alpha – This statistical measure shows the excess return of a portfolio over the expected return of the same portfolio as determined by the risk-reward equilibrium of the market. It has also been used by other researchers to measure the selection skill of a mutual fund manager. However for our study we have used the same to find if the criteria laid out by Shariah Rules lead to good selection of equities or not. The equation used to calculate the same is as given below:

$$\alpha_j = R_i - R_f - \{\beta_{iM} (R_M - R_f)\}$$

Here, α_j is Jensen's Alpha, R_i is portfolio return for the given period, R_f is the risk free rate of return for the same period, β_{iM} is portfolio beta and R_M is market return.

The list of equities which form the constituent of S&P Europe 350 index and S&P Europe 350 Shariah index has been obtained from the official website of S&P [26].

We have obtained share prices from three sources- Most of the share prices has been obtained from ICC Plum and Thompson One Banker databases, which has been provided by the University databases. For some of the shares where we did not have data available on these two databases we have used Yahoo finance [27].

We have obtained weekly closing share price for all the equities for a period of three years, starting from 31st July 2006 and till 30th June 2009. For the purpose of analysis the data has been again divided in three separate years from July 06 to June 07, July 07 to June 08 and July 08 to June 09. To maintain consistency in the data set, we had to omit some of the equities which have not been into existence for three years, or for whom we could not obtain data for the test period. A list of these equities, with reasons thereof has been provided in appendices.

We have taken UK Treasury bond [28] rates as a proxy of the risk free rates. For each of the three years we have taken rates of one-year bond as risk free rates, which is closest for the period we have taken for our portfolio. To obtain weekly risk free rates we have calculated weekly return based on the one-year rate for the same period.

Results and Analysis

In order to find out whether Islamic Equities behave differently from the conventional market equities, the analysis is based on the three different aspects. The first is simple overall return of the portfolio. The second aspect, which has been analyzed, is the return in comparison to risk or variability of the portfolio. The third aspect is the selectivity or the ability to pick good stocks. The findings are as follows.

Overall Return

The overall return of the portfolios has been calculated on annual basis and also for the overall period. In the first year all the three portfolios have given almost similar results as can be seen in figure 1 and have averaged near 30% return. However in the second year 2007-2008 when the market has started to face economic slowdown the performances of three portfolios differ considerably.

[Insert Figure 1 here]

Fig 1: Annual and Overall return of the Portfolios. The last cluster of columns show the overall return of the portfolios for the entire three years period

The S&P 350 ended up losing around one third of its value with a negative return of 33%, the 350-fin performed better with a loss of 21.5%. The Shariah portfolio was least affected in this downfall in the market and ended up losing only 20% of its value. In the third year when the markets saw the effects of recession, the S&P portfolio remained in negative zone while the rest of the portfolio recovered back, although marginally.

For the entire three year period the S&P 350 has given negative return while the other two portfolios has given positive returns. Also the 14% return over 9% of S&P350-Fin and a negative return of 9.5% by S&P350.

The observation of weekly cumulative return where the Shariah portfolio under performed in the first year when the market was booming but have performed better than the rest of the portfolios in the following years and also on an aggregate basis for the all three years.

[Insert Figure 2 here]

Fig 2: Cumulative weekly return of the three portfolios over the three year period from July 2006 to Jun 2009.

On the basis of our observation of absolute results we can conclude that for the overall period the Shariah portfolio has outperformed the other two portfolios. Also there is large difference between the S&P350 and S&P-Fin portfolios, which shows that the effect on the financial firms was the most severe. However the fact that Shariah portfolio outperformed even the S&P-Fin portfolio, we can safely conclude that the difference is not only due to the exclusion of financial firms and this portfolio have different intrinsic characteristics to outperform the market when the market has a downward trend.

Portfolio Risk and Return

Measurement of risk with respect to return has been done with the help of Sharpe's ratio. In the first year the excess reward (in comparison to risk free return) provided by the respective

portfolios for per unit of risk taken is almost same as was the case with absolute returns. In the second year 2007-08 the negative returns for per unit of risk is least for S&P-Fin, and is slightly better than Shariah However in the same year S&P 350 has largest negative returns per unit of risk. In the third year similar trend has been followed, but the values have come down.

