The Perspective of Islamic Index Performance in Indonesia: A Conceptual Paper

Eky Ermal M.[1], Vina Arnita[2]
[1]Faculty of Economics and Business, Universitas Medan Area,Medan, Indonesia
[2]Faculty of Social Science, Universitas Pembangunan Pancabudi,Medan, Indonesia
ekyermal@staff.uma.ac.id,vinaarnita@dosen.pancabudi.ac.id

ABSTRACT

This paperis objected to know the development studies related to the comparative Islamicindex. The perspectiveof this study showed inconsistency results, supporting studies accordingto the portfolio theory, the risk-return performance studies by focusing on comparative between Islamic funds or indices against their benchmark. The purpose of this study to know the performance Islamic investment risk-return profile and risk adjusted return measures whether Islamic funds outperform, underperform, or similar performanceagainst the conventional benchmark. Therefore, from this conceptual paper the Indonesian perspectiveof Islamic index describes not better than conventional benchmarking.

Keywords: *Islamic Index, JII, ISSI, Performance, Indonesian Stock Exchange*

1. BACKGROUND OF STUDY

The development of Islamic capital market in Indonesia was started more than a decade ago. This is introduced because one of many reasons that Indonesia is the biggest population Muslim in the worldwide. The capital market in Indonesia appreciates this phenomenon because of investment demand based on Islamic investment.Furthermore, Albaity and Ahmad (2008) explain that Islamic investment basically is adopted based on Islamic principles, such as “Mu’amalat” which is known as a stock exchange transactions willing in line with Islamic principles.

The distinguish feature of Islamic capital market activities is adopting the principles of Islam, whereas the conventional benchmark is not applying it (Dewi & Ferdian, 2009).Islamic Finance in this term is an Islamic investment adopt with Shariah requirements. Islamic stocks are screened to ensure that index that they are consistent with Islamic rule. The screening in Islamic Law is aimed that corporation who applied is compliant with Shariah activities and requirements. In this context, the investors who adopt Islamic finance should consist with their value and personal beliefs that appropriate with Islamic law. (Snoussi, Salah, & Rigobert, 2012).

Most of authors focus on prohibitions of Islamic finance, such as Gharar (doubtful transactions or uncertainty), Riba (Interest or Usury), Maysir (speculation or gambling) and Haram (Forbidden). Therefore, these four elements are clearly not allowed in Islamic finance (Abdelsalam, Duygun, Matallín-Sáez, & Tortosa-Ausina, 2014; Ahmad & Ibrahim, 2002).

Further, Indonesia Stock Exchange gives more explanation about the principles of Islamic finance. Business related to gambling activities (Maysir), Riba and Gharar is a group of stock that excluded on the Shariah index in Indonesia. This rule is insisted by Indonesia Shariah council and Indonesia Financial Services Authority (OJK) in law Number IX.a.13 about the Shariah capital market (IDX, 2010).Due to Islamic finance and investment, Riba is clearly as prohibition feature. This is explained in the Holy Qur’an that Riba known as earning from the interest that inflict on side party in business. Therefore, Islam focuses instead on partnerships and risk-sharing (Ghoul & Karam, 2007).

Moreover Lyn and Zychowicz (2010) argues in their statement related to Islamic investment as define as an ethical investment, for example; is religious beliefs related well with investment decision process or do Investors sacrifice their return as their faith. Then, to address this issue, this study of Islamic performance investment is expected given answer to the party who need information about this performance study.

Islamic Economic is relatively not denied on profit, private ownership, or market forces. Islamic economics are also focus on profit for the future, but in “Halal” Permitted way. In this context, Islamic economics is not total freedom rule. As long as the business activities follow the rule of Islamic screening or element, then the business can be accepted as Islamic economics (Forte & Miglietta, 2011).

Therefore, from this background, the purpose of this study is to examine and more observe Islamic study, especially in the investment field. Does it economic value include for religious beliefs into the investment-decision process? Is it the best decision for investors willing to sacrifice satisfactory economic returns by making ethically investing decisions based on their faith? To address this issue this study is expected gives a more comprehensive answer of performance of Islamic fund in Indonesia.

