RESEARCH REPORT

PPPP(N)/2006

SUMBANGAN

RESEARCH REPORT

THE MALAYSIAN UNIT TRUST FUNDS PERFORMANCE EVALUATION: A COMPARISON OF ISLAMIC AND CONVENTIONAL MUTUAL FUNDS

RESEARCH CODE: PPPP(N)/2006

LEAD RESEARCHER:

PROF. DR. JUHARI BIN SAMIDI

RESEARCHERS:

DR. MOHAMED SHARIF BASHIR MOHAMED ELSHERIF
WAN RASYIDAH BINTI WAN NAWANG

Perpustakaan USIM

1000042491

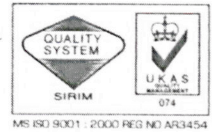
UNIVERSITI SAINS ISLAM MALAYSIA

AUGUST 2008

UNIVERSITI SAINS ISLAM MALAYSIA

جامعة العلوم الإسلامية الماليزية

ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA



MS ISO 9001 : 2000 REG NO AR3454

RESEARCH REPORT

THE MALAYSIAN UNIT TRUST FUNDS PERFORMANCE EVALUATION: A COMPARISON OF ISLAMIC AND CONVENTIONAL MUTUAL FUNDS

RESEARCH CODE: PPPP(N)/2006

UNIVERSITI SAINS ISLAM MALAYSIA
Bandar Baru Nilai, 71800 Nilai,
Negeri Sembilan

RESEARCH REPORT

THE MALAYSIAN UNIT TRUST FUNDS PERFORMANCE EVALUATION: A COMPARISON OF ISLAMIC AND CONVENTIONAL

RESEARCH CODE: PPPP(N)/2006

LEAD RESEARCHER:

PROF. DR. JUHARI BIN SAMIDI (s417)
(Faculty of Economics and Muamalat)
Tel: 06 – 798 8728
Email: juhari@usim.edu.my

RESEARCHERS:

DR. MOHAMED SHARIF BASHIR MOHAMED ELSHERIF (s264)
(Faculty of Economics and Muamalat)
Tel: 06 – 798 8755
Email: sharif@usim.edu.my

WAN RASYIDAH BINTI WAN NAWANG (s378)
(Faculty of Economics and Muamalat)
Tel: 06 – 798 8724
Email: wrasyidah@usim.edu.my

UNIVERSITI SAINS ISLAM MALAYSIA
Bandar Baru Nilai, 71800 Nilai,
Negeri Sembilan

AUGUST 2008

ACKNOWLEDGEMENTS

Bismillahirrahmanirrahim

Alhamdulillah, we thank Allah SWT for granting us with courage, patience and hard work in completing this research project.

We also would like to take this opportunity to express our gratitude to those who gave valuable comments and constructive criticism, directly or indirectly in making this research possible.

The deepest appreciation we owe to the Universiti Sains Islam Malaysia (USIM) for funding this research. Our utmost indebtedness goes to the Vice Chancellor of USIM, Y.Bhg. Prof. Dato' Dr. Abdul Bin Shukor Haji Husin and the Deputy Vice Chancellor (Academic and International), Y.Bhg. Prof. Dato' Dr. Muhamad Bin Muda, for their encouragement and continuous support throughout this research project.

We are also thankful to the Dean of the Faculty of Economics and Muamalat, USIM, Y.Bhg Prof. Dr. Hajah Mustafa Bin Mohd Hanefah for guiding us till the completion of this research.

Our thanks also go to the staffs of the Centre of Research Management and Conference (PPPP), USIM for the cooperation given. We are equally thankful to the Bursa Malaysia' librarians and the Federation of Management Unit Trust Managers' (FMUTM) librarians in assisting us from the beginning in collecting related data for our research. Not forgetting our research assistant En. Aznul Faizal Bin Ahmad, for his assistance towards the completion of this research.

Finally, our deepest gratitude to our beloved families for their inspiring and understanding in this stressful academic endeavor.

Wassalammualaikumwarahmatullahiwabarakatuh.

