The Volatility and Risk- Return Trade-off of Malaysian Islamic and Convectional Indexes During the Global Financial Crisis and COVID-19 Pandemic

Foo Siong Min[1], Nazrul Hisyam Ab Razak[1], Fakarudin Kamarudin[1], Nadisah Zakaria[2*]

[1]Accounting and Finance Department, School of Business and Economics, Universiti Putra Malaysia, 43400 Serdang, Selangor, Malaysia

[2]Faculty of Business, International University-Malaya Wales, Jalan Tun Ismail, 50480 Kuala Lumpur, Malaysia

*Corresponding author's email: nadisah@iumw.edu.my

ABSTRACT

This study examines the volatility characteristics and risk-return trade-off of Islamic and conventional indexes using daily data over the period of 1 August 2007 to 30 December 2022. The sample period has been further divided into four periods: full sample period, during-global financial crisis (GFC) period (1 August 2007-31 July 2009), post-GFC period (1 August 2009-21 February 2020) and during COVID-19 period (22 February 2020-30 December 2022). Using GARCH, GARCH-Mean, EGARCH and TGARCH models, this study finds that Islamic and conventional indexes have a memory that extends beyond a single period. Evidence also indicates that their volatility is more responsive to its lag values than it is to fresh news surprises in the market values. Furthermore, the persistence of the volatility for the Islamic index is always higher than the conventional index in every sample period. This study also finds a positive and significant risk premium in the full sample period for both Islamic and conventional indexes, as well as for the Islamic index in the post-GFC period. However, insignificant risk premiums are observed in other subperiods. The present study also finds that both the Islamic and conventional stock markets are weak-form inefficient markets. Interestingly, our study shows that the negative shocks have a higher immediate impact than the positive shocks observed in every period for the Islamic and conventional indexes, except during the COVID-19 period. Hence, with no leverage effect presence during-COVID-19 period for both indexes using EGARCH, this makes the COVID-19 crisis becomes a "unique" event. These findings will aid in quantifying market volatility in Malaysia and provide investors and supervisory entities with crucial knowledge on market efficiency, risk premium, long-memory process, and asymmetric and leverage effects. Finally, investors can consider of investing in the Islamic index in the long run and low volatility periods, which provides higher returns than the conventional index.

Keywords: Islamic index, GARCH family type models, Risk-return trade-off

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