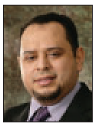
Early recovery can be seen in global Islamic equity markets

The global coronavirus pandemic has severely impacted the world economy beginning from March 2020 where most countries implemented lockdown and/or social distancing policies in their respective jurisdictions. This indeed has global social and economic consequences considering that countries unavoidably have been restricting their borders. Airlines and businesses related to travel as well as restaurants have been severely impacted. Negative growth has been forecasted in most, if not all, of the countries worldwide. FAROUK ABDULLAH ALWYNI writes.



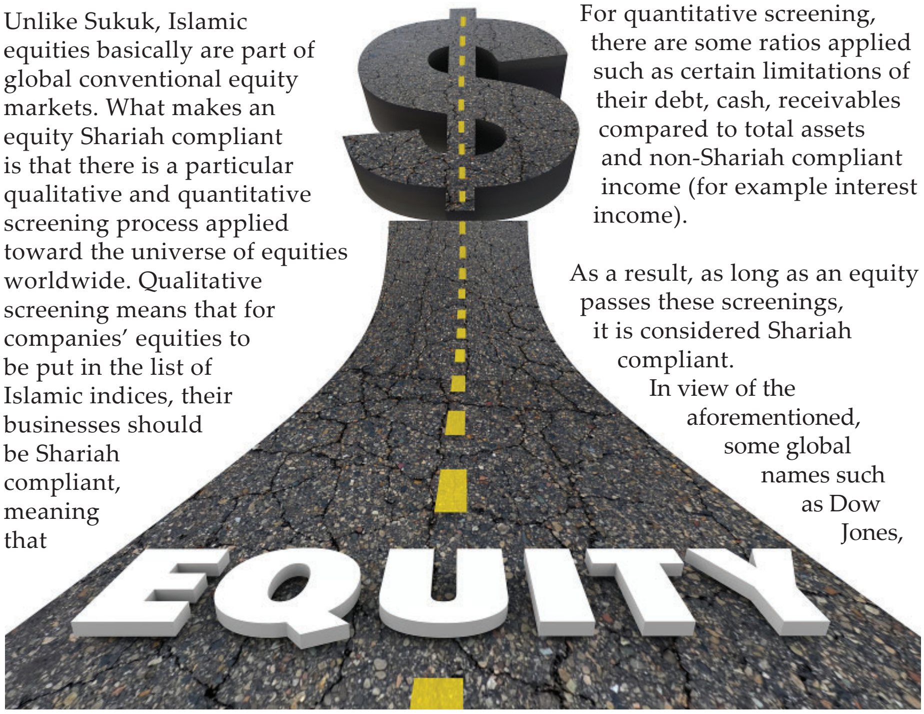
Farouk Abdullah Alwyni *is CEO of Alwyni Consulting and the chairman of the Center for Islamic Studies in Finance, Economics and Development. He can be contacted at faalwyni@alwynicapital.co.id.*

Hence, this has also affected global equity markets or stock markets. Some major indices such as Morgan Stanley, Dow Jones, S&P and others have witnessed negative yield hitting its worst point in March 2020. Thus, Islamic equity markets as part of the global equity markets have also been impacted by this health crisis, and over time could evolve into an economic crisis. Before we review further the state of the global Islamic equity markets after the worst effects of COVID-19 in March 2020, it is important to understand the concept of Islamic equity markets.

Table 1: Year-to-date index comparative returns		
Benchmark indices	Shariah (%)	Conventional (%)
MSCI World	-9.47	-7.95
MSCI AC ASEAN	-20.12	-21.88
MSCI GCC Countries Domestic IMI	-13.15	-16.23
S&P 500	2.33	-3.08
S&P Emerging	2.8	-10.03
S&P Developed BMI	2.26	-6.43
Dow Jones Emerging Markets (net total returns)	3.15	-9.95

Sources: MSCI Indices — data as of the 29th May 2020 based on gross returns in the US dollar; S&P Dow Jones Indices — data as of the 30th June 2020 based on total returns in the US dollar

Unlike Sukuk, Islamic equities basically are part of global conventional equity markets. What makes an equity Shariah compliant is that there is a particular qualitative and quantitative screening process applied toward the universe of equities worldwide. Qualitative screening means that for companies' equities to be put in the list of Islamic indices, their businesses should be Shariah compliant, meaning that they should not include businesses related to, among others, alcohol, gambling, pork, pornography and conventional financial services.



For quantitative screening, there are some ratios applied such as certain limitations of their debt, cash, receivables compared to total assets and non-Shariah compliant income (for example interest income).

As a result, as long as an equity passes these screenings, it is considered Shariah compliant. In view of the aforementioned, some global names such as Dow Jones, Morgan Stanley, S&P and Financial Times also have their own Islamic indices. Therefore, to look into the impact of COVID-19 on global Islamic equity markets, a review needs to be made on those global indices. Table 1 shows a comparison between some global Islamic indices and the conventional ones across different regions.

Except for the MSCI World Index, all other indices showed that Shariah indices outperformed their conventional counterparts. For the MSCI ASEAN and GCC, both Shariah and conventional indices experienced losses, but smaller losses for Shariah. As a whole, considering that MSCI indices recorded performance until the 29th May 2020, most indices performed worse compared with the S&P and Dow Jones indices which showed results until the 30th June 2020.

This is due to a gradual recovery of global equity markets since its worst performance in March 2020, hitting the lowest figures in almost all global indices including the Shariah ones.

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One main reason why Shariah indices performed better is that they have greater weight in the information technology and healthcare sectors which outperformed during the pandemic crisis.

In the S&P 500 Islamic Index, technology and healthcare sectors accounted for 40% and 17% of all sectors respectively whereas in the conventional S&P 500 Index, these two sectors respectively accounted for 27.5% and 14.6%, while the financials (conventional) sector accounted for 10.1%. This financials sector is not present in the Islamic index.

> ***"Other reasons for the better performance of Shariah indices include a more equity bias capital structure (low leverage)"***

Similarly, in the S&P Developed BMI Index, technology and healthcare sectors accounted for 30.9% and 20% respectively of all sectors, compared with the conventional index of only 20.6% and 13.9% respectively. In addition, as with S&P 500, the financials sector is absent in the Islamic index while it accounted for 12.6% in the S&P Developed BMI Index (conventional).

Other reasons for the better performance of Shariah indices include a more equity bias capital structure (low leverage). One study, using all of the aforementioned indices, argues that Islamic equity indices give hedging benefits during severe bearish markets due to them following the market value of equity-based Shariah screening criteria (Ashraf, Rizwan, and Ahmad, 2020).

Another study also shows that low-leverage portfolios perform better than high-leverage portfolios when markets are down. This reinforces the theories of capital structure and externality of debt that suggest low-debt indices perform better during market downturns (Khan and Azmat, 2020).

Within the foregoing context and Table 1, it seems that a gradual recovery of global Islamic equity indices is on the cards. Although no one is certain yet with regards to the discovery of a COVID-19 vaccine, one thing is certain: work is underway from many major research organizations all over the world. In addition, many countries have also over time learned how to deal with this pandemic properly without resorting to fully-fledged lockdowns as seen in Hong Kong.

Considering that the global pandemic crisis in March 2020 brought down significantly indices all over the world, including global Islamic indices and indices in Muslim countries, the positive figures of some Islamic indices seen at the end of June give a ray of hope for the global Islamic finance industry.