ABSTRACT

The issues of unit trust performance has gained considerable attention due to its strategic implication for investment position. A number of studies have been conducted on performance evaluation of unit trust but without comparison between Islamic and conventional unit trusts. The main objective of this study is to evaluate the overall performance of Islamic and conventional unit trust funds in Malaysia. This study provides some insights on the risk, return, diversification, market timing and selection ability of selected unit trusts in Malaysia for the period of 2002 to 2006. It is found that conventional funds outperform the market and on the contrary, Islamic funds underperform the market. In terms of risk, both conventional and Islamic funds are less risky than the market. This indicates that both unit trust funds are safer investments compared to the market funds. Based on the results of *R-square* the overall diversification was low. This shows that managers are conservatives in selecting securities to be included in the investment portfolio. From results of the selection abilities and timing performance, the overall fund managers have positive timing and selection abilities irrespective of the fund objective. However, further analysis shows that managers have negatives timing abilities during 2004-2006, which implied that managers failed to shift their portfolio beta in the same direction to the market portfolio. It is clear that the managers are lacking of stock maintaining skills. The poor market timing capabilities of fund mangers is not peculiar to Malaysia's fund mangers as the literature similar results in developed market.

TABLE OF CONTENTS

	Page
ACKNOWLEDGEMENTS	**i**
ABSTRACT	**ii**
TABLE OF CONTENTS	**iii**
LIST OF TABLES	**v**
LIST OF FIGURES	**v**
CHAPTER ONE: INTRODUCTION	**1**
1.0 Introduction	1
1.1 Growth of Unit Trust Industry in Malaysia	1
1.2 Malaysian Islamic Unit Trust	2
1.3 The Development of Unit Trust in Malaysia	5
1.3.1 The Formative Years: 1959 to 1979	5
1.3.2 The Period from 1980 to 1990	6
1.3.3 The Period from 1991 to 1996	6
1.3.4 The Period from 1997 to Present	6
1.4 Types of Unit Trust	7
1.4.1 Equity Unit Trust	7
1.4.2 Property Unit Trust	8
1.4.3 Islamic Unit Trust	8
1.4.4 Balanced or Diversified Unit Trust	9
1.4.5 Specialty Unit Trust	9
1.5 Research Problems	9
1.6 Research Objectives	10
1.7 Research Questions	10
1.8 Significance of the Research	11
1.9 Research Scope and Limitation	11
CHAPTER TWO: LITERATURE REVIEW	**12**
2.0 Introduction	12
2.1 Conventional Unit Trust Studies	12
2.2 Islamic Unit Trust Studies	18
2.3 Comparative Studies of Unit Trust Funds	23
CHAPTER THREE: RESEARCH METHODOLOGY	**27**
3.0 Method Specification	27
3.1 Measurement of Performance	27
3.2 Measurement of Risk	30
3.3 Measurement of Selectivity and Timing	31
3.4 Data Sources	31
CHAPTER FOUR: FINDINGS	**33**
4.0 Data Source and Sample Selection	33
4.1 Correlation of Benchmarks	33
4.2 Return and Risk Profile for Conventional Funds	34
4.2.1 Return	35
4.2.2 Risk – Standard Deviation	36

4.2.3 Risk – Beta 37
4.3 Return and Risk Profile for Islamic Funds 38
4.3.1 Return 38
4.3.2 Risk – Standard Deviation 39
4.3.3 Risk – Beta 40
4.4 Performance Measures 40
4.4.1 Treynor Index 40
4.4.2 Sharpe Index 41
4.4.3 Jensen Index 41
4.5 Risk Adjusted Performance 41
4.6 Degree of Diversification 42
4.7 Selectivity and Timing Performance 43
4.8 Summary 44

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS 45

BIBLIOGRAPHY 47

APPENDICES
Appendix I: List of Conventional Unit Trust Funds
Appendix II: List of Islamic Unit Trust Funds
Appendix III: NAV and Return

LIST OF TABLES

		Page
Table 1	Statistics of Unit Trust Funds in Malaysia	2
Table 2	Statistics of *Shariah* Based Unit Trust Funds in Malaysia	4
Table 3	Sample Selection	34
Table 4	Average Return and Risk Profile for Conventional Unit Trust Funds	35
Table 5	Average Return for Conventional Unit Trust Funds	36
Table 6	Standard Deviation for Conventional Unit Trust Funds	37
Table 7	Average Beta for Conventional Unit Trust Funds	38
Table 8	Average Return and Risk Profile for Islamic Unit Trust Funds	39
Table 9	Average Return for Islamic Unit Trust Funds	39
Table 10	Standard Deviation for Islamic Unit Trust Funds	40
Table 11	Average Beta for Islamic Unit Trust Funds	41
Table 12	Risk Adjusted Performance	42
Table 13	R-Square for Unit Trust Funds	43
Table 14	Average Selectivity Performance	44
Table 15	Average Timing Performance	44