The day of a launched of JII was on 3 July 2000. As a barometer for Islamic investment in Indonesia, JII reflected Islamic stock conditions in Indonesia. Then Indonesia Stock Exchange collaborated with Danareksa Investment Management developed this index as a benchmark based on Islamic Shariah stock exchange. Furthermore, for regulation purposesIndonesia Shariah Council collaborate with Indonesia Financial Services Authority (OJK) made some criteria to fulfil Shariah principles. As mentioned in background of study, four principles of Islamic screening are compulsory to apply. JII consist of 30 of stock that selected with Islamic principle. Therefore, Jakarta Islamic index will be reviewed and monitoring twice a year every six months.

Islamic instrument is expected to serve benefit from diversification of portfolio to enrich global capital market activities. Related to the performance, the most investors can find the easiest and efficient way to improve return is to invest in Islamic indices which are more transparent with lower risks(Ho, Abd Rahman, Yusuf, & Zamzamin, 2013).

Thus, this concept is recognizedas an important design parameter for Islamic investment performance both of the investor's perspective and academic idea. With regards to Islamic Index in Indonesia, Figure 1 and Figure 2 below shows the one year period movement of the JII and ISSI Index. This plot clearly shows the increasing trend of the JII and ISSI Index in 2014.

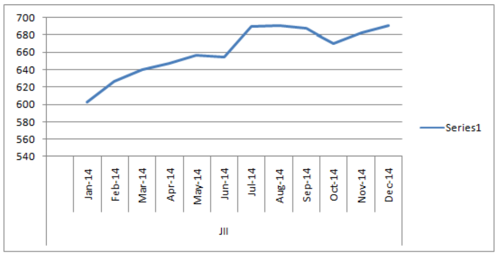

Figure 1.1 the JII monthly closing price index from January 2014 to December 2014

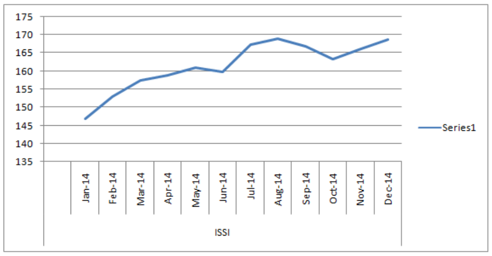

Figure 1.2 the ISSI monthly closing price index from January 2014 to December 2014

This study showed the value of Islamic Indices (JII and ISSI)compare with market benchmark. The Jakarta Composite Index (JCI) as recognised as a market conventional index. This market index is aimed as a benchmark for the performance comparison study. As a benchmark for Islamic investment index fund and also as the main market barometer, the Jakarta Composite Index (JCI) is attempted used as a conventional index in this study. The JCI serves as an indicator of the performance of the Indonesian economy. Thus, the JCI is the important indicator of local business and market conditions.

2. LITERATURE REVIEW

The financial return is as an important aspect of investment process. Markowitz (1952), in his portfolio theory describes the aim of investors is to maximize their wealth. In addition, the portfolio theory describes the importance of diversification in reducing risks without sacrificing returns.This portfolio effect is an output from the correlation of returns among securities (Zulkafli., et, al. 2017)

Albaity and Ahmad (2008) argue that traditional investors' focuses on their diversifying investment to maximise return and get purposes minimum risk. Hickman, Teets, and Kohls (1999) indicate that the lower the correlations of returns between securities, the higher the reduction of risk. Therefore, a well diversified portfolio will only be affected by an economy-wide risks or market risks. More existing empirical literature about portfolio study, however, finds three results of performance, Outperform, Similar performance and Underperform. Table 1 showed the results of several Islamic fund performance.

Table 1. Several Results of Islamic Performance.

Authors	Results
Lai and Windawati (2017)	The volatility is higher around Ramadan for the Indonesia stock market
Listyaningsih and Krishnamurti (2017)	This result was consistent with the theory in which regarding to the bad news, investors will conduct more transaction on risky stocks (Non-Sharia) to avoid loss.
Abdelsalam et al. (2014)	Islamic funds generally outperformed than their benchmarks.
Ho et al. (2013)	Islamic tend to similar performance to the conventional benchmark.
Cahyaningsih et al. (2009)	The result showed Islamic fund tends to underperformed compared to conventional benchmark.
Albaity and Ahmad (2008)	There is no significantly different risk-adjusted return. However Islamic index are underperform than conventional benchmark.
Ahmad and Ibrahim (2002)	Islamic index is really slightly lower than conventional benchmark.

