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Performance of Shariah-Based Investment: Evidence from Pakistani Listed Firms

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Abstract : Following the stock selection guidelines provided by the Sharia Board (SB), we segregate the firms listed at Pakistan Stock Exchange (PSX) into Sharia Compliant (SC) and Non-Sharia Compliant (NSC) stocks. Subsequently, we form portfolios within each group based on market capitalization and volatility. The purpose is to analyze and compare the performance of these two groups as the SC stocks have lesser diversification opportunities due to SB restrictions. Using data ranging from January 2004 until June 2016, our results indicate that in most of the cases the risk-adjusted returns (alphas) for the returns differential between SC and NCS firms are positive. In addition, the SC firms in comparison to their counterparts in PSX provides excess returns that are hedged against the market, size, and value-based systematic risks factors. Overall, these results reconcile with one prevailing notion that the SC stocks that have lower financial leverage and higher investment in real assets are lesser exposed to market-based risks. Further, the SC firms that are more capitalized and less volatile, perform better than lower capitalized and higher volatile SC and NSC firms. To sum up our results, we do not find any substantial evidence for opportunity loss due to limited diversification opportunities in case of SC firms. To optimally utilize scarce resources, investors should consider SC firms as a candidate in portfolio construction.

Keywords : diversification, performance, sharia compliant stocks, risk adjusted returns
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