



UNIVERSITI PUTRA MALAYSIA

**A COMPARATIVE ANALYSIS OF PERFORMANCE
OF ISLAMIC AND CONVENTIONAL UNIT TRUSTS
IN MALAYSIA**

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By

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The investment management of the Islamic funds is based on the syariah principles, meanwhile the conventional funds are not restricted to any principles. Hence, the performance of the Islamic funds and conventional funds may have a significance difference. Moreover, the economic condition may influence or have some implications on the performance of both funds.

The study analyzed 65 unit trust funds as the sample of the study. Monthly data were collected over the ten-year period starting from January 1992 up to December 2001. The measure of performance applied in this study includes the non risk-adjusted performance measures, risk-adjusted performance measures and the measurement of risks. Apart from that, Treynor and Mazuy model was also used to measure the funds managers' selection and market timing ability.

The findings revealed that over the ten-year period, the performance of the Islamic funds and the conventional funds are equally well. However, both funds underperformed the

market but it is not statistically significant (which have not been tested in previous studies).

The performance of the funds was influenced by the economic condition. During the economic crisis, the market was badly affected as compared to unit trust funds, hence the funds outperformed the market (however, statistically it is not significant). Islamic funds performed better during bearish economic trend, while the conventional funds showed better performance during bullish economic period.

The findings indicate that the Islamic funds have lower risks as compared to the risk associated with the conventional funds. However, the differences are not statistically significant. Besides that, conventional funds have a marginally better diversification level than the Islamic funds, although both funds were unable to achieve at least 50% market diversification level.

The findings also summarized that both funds managers have poor selection and market timing ability as the values of α and γ are negative. The result implies that funds managers are unable to correctly identify good bargain stocks and also to forecast the price movements of the general market.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia
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**ANALISIS PERBANDINGAN PRESTASI SAHAM AMANAH ISLAM DAN
KONVENSIONAL DI MALAYSIA**

Oleh

FIKRIYAH ABDULLAH

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Pengurusan pelaburan bagi dana Islam adalah berdasarkan prinsip-prinsip Syariah, manakala bagi dana konvensional tidak terikat pada mana-mana prinsip. Dengan itu, mungkin terdapat perbezaan prestasi yang nyata di antara dana Islam dan dana konvensional. Selain dari itu, keadaan ekonomi mungkin mempengaruhi atau mempunyai implikasi terhadap prestasi bagi kedua-dua dana tersebut.

Kajian ini menganalisa 65 dana saham amanah sebagai sampel kajian. Data bulanan bagi jangka masa sepuluh tahun bermula dari Januari 1992 sehingga Disember 2001 dikumpul. Dalam kajian ini, prestasi saham amanah diukur menggunakan pengukuran prestasi tanpa penyesuaian risiko, pengukuran prestasi dengan penyesuaian risiko dan pengukuran risiko. Selain itu, model Treynor dan Mazuy juga digunakan bagi mengukur prestasi pemilihan dan pemaasan pasaran pengurus dana.

Hasil kajian ini menunjukkan, dalam tempoh sepuluh tahun, prestasi dana Islam dan dana konvensional adalah sama. Prestasi kedua-dua dana ini adalah di bawah paras

prestasi pasaran, bagaimanapun ia adalah tidak nyata secara statistiknya (di mana ia tidak pernah diuji dalam kajian terdahulu).

Prestasi dana dipengaruhi oleh keadaan ekonomi. Ketika krisis ekonomi, kesan ke atas pasaran adalah lebih teruk berbanding dengan dana-dana saham amanah, maka prestasi dana berupaya mengatasi prestasi pasaran (bagaimanapun, secara statistiknya, ia adalah tidak nyata). Prestasi dana Islam adalah lebih baik ketika keadaan ekonomi yang menurun, manakala dana konvensional menunjukkan prestasi yang lebih baik dalam keadaan ekonomi yang meningkat.

Hasil kajian menunjukkan bahawa dana Islam mempunyai risiko yang lebih rendah berbanding dana konvensional. Bagaimanapun, perbezaan ini secara statistiknya adalah tidak nyata. Selain itu, dana konvensional mempunyai tahap kepelbagaian yang lebih baik dari dana Islam, walaupun kedua-dua dana tidak dapat mencapai sekurang-kurangnya 50% tahap kepelbagaian pasaran.

Pada keseluruhannya, penemuan menunjukkan prestasi pemasaan dan pemilihan pasaran bagi bagi kedua-dua pengurus dana adalah kurang memuaskan, di mana nilai-nilai α dan γ adalah negatif. Penemuan ini memberi implikasi bahawa pengurus dana tidak berupaya mengenalpasti dengan betul saham-saham yang mempunyai penawaran yang baik dan juga meramalkan pergerakan harga pasaran.

