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Advanced Risk Profile Analysis of Islamic Equity Investment : Evidence from the American, Asian and European Market

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Abstract

As far as the asset and liability management is concerned, the advanced analysis of the risk and return profile of Islamic financing and investment products constitutes today one of the great challenge of Islamic financial institutions. From the fact that by design, Islamic financial institutions should be keeping a handsome portion of their assets in equity investments, this paper brings out the dynamics of specific risk profile inherent to the Islamic equity investment based on investing in Sharia compliant stock market. Therefore, we investigate three Islamic equity indexes classified by economic hubs (the Dow Jones Europe, Asia-Pacific and USA) against their conventional peers from 2003 to 2009. Drawing from the specific features of the Dow Jones Islamic indexes and its compounds inherent features, the paper argues that Sharia screening which alters the composition of Islamic indexes would contribute to the shaping of a distinguished risk profile.

I. Introduction

BY DESIGN, ISLAMIC banking should be keeping a handsome portion of their assets in equity investments in order to be consistent with the fundamental principle of Islamic finance that is the Profit and loss sharing. Islamic banks are supposed to hold equity in corporations and sit on their boards of directors. Nevertheless, any investment in equity based or profit and loss sharing partnerships exposes Islamic financial institutions to equity investment risk that are not applicable to conventional financial institutions. While Islamic economic and banking has received a fair share of research and investigation, the existing academic literature on Islamic equity investments is still embryonic despite their increasing growth and

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