LIST OF FIGURES

		Page
Figure 1	Benchmarks Correlation	35

RESEARCH REPORT

THE MALAYSIAN UNIT TRUST FUNDS PERFORMANCE EVALUATION: A COMPRISON OF ISLAMIC AND CONVENTIONAL MUTUAL FUNDS

RESEARCH CODE: PPPP(N)/2006

LEAD RESEARCHER:

PROF. DR. JUHARI BIN SAMIDI

RESEARCHERS:

DR. MOHAMED SHARIF BASHIR MOHAMED ELSHERIF
WAN RASYIDAH BINTI WAN NAWANG

UNIVERSITI SAINS ISLAM MALAYSIA

AUGUST 2008

CHAPTER ONE
INTRODUCTION

CHAPTER ONE
INTRODUCTION

1.0 Introduction

A unit trust fund is a collective investment scheme, which pools the savings of investors with similar investment objectives in a 'special' fund managed by professional fund managers. The fund will then be invested in a diversified portfolio of equities, fixed income securities and other assets in accordance with the fund's investment objectives and as permitted under the Securities Commission's (SC) guidelines on unit trust.

The organization of a unit trust fund is a tripartite relationship between the manager, the trustee and the unit holders. The obligations and the rights of each of the three parties are specified in the Deed, a legal document drawn up by the manager and registered with the SC. The Deed is designed to govern the operations of the fund whilst the trustee holds all the assets.

The issue of unit trust performance has gained considerable attention among researchers due to its strategic implication for investment decision. A number of studies have been conducted on performance evaluation of those funds but without comparing the Islamic and the conventional unit trusts. This study however covers the evaluation of both Islamic and conventional unit trusts in comparative context by measuring the risk associated with the investment and determining the selection and timing predictive ability of both fund management.

1.1 Growth in the Unit Trust Industry in Malaysia

The investment management is a growing industry in Malaysia. By December 2006, total funds managed by licensed fund management companies increased to RM164.42 billion showing an increase by 22.6 percent over the 2005 (Securities Commission, 2007). Of this, unit trust funds continued to be the main contributor of funds under management. Figure of the management of unit trust increased to RM121.77 billion in 2006 from RM98.48 billion in 2005.

Based on the SC Annual Report 2006, as at the end of December 2006, there were 38 approved unit trust management companies. The number of approved unit trust scheme increased from 340 (end of December 2005) to 392 as at the end of December 2006, showing an increase of 22.4 percent. In addition, the total Net Asset Value (NAV) of unit trust funds as at 31 December 2006 was RM121.77 billion which was an increase of 23.6 percent from the previous year's NAV of RM98.49 billion. The total NAV of unit trust funds at the end of December 2006 represented 14.4 percent of the market capitalization of Bursa Malaysia as compared to 14.2 percent for 2005.

Table 1: Statistics of Unit Trust Funds in Malaysia

(As at 31st December 2006)

No. of Management Companies*	38
No. of Approved Funds*	392
Total Approved Fund Size*	339.884 billion units
Unit in Circulation (billion units)	154.067 billion units
No. of Accounts (million)	11,163,901
Total Net Asset Value (NAV) of Funds	RM 121.762 billion
KLSE Market Capitalization	RM 848.70 billion
% of NAV to KLSE Market Capitalization	14.35%

*Include approved funds but not yet launched

Source: Securities Commission, 2007.

1.2 Malaysian Islamic Unit Trust

Over the last few years, the growth of Malaysian Capital Market is very encouraging. Various financial investment products were introduced to cater to the needs of Malaysian investors. However, the capital market is functioning based on interest, thus it does not conform to the *Shariah* principles as prescribed by the Holy Quran and the Sunnah. Therefore, it is difficult for the Muslim communities to participate freely in the Malaysian Capital Market especially to those who strictly follow the Islamic teachings. Since the majority of Malaysian population is Muslim, Islamic financial products are highly demanded. Responding to these requirement, the government took the initiative to establish the first Islamic bank, namely Bank Islam Malaysia Berhad (BIMB) in 1983, followed by the Kuala Lumpur *Shariah* Index (KLSI) in 1999. As a result of an emerging Islamic banking and financial sector, Malaysia has witnessed active involvement of Islamic Capital Market (ICM). The objective of ICM is to

fulfill the investment needs of Muslim investors. Based on the *Shariah* principles (Islamic law), financial transactions taking place in the capital market should be free from activities prohibited by Islam such as usury (*riba*), gambling (*maisir*) and ambiguity (*gharar*).