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LIST OF ABBREVIATIONS

BNM	Bank Negara Malaysia
FMUTM	Federation of Malaysian Unit Trust Managers
KLCI	Kuala Lumpur Composite Index
KLSE	Kuala Lumpur Stock Exchange
KLSI	Kuala Lumpur Syariah Index
MASDEX	Malaysia Exchange Securities and Derivatives Asset Quotation
NAV	Net Asset Value
PNB	Permodalan Nasional Berhad
SAC	Syariah Advisory Council
SC	Securities Commission

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

A unit trust fund is managed by a group of professional fund managers who invest the pooled money in a portfolio of securities. Such a diversified portfolio enables investors to spread investments thereby reducing portfolio risk in the event that some investments drop in value and at the same time it increases the chances of picking up good stocks at good prices. The issue of unit trust performance has gain considerable attention among the practitioners and also the academicians due to its strategic implication for investment position. A number of studies have been conducted on the performance of unit trusts in Malaysia but there is no documentation of findings on the comparative performance of Islamic and conventional unit trusts.

Malaysian capital market has been growing at a very fast pace and this has been supportive of the various complex needs of the country. In addition, the market has been developing with the utmost care and vigour that is well-poised to meet the investment needs of general public. Since capital market is functioning based on interest, it does not conform to the Syariah principles, and hence Muslims are not able to freely participate.

In view of the concern about the needs of alternative investment vehicles that conform to the Syariah principles, the Kuala Lumpur Syariah Index (KLSI) has been introduced in 1999 to boost the Islamic capital market (ICM). This has become an integral part of the capital market in order to meet the needs of the Muslim society particularly and investing public generally. The ICM refers to the market where the trading activities are

being performed in ways that conform to the conscience of Muslims and the Islamic law. Based on the Syariah principle, the transactions done in the capital market are free from prohibited activities or elements such as usury (*riba*), gambling (*maisir*) and ambiguity (*gharar*). The compliance to the root values and principles of Islam as well as Syariah is significantly important in order to ensure the success of the ICM.

The growth of Islamic funds has been growing at a faster pace. Presently, the amount of Middle East funds invested in banks throughout the world is estimated to be approximately US\$1 trillion. Apart from that, the expanding rate of global Islamic investment is expected to be between 12% and 15% per annum¹. Thus, with the availability of such a large amount of Islamic funds internationally, the ICM could provide a better platform in the establishment of the Malaysian International Islamic Capital Market Centre. The establishment of such a centre would provide investment opportunities for international investors to invest their money in Malaysia.

The Malaysian population is predominantly Muslims, therefore the potential for the development of Syariah-based Islamic products is enormous in Malaysia. The demand for capital and modes for raising the fund according to Syariah principles will be greater as more Muslims tend to contribute and play an active role in the rapidly growing Malaysian economy. Thus, it is necessary to have ICM working and operating at par with the conventional capital market. Malaysia has the capabilities and the necessary infrastructure to further develop and strengthen the ICM since the number of Muslims

¹ The quarterly bulletin of the Securities Industry Development Centre, May 2002

participation in the capital market is increasing and to a certain extent, there are also non-Muslims investors investing in Islamic investment products.

Generally, investment in the capital market can be classified into two different forms, direct and indirect investments. Direct investment refers to the investors who have the ability to access the capital market and participate in investment activity directly. However, there are investors who are not in a position to access some of the investment instruments available in the market such as shares, money market instruments, futures contracts, commodities, bonds, private debt securities, deposits with financial institutions and others. This is due to the unaffordable price range and some of the instruments are only traded in large denomination. A unit trust is a form of indirect capital market investment. Thus, a unit trust provides a simple but yet affordable mean for investors to invest their money in any of or a combination of the above investment instruments or assets. Table 1.1 indicates the differences between unit trust (indirect investment) and direct investment.

Table 1.1: Differences between Unit Trust and Direct Investment

Factors	Unit Trust	Direct Investment
<ul style="list-style-type: none"> • Spread of risk 	Risk from any one security is reduced.	High risk exposures as funds are being invested in single counters.
<ul style="list-style-type: none"> • Economies of scale 	Institutional investors pay lower commission rates and	Transaction size not usually large enough to be economical.

	transaction costs.	
<ul style="list-style-type: none"> • Expertise 	Investments are being managed by full-time, experience professionals.	Investments are looked after personally by the investor himself, who may not have the time or expertise to do the job thoroughly.
<ul style="list-style-type: none"> • Capital outlay 	Unit trusts offer a wide spread portfolio for a small capital outlay.	The lot size makes it very costly to create a well-spread portfolio.
<ul style="list-style-type: none"> • Convenience 	Administration, such as monitoring of dividends and collecting of dividends is well handled by the fund manager.	The investor has to manage the administration work himself.
<ul style="list-style-type: none"> • Access 	Able to invest into regional and global markets at lower cost, with proper research.	May not be able to invest personally into regional and global markets.