3. RESULT AND DISCUSSION

3.1 ISLAMIC INVESTMENT

The laws of economic Islam are clearly teaching based on the Holy Quran (the holy book of Muslims) and the Sunnah (the practices of the Prophet Muhammad). Islamic investment fund can be a tool for investors to contribute their surplus money for the purpose of its investment to earn “Halal” profits that reliable with principles of Islamic Shariah (Usmani, 2007).

There has been a growing desire to have funds in which profits are not based on riba, or interest, which is rejected in Islam. The Muslim faith deems that profit should come as a result of efforts; this is not the case in interest dominated investments. In addition, there is a desire for investment portfolios which are morally purified. Thus investments in companies that do not comply with Muslims moral orientations are not permitted and are eliminated from the portfolio. To ensure compliance with the forgoing condition, Islamic mutual funds are governed by Shariah advisory boards whose role is mainly to give assurance that money is managed within the framework of Islamic laws (Hassan & Girard, 2011).

3.2 ISLAMIC SCREENING

Islamic teachings are clearly prohibited in “Haram” (*Forbidden*) Principles. This is explained in the characteristic of Islamic screening. Islamic screening related to forbid bad activities such as alcohol, pork-related products, interest in conventional finance, gambling, pornography and other product that inconsistent with Islamic rule. Moreover, Indonesia Financial Services Authority (OJK) explains about Maisir, Gharar and Riba. Maisir can be interpreted as gambling, every activity involving gambling and the party the gambling will take all the bets and the losing party will lose its bet. Gharar means any element of absolute or excessive uncertainty in any business or a contract that lead to a dispute. And Riba describe about an additional to the principal loan due to the time period element. In banking, it is called 'interest'.

Related in this study, Lobe, RÖBle, and WalkshÄUsl (2012) explain that the most of the index should consist with Islamic principles. The Islamic index is also should have an independent Shariah board to ensure Islamic index that listing in the capital market are consistent with Islamic principles. There are no activities of negative business that allowed in this Shariah index. Therefore, based on Islamic screening the index not applied Islamic principle will not included to the Islamic capital market.

3.3 ISLAMIC INDEX

Islamic indices are offered mainly by the world's largest providers of financial market indices and banks. The first indices were introduced at the end of the 1990s. After the RHB (Rashid Hussein Bank) Islamic Index was launched in 1996, the

Independent Global Index Company launched the FTSE Global Islamic Index Series in 1998, followed by the Dow Jones Islamic market index (DJIMI) in 1999, tracking the performance of Shariah compliant companies from 34countries. At the moment, more than 400 Islamic indices exist at different levels (country, region, and worldwide), for example Credit Suisse HS50 Shariah Index, Dow Jones Islamic Market Index, Dubai Shariah Hedge Fund Index, FTSE Shariah Global Equity Index, Jakarta Islamic Index Indonesia, MSCI Barra Islamic Index, Kuala Lumpur Stock Exchage Shariah Index, MSCI Islamic Index etc (Lobe et al., 2012).

As well as more hundreds of variants there of (sector indices and indices with the same content in different currencies),these equity benchmark indices, designed to track the performance of leading publicly traded companies whose activities are consistent with the Shariah, cover more than70 developed, emerging, and frontier markets, as well as the GCC (Gulf Cooperation Council) countries Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates. (Lobe et al., 2012)

What are the differences in the composition of Islamic indices compared with conventional market indices? According to the MSCI Islamic Index Series Methodology, the equity portfolio of an Islamic index is initially based on the underlying conventional market benchmark but excludes all non-compliant securities in accordance with the principles of Shariah (the selection process is based on the criteria business activity and financial ratios. Specifically, companies are screened out that a reactive in order more than 5% of the revenues from business activities based on alcohol, tobacco, pork related products, conventional financial services, defence/weapons, gambling, or adult entertainment). In addition, firms with significant income from interest or excessive leverage are excluded (WalkshÄUsl & Lobe, 2012)

4. CONCLUSION

Related to the previous studies the Islamic studies showed inconsistency results, but most underperform. According to portfolio theory, Islamic fund is restricted by the Islamic law which is Islamic screening. This is the reason why Islamic tend to underperform. By focusing on comparative between Islamicfunds against the benchmark fund, several results showed Islamic funds namely outperform, underperform, or similarly perform as well as compared to the conventional benchmark. Therefore, based on Indonesian Islamic fund performance showed tend to underperform. This conceptual paper is expected giving new idea to the new empirical study in Indonesia.