Islamic unit trust fund is one of the Islamic financial products present in the market. These funds are operating in compliance with *Shariah* principles. With the introduction of unit trust funds to the ICM, the Securities Commission (SC) was established on the 1st March 1993. The establishment of SC is to promote, maintain fair, efficient, secure and transparent securities and future markets and to facilitate the orderly development of an innovative and competitive capital market. In addition, responsibility of the SC is to supervise and regulate all issues related to unit trust schemes, the trust fund companies and the investors. From the Islamic perspective, investing in Islamic unit trusts is about the contractual relationship (*'aqd*) between a unit trust company and the respective investors. All investment companies which have Islamic unit trust component is required to have their own *Shariah* boards to advise, monitor and ensure that the investment operations and portfolios are managed in compliance with *Shariah* principles.

On May 1996, the SC has established a *Shariah* Advisory Council (SAC) which is to oversee the operations of the ICM in Malaysia fulfills the *Shariah* principles. The SAC applies some standard procedure for approval of *Shariah* compliance securities. The non-compliant securities will be excluded from the approved securities based on a number of criteria as follows:

a) Operations based on interest *(riba)* such as activities of commercial and merchant banks, finance companies and investment funds,
b) Operation involving gambling,
c) Activities involving sale and/or production of forbidden *(haram)* products such as non-halal foods, and
d) Operation containing elements of uncertainty *(gharar)* such as conventional insurance businesses.

The Islamic unit trusts in Malaysia have been operating since the launch of the first Islamic equity fund which is Arab-Malaysian Tabung Ittikal in 1991 followed by Tabung Amanah Bakti by Asia Unit Trust in1993. Since then, the Islamic unit trusts have grown steadily and

significantly. Based on the BNM Annual Report 2003, 14 new Islamic funds were launched in 2003 compared to eight funds in 2002, bringing the total number as at December 2003 to 50. The NAV has also increased by almost 50 percent to RM RM4.7 billion. As at 30th of June 2004, there were 65 Islamic unit trust funds in Malaysia, with total approved fund of 31.2 billion units and a NAV of RM 5.4 billion commanding seven percent of total NAV of the country's unit trust industry.

In 2006, the SC approved another 17 new *Shariah*-based unit trust funds bringing the total funds to 100 or 24 percent of the 416 approved funds. Out of this, 50 were equity funds, 18 were *Sukuk* funds, 19 were balanced funds and the remaining were money market funds, structured products, feeder funds and fixed income funds. Table 2 shows the detail statistics of *Shariah* based unit trust funds in Malaysia as at end December 2006.

Table 2: Statistics of *Shariah* Based Unit Trust Funds in Malaysia

(As at 31st December 2006)

No. of Approved Funds*	100
Total Approved Fund Size* (billion units)	64.3 billion units
Unit in Circulation (billion units)	18.54 billion units
No. of Accounts (million)	11,163,901
Total Net Asset Value (NAV) of Funds	RM 9.17 billion
KLSE Market Capitalization	RM 848.70 billion
% of *Shariah* based to total industry	7.5%

*Include approved funds but not yet launched

Source: Securities Commission, 2007

The growth of NAV of *Shariah*-based unit trust funds was at a compounded annual growth rate of 33.8 percent from 1997 to 2006 superseding the industry's growth rate of 15.4 percent. This shows strong demand for Islamic investment products.

Although the growth of Islamic unit trusts market has shown positive results, there are still rooms for development and expansion. Investment in Islamic unit trusts is not only limited to the Muslim investors but is also open to the non-Muslims. Furthermore, the percentage of the Muslim populations who that invest in the Islamic unit trusts is still small. Hence, the investment opportunity in Islamic unit trusts market is vast.

1.3 The Development of Unit Trusts

Malaysia introduced the unit trust concept relatively early compared to its Asian neighbors, when, in 1959, a unit trust was first established by a company called Malayan Unit Trust Ltd. The unit trust industry in Malaysia has therefore only a short history of more than four decades. The development of this industry can be presented in chronological order as follows:

Unit trust in Malaysia was first initiated and established by Malayan Unit Trusts Ltd. in 1959, which later became known as Asia Unit Trusts Bhd. The growth in sales of units in the first two decades was slow due to lack of public interest in this new investment. Within these two decades, the second unit trust company called MARA Unit Trust Bhd was established in 1967.