Year	S&P 350	Shariah	S&P-Fin
2006-07	0.27895	0.27304	0.29516
2007-08	-0.29608	-0.17830	-0.17345
2008-09	-0.04231	-0.00883	-0.02178
2006-09	-0.04094	0.00119	0.06503

Table 1: Sharpe Ratios for the three portfolios. The last row shows the values for the entire three year period

For the overall three-year period the S&P- Fin has given the best return per unit of risk taken. This is very logical by the fact that its financial sector which went through the largest fall during the Financial Crisis creating more volatility and risk for the investors. It can be concluded that the excess return for per unit of risk taken is moderate by the Shariah portfolio; however it is not the best in the market.

Considering another perspective, the beta of the two portfolios Shariah and S&P-Fin with respect to S&P350 considered as proxy for market, for the entire three year period, as shown in fig.3 shows that it is close to one, but the same for S&P-Fin is very small at 0.15.

[Insert Figure 3 here]

Fig 3: Beta of the Shariah and S&P-Fin portfolios. The last set of columns shows the value for the entire three year period.

Considering beta as a measurement for the absolute risk of the portfolio, these values show that there has been much more variability in the returns for S&P-Fin. However the Shariah portfolio has moved more or less with the overall market but at the same time has avoided the downfalls. This suggests that Shariah portfolio exhibits less risk than the other two portfolios.

Diversification and Performance

The values of Jensen's Alpha (αj) for the three portfolios has been shown in the table 2 which depicts that the Shariah portfolio has continuously outperformed both other portfolios as far as the excess return over expected return (according to the risk-return equilibrium of the market as determined by the CAPM) is concerned. Also it is significantly more than both other portfolio for the entire period.

Year	S&P 350	Shariah	S&P-Fin
2006-07	0.0046	0.0493	0.0151
2007-08	-0.0071	-0.0797	0.0314
2008-09	-0.0024	-0.1042	0.0654
2006-09	-0.0015	0.2406	-0.0110

Table 2: Value of Jenson's Alpha for the three portfolios

Based on these results, we can conclude that the comparatively higher Jenson's Alpha for the entire three-year period exhibited by the Shariah portfolio shows that the Shariah guidelines led to better selection of stocks from the given market. In other words we can say that Shariah portfolio provides better returns than what is determined by the CAPM for a given level of risk in a market. This also corroborates with our conclusion arrived at by analyzing the beta of the portfolios as given in figure 3.

Findings and Implications

The analysis and the results obtained in our study provide statistical evidences to support the opinion that the Shariah Compliant equities have significantly outperformed the market during the period of general economic downfall. There is also evidence that a portfolio of Shariah Compliant equities shows less variability and hence is less risky. We also found evidence for the ability of Shariah Guidelines to pick better stocks in the market during the period of general downfall.

The fact that the Shariah portfolio outperformed the S&P-Fin portfolio on all counts implies that the better performance of Shariah portfolio is not only due to the exclusion of a unique set of equity (Financial) which have been worst affected during the period of financial downfall, and provides statistical evidence to the view that in general Shariah Equities have performed better during the given period.

The higher Jensen's alpha for the Shariah portfolio for each of the three years and also for the entire period shows that the concern that the loss of diversification by restricting the choice of securities available for investment will lead to non-optimum returns, does not hold good for our data in particular and for the market in general.

In the light of our findings we can reject our null hypothesis and accept our alternative hypotheses and can safely conclude that the return of Shariah compliant equities during a period of general market downfall is better than the conventional market.

H_0: Return on Islamic Equities is not different from average return of the market: **Rejected**
H_1: Return on Islamic Equities is different from average return of the market: **Accepted**

This study has analyzed a comparatively small data set. Also the period of analysis has been small and contains only one event of general economic downfall. It is suggested that a comprehensive study to be undertaken with a larger data set and for more than one event of economic downfall. In other words, this needs to be verified on a much larger data over a significant time period before general acceptance. The results obtained in the present study are more of indicative in nature.