REFERENCE

Abdelsalam, O., Duygun, M., Matallín-Sáez, J. C., & Tortosa-Ausina, E. (2014). Do ethics imply persistence? The case of Islamic and socially responsible funds. *Journal of Banking & Finance, 40*(0), 182-194. doi: http://dx.doi.org/10.1016/j.jbankfin.2013.11.027

Ahmad, Z., & Ibrahim, H. (2002). A study of performance of the KLSE syariah Index. *Malaysian Management Journal, 6* (1&2), pp. 25-34.

Albaity, M., & Ahmad, R. (2008). Performance of Syariah and Composite Indices: Evidence from Bursa Malaysia. *Asian Academy of Management Journal of Accounting and Finance, Vol. 4*(No. 1), 23–43.

Dewi, M. K., & Ferdian, I. R. (2009). Evaluating performance of Islamic mutual funds in Indonesia and Malaysia. *Retrieved March, 28*, 2011.

Forte, G., & Miglietta, F. (2011). A comparison of socially responsible and Islamic equity investments. *Journal of Money, Investment and Banking*(21), 116-132.

Ghoul, W., & Karam, P. (2007). MRI and SRI mutual funds: A comparison of christian, islamic (morally responsible investing), and socially responsible investing (SRI) mutual funds. *The Journal of Investing, 16*(2), 96-102.

Hassan, M., & Girard, E. (2011). Faith-based ethical investing: the case of Dow Jones Islamic indexes. *Networks Financial Institute Working Paper*(2011-WP), 06.

Hickman, K. A., Teets, W. R., & Kohls, J. J. (1999). Social investing and modern portfolio theory. *American Business Review, 17*(1), 72-78.

Ho, C. S. F., Abd Rahman, N. A., Yusuf, N. H. M., & Zamzamin, Z. (2013). Performance of global Islamic versus conventional share indices: International evidence. *Pacific-Basin Finance Journal*(0). doi: http://dx.doi.org/10.1016/j.pacfin.2013.09.002

IDX, I. S. E. (2010). Buku Panduan Indeks Harga Saham Bursa Efek Indonesia, from http://www.idx.co.id/Portals/0/Information

/ForInvestor/StockMarketIndicies/FileDownload/Buku%20Panduan%20Indeks%202010.pdf

Lai, Y.-W., & Windawati, A. (2017). Risk, return, and liquidity during Ramadan: Evidence from Indonesian and Malaysian stock markets. *Research in International Business and Finance, 42*, 233-241.

Listyaningsih, E., & Krishnamurti, C. (2017). The Impact of Global Financial Crisis on Jakarta Islamic Index (JII): A Trading Volume Perspective. *Advanced Science Letters, 23*(9), 8197-8203.

Lobe, S., RÖBle, F., & WalkshÄUsl, C. (2012). The Price of Faith: Performance, Bull and Bear Markets, and Screening Effects of Islamic Investing Around the Globe. [Article]. *Journal of Investing, 21*(4), 153-164.

Lyn, E. O., & Zychowicz, E. J. (2010). The impact of faith-based screens on investment performance. *The Journal of Investing, 19*(3), 136-143.

Snoussi, J., Salah, B., & Rigobert, M. (2012). The Performance of Islamic Investment: Evidence from the Dow Jones Islamic Indexes. doi: http://dx.doi.org/10.2139/ssrn.2033781

Usmani, M. T. (2007). Principles of Shariah governing Islamic investment funds. *Islamic Mutual Funds as Faith-Based Funds in a Socially Responsible Context*.

WalkshÄUsl, C., & Lobe, S. (2012). Islamic Equity Investing: Alternative Performance Measures and Style Analysis. [Article]. *Journal of Investing, 21*(4), 182-189.

Zulkafli, A. H., Ahmad, Z., & M, E. E. (2017). The Performance of Socially Responsible Investments in Indonesia: A Study of the Sri Kehati Index (SKI). *Gadjah Mada International Journal of Business, 19*(1), 59-76. doi: https://doi.org/10.22146/gamaijb.17959