The year 1981 marked the entry of government participation in the unit trust industry when the Skim Amanah Saham Nasional (ASN), which was launched, by Permodalan Nasional Berhad (PNB). The response was overwhelming. Since then, more unit trust management companies were established with more unit trusts were launched. As a result, the period from 1991 to 1999 witnessed the fastest growth of the unit trust industry coinciding with the peak economic condition.

After the financial crisis in 2001, the unit trust industry experienced another year of strong growth. In 2005, the NAV of managed funds capitalized 14.2 percent of Bursa Malaysia's market at RM98.5 billion at the end of 2005. Further, as a result from the liberalization of overseas investment rules by BNM, has seen numerous of offshore funds, which also contributed, to the growth of the Malaysian unit trust industry.

1.3.1 The Formative Years: 1959 to 1979

The first two decades in the history of the unit trust industry were characterized by a slow growth in sales and a lack of public interest in the new investment product. Only five new unit trust management companies were established, with 18 funds introduced over that period. A number of agencies including the Registrar of Companies (ROC), the Public Trustee of Malaysia, BNM and the Ministry of Domestic Trade and Consumer Affairs regulated the industry. The 1970s witnessed the emergence of state government sponsored unit trusts. This is in response to the Federal Government's call to mobilize domestic household savings.

1.3.2 The Period from 1980 to 1990

This period marked the entry of government participation in the unit trust industry and the formation of a committee to regulate the industry, called the Informal Committee for unit trust funds, comprising representatives from the ROC, the Public Trustee of Malaysia, BNM and the Capital Issues Committee (CIC). The 1980s marked a significant development in the history of the industry when PNB launched the Sekim ASN in 1981. Despite only 11 funds being launched during that period, the total unit subscribed by the public swelled into an unprecedented level because of the overwhelming response to ASN. The 1980s also witnessed the emergence of unit trust management companies, which were subsidiaries of financial institutions. Their participation facilitated the marketing and distribution of unit trusts through bank's branch network that widened investor reach.

1.3.3 The Period from 1991 to 1996

This period witnessed the fastest growth of the industry in terms of new management companies established and funds under management. The centralization of industry regulation following the establishment of the SC on 1st March 1993, coupled with the implementation of the SC (Unit Trust Scheme) Regulation in 1996 and extensive marketing strategies adopted by ASN and Amanah Saham Bumiputera (ASB), played key roles in making unit trust a household product in Malaysia. Consequently the total NAV of funds under management grew more than five-fold from RM11.7 billion at the end of 1990 to RM60.0 billion at the end of 1996. The period also saw greater product innovation and deregulation of the industry.

1.3.4 The Period from 1997 to Present

Although the pace of growth of unit trust funds has moderated since the financial crisis of 1997 – 1998, it has nevertheless maintained its upward trend, in terms of the number of units in circulation and unit holders. As at 29th February 2004, there were a total of 99.6 billion units in circulation held by 10.3 million unit holders. This period also saw that *Syariah* funds continue to gain popularity in terms of the increasing number of funds offered by a host of unit trust providers. New regulation that allowed third party distribution and the licensing of tied-agents involved in the distribution of unit trusts, as well as stock broking companies are being permitted to manage unit trusts, provided further impetus to growth and development in the industry. More banks joined the foray of unit trust management companies as Institutional Unit Trust Agents (IUTAs). With the opening up of various distribution channels and (liberal)

developments on the regulatory front, it is anticipated that the industry will register markedly growth to confirm its importance in the Malaysian Capital Market.

1.4 Types of Unit Trust

Unit trust can be grouped into five types, which are:

1.4.1 Equity Unit Trust

An equity unit trust is the most common type of unit trust. The major portion of its assets is generally held in equities or securities of listed companies. Equity unit trust funds are popular in Malaysia as they provide investors with the exposure to the Malaysian stock market, which is the largest equity market in South East Asia. The performance of unit trust is therefore linked to the performance of the market. A rising market will normally give rise to an increase in the value of the unit and vice-versa.

There is a wide array of equity unit trusts available in the market ranging from funds with higher risk and higher return characteristics to funds with lower risk and lower returns. Funds labeled "aggressive growth funds" generally invest in stocks with higher growth potential, but with possibly higher risk characteristics. Over the long term, it would be anticipated that funds of this sort would produce higher returns but with higher volatility.