A unit trust is a professionally managed, collective form of investment whereby the financial resources of individuals, corporations, society and institutions that have

common investment objectives are pooled together for the purpose of making large-scale investments in a selected portfolio of authorized investments. In addition, the investors of a unit trust will not only enjoy the earning potential of large-scale investors, but their investment risks are also spread out over a broad selection of securities².

From the Islamic perspective, through the Islamic unit trust, the *Ummah* (society) can cooperate to pool their investment resources. Indirectly this approach promotes collective responsibility and collective effort (*muafakat*), a characteristic of society demanded by the tenets of Islam.

The Islamic unit trust is an investment vehicle that is governed by the Syariah principle. The principles that governs the Islamic unit trust are derived from the source of the Islamic Jurisprudence, mainly the Al-Quran, Sunnah, Ijma' and Qiyas. Based on Syariah principles, what is termed as the Islamic funds, are funds that invest in 'halal' investments. 'Halal' or permissible investments are defined by the Syariah principles and are further discussed in the second chapter, under the section of stock selection criteria. As such, business activities that contravene such principles are not considered as Islamic funds. Thus, it allows the Muslim investors to fulfill both their religious obligations as well as investment needs.

This study addresses four main issues of interest. Firstly, to determine if there exists any significant difference in the performance of Islamic and conventional unit trust funds as there is no particular principle that guides the investment activities of the conventional

² RHB Master Prospectus, August 25, 2001 and expires on August 24, 2002

unit trust funds. On the other hand, the Islamic unit trust funds are based on the Syariah principles. Furthermore, the study also aims to determine whether the unit trust performance was affected by the recent economic crisis. Secondly, like any other investment alternatives, unit trust funds are very much associated with risks. Risks and returns move in the same direction because they have a positive relationship. Hence, although the level of risks associated with a unit trust is considerably low as compared to other alternatives, it still has to commensurate with the rate of returns generated by the unit trusts. Another issue is regarding diversification, which is important in order to minimize the level of risks. Hence, the unit trusts should be able to diversify its investment at least at the level that is difficult to be achieved by the individual investors. Finally, determination of the managers' selection and timing abilities also need considerable attention. These abilities are significant because it may influence the performance of unit trusts.

As at December 31, 2001, the unit trust industry in Malaysia only accounts for 10.18% of market capitalization as compared to the amount of money tied up in capital market such as in shares, deposits or insurance. This market capitalization is low compared to the other countries such as Thailand, India and Taiwan where mutual funds hold over 15%, meanwhile a higher market capitalization for unit trust can be seen in the U.S. and European markets as indicated in Table 1.2.

Table 1.2: Investment by Unit Trust as a Percentage of Market Capitalization as at February, 2001

Country	% of Market Capitalization
Thailand	15
India	15
Taiwan	15
U.S.	40
European	40
Malaysia	10.12

Source: News Straits Times, April 20, 2002

The popularity of Islamic unit trust cannot be denied as the number of funds offered by the larger players in the domestic unit trust industry keeps on increasing. However, as mentioned earlier, the size and market share of Islamic unit trust is relatively small as compared to the entire industry. As at December 31, 2001, there were 32 Islamic funds, including funds approved but not yet launched. These funds represented 19.5% of the total 164 unit trust funds and the net asset value (NAV) of Islamic funds amounted to RM 2.42 billion.

This is a good sign for the growth of Islamic unit trust funds because the funds have increased more than four times as compared to the number of funds in 1995 which have only 7 funds. Furthermore, the NAV of Islamic unit trust funds amounted to RM2.42 billion constituting only 5.11% over the total NAV of RM47.34 billion as shown in Table 1.3. Thus, based on these figures and with the growing investors' population (with

high savings rates, miscellaneous eligible investment products, and the sizable pool of global Islamic funds), there is a potential to further develop the Islamic unit trust funds to be more competitive, attractive and able to capture a wider scope of the unit trust industry.

Table 1.3: Profile of the Islamic Unit Trust Funds and the Malaysian Unit Trust Industry as at December 31, 2001

	Islamic Unit Trust Funds	Total Industry	Islamic Unit Trust Funds to Total Industry (%)
Number of management companies	23	37	62.6
Number of approved funds*	32	164	19.51
Units in circulation (billion units)	4.26	71.39	5.97
Number of accounts (million)	0.266917	9.99	2.67
NAV of funds (RM billion)	2.42	47.34	5.11

*Include funds approved but not yet launched

Source: Securities Commission

Malaysian unit trust industry has gained acceptance as an alternative investment channel for long term savings as well as for retirement planning, even though the amount of money invested in unit trust is small compared to the portion of money tied up in shares, deposits or insurance. Thus, this current situation implies that although Malaysian unit trust has come a long way, which is more than four decades, but there is still ample room for improvement.