Nevertheless, the implications of the results of this study are equally important for policy makers, Investors, corporate firms and fund managers. One of the major concerns of the policy makers in the modern market is to avoid the general downfall in the market or recession. Knowledge of what kind of corporate practices lead to more variability or instability on the market can provide significant guideline to curb such activities and provide more stability in the market. For example leverage has been considered as one the major criteria and the policy determining borrowing capacity of the corporate may prove effective to control firms which operate in a too risky zone and cause major upheavals in market when they make abnormal profits or go bust.

Corporate firms can benefit from the knowledge of what practices lead to better stability during tough times in the market and what they should avoid in terms of funding as well as markets when they go for expansion of their business. The investors will also get a much better knowledge of risk associated with a Shariah compliant investment and a non Shariah compliant investment while selecting industry and firms in a market based on their risk appetite and perception for the future movement of market.

Fund managers, are the one of the most important entities to be affected by the results of this study. Generally when the market goes down, everything goes down with it. However, Islamic equity provides a hedge against this downward movement of the market, both by resisting the downward movement as well as recovering quickly that the rest of the market. At the same time, it does not compromise much on the returns during a period of general economic growth. This put Islamic fund managers in a better position to market their products.

Conclusion and Future Direction for Research

In the light of economic slowdown and recession, which took place during 2007-09, it was claimed that the Islamic Financial Institutions performed better than the conventional financial institutions due to their avoidance of certain sectors and practices. According to our study the same effect should be observed in the performance of Shariah Compliant equities since they also adhere to it and avoid certain sectors and firms.

The analysis of three portfolio representing market, market except financial firms and Shariah, concluded that the Shariah Compliant equities have performed better than the rest of the market. Also they exhibit less variability in return and hence are less risky. However this is true only for a period of economic slowdown. The Shariah Complaint equities tend to slightly underperform during a period of economic boom. On an overall basis the underperformance during boom is well settled off by the outperformance during the period of economic downfall in the short run.

This study is based on a single event of economic slowdown and also the sample size is small in comparison to the actual market. Further study in this area can analyze a large data set over more than one event of economic slowdown. However the limited availability of data and very small period of emergence of Islamic Finance drastically limits such opportunity.

Another direction of research from here is the analysis of each of the criteria laid down by Shariah and the screens with respect to their relation with the financial performance of the firm. A number of studies have already been published but most of them are based on one or two aspects at a time. There is scope for a detailed multivariate analysis taking all parameters into account.

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Appendix

3 Year Analysis of Data Set			
DESCRIPTIVE	**S&P 350**	***Shariah***	**S&P-Fin**
Average Weekly Return of Portfolio	**-0.00061**	**0.00092**	**0.00760**
Average Annual Return of Portfolio	**-0.03829**	**0.04322**	**0.02476**
SD of Portfolio (Weekly)	**0.03639**	**0.03480**	**0.10336**
SD of Portfolio (Annually)	**0.31235**	**0.25013**	**0.26068**
Sharpe's Ratio (Weekly Data)	**-0.04094**	**0.00119**	**0.06503**
Sharpe's Ratio (Annual Data)	**-0.26907**	**-0.01012**	**-0.08051**
Covariance with Market (S&P 350)	**0.00132**	**0.00122**	**0.00162**
Variance of Portfolio	**0.00132**	**0.00121**	**0.01068**
Beta of Portfolio	**0.99359**	**1.00737**	**0.15154**
Market Return	**0.09517**	**0.09517**	**0.09517**
Risk Free Rate of Return	**0.13725**	**0.13725**	**0.13725**
Portfolio Return	**-0.09517**	**0.14369**	**1.18584**
Jensen's Alpha	**-0.00149**	**0.24057**	**-0.01104**

Aggregate Return of Portfolios

Year	**S&P 350**	**Shariah**	**S&P-Fin**
2006-07	**0.2913**	**0.3030**	**0.3025**
2007-08	**-0.3299**	**-0.1960**	**-0.2146**
2008-09	**-0.0763**	**0.0226**	**-0.0136**
2006-09	**-0.0952**	**0.1437**	**0.0910**