Another type of equity unit trust is the "index tracker" fund. Such a fund invests in a range of securities whose performance will most closely match that of Kuala Lumpur Stock Exchange (KLSE) Composite Index. Investors taking this fund type can normally expect returns that closely resemble the performance of the stock market index, both in terms of risk and return.

Equity unit trust can also take the form of income funds i.e. unit trust, which emphasizes income as a priority or a combination of both income and growth. This means that the funds will invest primarily in stocks, which earn significant dividend income, as opposed to stock that pay little or no dividends, but focus on capital growth potential. These trusts invest mainly in corporate bonds, government securities and liquid securities like bills and cash. The objective of a fixed income (or bond) unit trust is generally to provide regular income with less emphasis on capital growth. It is possible however, during periods of volatile interest rates, for these funds to generate both capital gains and losses.

The volatility or risk of fixed income funds is lower than the other equity funds. Capital is more secure especially if the bonds are held to maturity. Due to this risk characteristic, it is normal to expect that the returns offered by these funds are lower than offered by equity unit trusts. However, this is not always the case and there have been instances in the history of Malaysian financial markets, where fixed interest unit trust products have delivered higher returns at significantly less risk.

Often, an investor as part of their overall investment portfolio holds fixed interest units. They provide a useful diversification to insulate an investor's unit trust portfolios from the risk of negative returns in any one period. In some markets, fixed interest investments have a high negative correlation with equities, which means that when equity markets are down, the return from fixed interest are up. This is a very useful concept employed in the management of less risky portfolios.

1.4.2 Property Unit Trust

Property trust invest in real property such as retail and commercial office properties, and provide the investor with an opportunity to gain exposure to the property market in a way which is normally impossible for the small investor. Since buying building requires a huge capital, thus it is impossible for small investors to invest in this type of unit trust. However, with the unit trust product, it is possible to invest into a pool of funds with exposure to the property market.

1.4.3 Islamic Unit Trust

The main objective of an Islamic Unit Trust is to invest in a portfolio of *halal* stocks, which comply with the principles of The *Shariah*. Such *halal* stocks will exclude companies involved in activities, products or services related to conventional banking, insurance and financial services, gambling, alcoholic beverages and non-halal food products.

The return of the Islamic unit trust will also avoid the incidence of *riba* or usury interest through the process of cleansing or purification by the removal of such amounts representing the interest element. Such proceeds are normally donated to charities.

1.4.4 Balanced or Diversified Unit Trust

Some investors seek to maintain an exposure to the full range of assets, all of the time, to decrease the risk of investing. They can either invest directly into specific equity unit trusts, or they can invest in a product that already has a wider range of asset classes in its investment portfolios, e.g. a balanced fund may hold shares, bonds, cash and property.

These funds already have in-built risk mechanisms to ensure that the returns generated by the different asset classes are smoothed out through diversification. Depending on the investors' risk and return appetite, the composition of the asset classes can vary. For instance, a high risk, high return investor may wish to invest in a balanced product that has a higher component of growth assets (i.e. property and equities), whereas a low risk investor may prefer a mix of more defensive assets (i.e. bonds and cash).

1.4.5 Specialty Unit Trust

These unit trust funds invests in a single industry or similar group of industries, in a particular state, specific geographical area or particular class/categories of investments to achieve its investments objectives.

However, in this study the focus is only for two types of funds namely equity unit trust funds and Islamic unit trust funds.

1.5 Research Problems

Unit trusts investments have been widely accepted as one of the investment vehicles in Malaysian Capital Market. Although it is launched as early as in 1950s, significant growth of the unit trust industry can be seen only in 1980s when the PNB introduced the Sekim ASN. From that year to the present, unit trusts investment is growing at a very fast pace.

The most common issue related to unit trust investments is in its performance. Many studies have been conducted both in international and national levels on this issue. In studying performance, most of the scholars use similar indexes such as the Sharpe index, Treynor index and Jensen Alpha Index. These models are able to predict the performance of particular unit trust funds over a certain period using few benchmarks such as KLCI, KLSI and EMAS.

Since the majority of Malaysians are Muslis, the demand for Islamic unit trust funds is also very encouraging. Statistics on the *Shariah* based unit trust industry shown increases yearly, especially in terms of number of funds, number of account holders, the NAV and its contribution to the overall NAV of KLSE market capitalization. The growth of Islamic unit trust funds also interest scholars to study the performance of these funds.

