

Comments of

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on

Islamic Investment: Evidence from Dow Jones

and FTSE indices

by

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1. General Comments

The paper provides an empirical evidence for Islamic indices; FTSE Global Islamic Index (GIIS) and Dow Jones Islamic Index (DJIMI) and evaluates the impact of Shari'ah screening on the performance of the respective indices over 1993 to 2004. The paper makes contribution towards empirical literature in Islamic finance, a niche that has potential for significant growth and is likely to promote benefits of Islamic finance or modes of finance based on this concept. The author used well-tested methodological tools in the western economics to define the variables and apply techniques to infer the results. The paper draws upon important emerging and existing literature to provide academic underpinning and justify the study. Some policy issues are considered but results reported do not consider implications and there are no explicit recommendations for policy makers or users. Results reported are derived using robust econometric techniques but there is limited discussion or justification for the definitions and construction of the indices; given the fact the indices are extracted from the FTSE and Dow Jones, a prior reasoning could be applied to argue that the results will mimic one another.

2. Specific Comments

I have a number of comments, which I hope the author will find useful in polishing the final version of his paper.

1. The introduction is competent and motivates the paper well; right length, appropriate exposition to the issues under consideration, provides some facts about the introduction of Islamic indices. However, it provides no rationale for why an index extracted from the main FTSE or Dow Jones should exhibit different outcomes, though it is acceptable practice to provide most of the

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discussion in the body of the paper but the introduction ought to refer to landmarks to motivate the paper and state the purpose of the paper. For example, I will be inclined to justify the derivation of Islamic Indices, contribution they make and why their results should be different from the existing empirical results reported for western economies. The penultimate paragraph is same as the abstract; it can be expanded to provide a rationale of the paper; given the length of this section, further exposition would be useful.

2. In section 2, which deals with “an overview”, it is helpful to read definitions and development of Islamic indices, but there is not much of critique or rationale provided of these indices. It is important to question/justify the composition of such indices and how they contribute towards advancement of Islamic finance in general and the user in specific. The likely criticism of Islamic indices is that, extracted data from western financial sources are likely to mimic and closely exhibit the western indices. The interesting findings of higher volatility of Islamic indices are interesting and could benefit from further exploration; smaller companies by definition are more responsive to changing economic conditions but the definition includes all those companies which have less than 33 per cent debt in their capital structure, one would expect the volatility level to be mitigated by lower financial exposure; therefore, it would be useful to consider the major causes of volatility and implications for an investor. The second observation the author makes is that the criteria used to select companies to be included in the Islamic indices helps to minimize bankruptcy risk as evidenced by WorldCom and Enron; it can be argued that portfolio managers do use such filters and it is not a unique practice in Islamic finance. Therefore, to motivate debate and theories the risk minimization principal implicit within the selection criteria needs further exploration if we are to infer global benefit of the practice. The conclusion of empirical studies cited is that “.ethical screens does not have an adverse impact on GIIS”, a point that will benefit from further analysis; this should be used to rework the concluding paragraph of section 2.
3. The opening sentence of section 3 is not that easy to comprehend and author my wish to reconsider the hypothesis to make the statements more explicit, conclusive and address the corporate responsibility aspect in a more meaningful way. However, the last sentence does reflect the hypothesis quite well.
4. It is useful to extend the data series up to 1993, to give a large set of data to undertake statistical studies; it would be useful to use quarterly data and reported statistics. The author attempts to use innovation to capture the impact of changes in the economic conditions on the indices performance but this is not backed by theoretical exposition, in particular why indices performance should vary during the ‘bull’ or ‘bear’ market. There is no explanation as to why Morgan Stanley database is an appropriate proxy for the market portfolio

and why the same proxy measure is applicable for different regions; at least consideration of the point will lend credibility to the paper.

5. The methodology is easy to follow; it is consistent with studies that have attempted to test market efficiency or test stock market predictability. The model derived to apply to Islamic indices closely matches the establish literature. It is appropriate to be used as it is used for a subset of the FTSE and Dow Jones Index. However, the methodology section would be robust if author could have cite research where the same methodological techniques were employed, for example Fama 1990 etc.; especially, when the study employs the set of companies extracted from the indices which are compliant with the definitions of Islamic finance.
6. Results reported are clear and consistent with the model employed. However, the author provides no analysis that may explain why the Dow Jones Islamic index outperforms its counterpart for the period (1996-2004) and 'bull' period (1993 – 2000). Author may wish to extrapolate and consider possible reasons for this pattern and draw inferences for investors and institutions. In particular, it would be useful to consider what makes companies in Islamic indices more risky and what lessons investors and institutions may learn to engender lower financial risk for all agents engaged in economic activity. In general, I would encourage the author to reconsider the results from the regressions in the paper. Ideally, the results obtained ought to tell a story, extend the logical inferences drawn from this study and consider variables which could be germane to the paper. Furthermore, the author questions the suitability of MSCI index but no discussion ensues to reason suitability of this index.
7. Surely, tables 1, 2, 3, 4 and 5 can be presented in smaller fonts that will improve presentations. Results reported in tables 3, 4 and 5 offer interesting findings; surely these need to be explained and reasoned to tell the story.
8. The conclusions are plausible, in that the key stated objectives were met. However, the hypothesis is too narrowly framed and heavily relies on basic statistical tests; secondly, there are a number of important issues which are not addressed. Firstly, the data used to test the hypothesis, FTSE and Dow Jones indices subsets could have covariance that could impact on the results, if not then at least an explanation ought to be furnished. Very important here is the source of data derived for Islamic indices and their usefulness for investors and institutions. I believe that this issue should be addressed in the literature review and implications stated in the concluding section
9. It is regrettable that no attempt is made to examine the limitation of the pure econometric studies, in particular, how data can shadow the real story; how relevant is the data and what are the limitation of this data to infer conclusion for Islamic companies operating in Islamic countries in compliance with Shari'ah law.
10. Let us think of a number of questions in sequence.

Question 1: How reliable is a measure that is extracted from main indices using Islamic finance definitions? I suppose, this question can be answered for this study by stating that the study has set clear parameter and has not considered the definition used to extract companies to be included in Islamic indices.

Question 2: Can we quantitatively measure the performance of screened portfolio using Shari'ah offer with those of unscreened portfolios? The framework used to test the hypothesis is sufficient. The answer to this is yes as well; the study achieved its stated objectives. Combining question 1 and 2 and theorizing the model lends itself to credible empirical study that could serve foundation for further studies. It may be too late for the author to fully incorporate the above points but at least the author should be considering some discussion in the conclusion, in order to broaden the research question and provoke some intense empirical research.