However, most of the studies undertaken concentrated either on the conventional or Islamic funds performances with less attention on the comparison between the performances of both funds. Thus, this study will evaluate and compare the performance of both Islamic and conventional funds' performance.

1.6 Research Objectives

The main objective of this study is to evaluate the overall performance of Islamic and conventional unit trust funds in Malaysia. More specifically, the study has the following underlying objectives.

1. To investigate the performance of Islamic and conventional unit trust funds in light of market timing, selectivity and efficiency.
2. To evaluate the degree of diversification of both Islamic and conventional unit trust funds.
3. To measure the risk associated with the investment in both Islamic and conventional unit trust funds.
4. To provide suggestions for fund managers to be able to improve their investment strategies and to diversify their funds.

In addition, this study provides guidance to improve overall performance of the mutual funds by identifying the weakness and strengths over different economic conditions.

1.7 Research Questions

Based on the research objectives, this study aims to answer the following question:

1. Is there any significant difference in the performance of Islamic and conventional unit trust funds in light of market timing, selectivity and efficiency?
2. Is there any significant difference in the degree of diversification of both Islamic and conventional unit trust funds?

3. What kind of measurement to adopt in order to measure risk associated with the investment in both Islamic and conventional unit trust funds?
4. What are the relevant suggestions and recommendations fund managers to be able to improve their investment strategies and to diversify their funds?

1.8 Significance of the Research

The evaluation of the performance of investment managers is a topic of considerable interest to practitioners as well as academics. This empirical study addresses the issues of unit trusts performance with comparison to Islamic and conventional funds has gained considerable attention due to its strategic implication for investment position in Malaysia.

It is hope that this study will benefit the fund companies, fund managers and related agencies to be able to improve their investment strategies. At the same time they are able to improve and enhance the performance of unit trust funds. In addition, the findings of this study may also present some insights to the government to be able to formulate relevant policies to improve the country's unit trust industry. Finally, it is also hope that, the individual investors will be able to choose wisely the fund that suitable to their investment objectives.

1.9 Research Scope And Limitation

The study covers the selected conventional and Islamic unit trust funds over the five-year period of 2002 to 2006. The total unit trust fund chosen is 40 funds, with 29 conventional funds and 11 Islamic funds.

This study has some limitations:

1. The sample of this study is limited to only 40 funds out of 392 funds available in the market.
2. The period of this study also restricted to only five years.
3. The market benchmarks used were KLSI and KLCI.

Therefore, further study should be conducted to extend the scope of the research.

CHAPTER TWO
LITERATURE REVIEW

CHAPTER TWO
LITERATURE REVIEW

2.0 Introduction

The purpose of this section is to review the studies on Malaysia's Islamic and conventional unit trust performance theoretically and conceptually. It aims at evaluating the previous studies that are related to the topic. All the studies that have been reviewed and evaluated here are relevant to each other. Each study has its own specific areas of investigation, different period of time and approach. Therefore, the primary focus of this section is to review and evaluate all the papers in order to produce a comprehensive study on performance of both unit trust funds.

In analyzing the unit trust performance, most of the research applied the three standard performance measurements, which are the Sharpe index, Treynor index and Jensen Alpha Index. NAV and returns of the unit trust trusts were widely used to examine the performance of unit trusts and the period of time was within a 5 to 10 years.

2.1 Conventional Unit Trust Studies

Studies on the performance of unit trust funds have long standing issues. The issues addressed by past studies include the risk return performance, selection and market timing abilities of fund managers and the level of diversification of unit trust funds.

The classic researches in mutual fund performance evaluation are Treynor (1965), Sharpe (1966) and Jensen (1968). Chang and Lewellen (1985) and Connor and Korakczyk (1986), use APT frameworks to measure performance. Lehmann and Modest (1987) discuss the effect of benchmark used on the performance. Grinblatt and Titman (1989b) discuss some of the important issues in performance evaluation and provide a more general, period weighing measure. Some theoretical articles related to the issue of performance evaluation are Admati, Bhattacharya, Pfliederer and Ross (1986), Dybvig and Ross (1985b), Dybvig and Ross (1985a), Henriksson and Merton (1981) provide theoretical model and Henriksson (1984) present an empirical test of the timing ability of fund managers. Some papers implementing performance evaluation methods are Grinblatt and Titman (1989a), Grinblatt and Titman

(1994) and Malkiel (1995). Shukla and Trzcinka (1992) and Ippolito (1993) provide comprehensive review in mutual funds performance.

Most tests of performance evaluation do not support the hypothesis that managers have superior ability and performance. Ippolito (1989) provides evidence to the contrary. Elton et. al. (1993) provide and point out some flaws in Ippolito's (1989) test design and find no evidence for superior performance after correcting these flaws. Most performance evaluation methods depend on an Asset-Pricing Model (APM) to measure superior performance. These measures suffer from Roll's (1978) critique. Papers that provide measures that do not depend on the APM include Cornell (1979) and Griblatt and Titman (1993).

Two issues related with performance evaluation are persistence of performance and survivorship bias. For persistence of performance, see Hendricks, Patel and Zeckhauser (1993), Brown and Goetzmann (1995), Grinblatt and Titman (1992), Shukla and Trzcinka (1994), Elton et. al. (1996).

Block and French (2002) investigate the effect of portfolio weighting on investment performance evaluation based on the case of actively managed mutual funds. The weight that a fund manager assigns to each security in a portfolio is one of the factors can influence the investment performance evaluation. Thus, this paper examines the impact of portfolio weighting on investment performance evaluation. The purpose of this paper is to address the issues on to what extent do portfolio managers tend to equally weight or value-weight their portfolios, and how do their weighting choices affect investment performance evaluation. To address the issues, this paper uses the derivation of metrics to measure the extent to which a portfolio is tilted toward equal or value weighting. Then, apply these metrics to the sample of 506 monthly returns of actively managed mutual funds in order to show how fund managers typically weight their portfolios. A sample of 506 actively managed mutual funds and the Wilshire 5000 value-weighted and equal-weighted indexes showed funds tend to be equally weighted to a greater degree than they are value weighted, implying that investment performance based solely on a single value-weighted benchmark may not adequately identify excess performance. In conclusion, a two-factor model utilizing both equally weighted and value-weighted indexes is important and provides a better fit than the single index model.

In Malaysia, the performance of unit trust industry has created intense examination among researchers and policymakers since 1980s. Among the earliest study on unit trusts performance was by Chua (1985) and he finds that unit trust funds in Malaysia perform better than the market during his study period, 1974-1984 and the performance is fairly consistent over time. High performance funds tend to relate to those with low expense ration, low asset size and low portfolio turnover. Chua also adds that the government funds perform better than private funds, this may be resulted from certain privileges accessible to only government sponsored funds.

Later studies on Malaysian unit trust performance was done extensively by researchers, among them were by Ewe (1994), Shamsher and Annuar (1995), Tan (1995), Mohamed and Mohd Nasir (1995), Kok and Khoo (1995), Leong (1997), Leong and Aw (1997), Annuar et. al. (1997), Mohd Nawawi et. al. (1999), Shamsher et. al (2000), Soo-Wah Low (2007) and Huson Joher (2007).

In subsequent study by Ewe (1994), Ewe utilizes a sample of 37 funds over a five-year period of 1988-1992. The performance is tested using Jensen's Alpha Measure and Sharpe Index Measure. The results conclude that while risk adjusted returns overall were less than those of stock market implying that the managers had low forecasting ability.

Shamser and Annuar (1995) agree with Ewe. They study the performance the performance of 54 unit trusts managed by 16 unit trust companies over the period of late 80s to early 90s by using adjusted Sharpe's index. Their findings show that the average returns on investment in the Malaysian unit trust were well below the market returns. The degree of diversification of the portfolio is below expectations while the performance is not consistent. Their findings are inconsistent with the study done by Chua.

Tan (1995) also finds results that are inconsistent with Chua's findings. Tan analyzes performance of 12 unit trusts over a 10-year period, 1984-1993. He concludes that unit trusts in general perform worse than the market portfolio. However, he agrees with Chua that government sponsored funds perform better than private funds.

Mohamed and Mohd Nasir (1995) study the performance of 54 unit trusts in Malaysia from January 1988 to December 1992. The sample was further classified based on the type of funds and divided into Malaysian and foreign managed funds. The results of the study show that growth funds have highest returns per unit of risk measured in term of standard deviation whereas; the balanced funds are rank highest in term of the risk per unit of return. The findings reveal that none of the trust funds achieve an acceptable level of diversification. In conclusion they suggest that unit trust are not able to generate and accept reasonable risk-adjusted return regardless of their reliance on professional fund managers.

In another study by Annuar et. al. (1997), they examines the selectively and timing performance of 31 unit trusts for the period of July 1990 to August 1995 by utilizing the Treynor and Mazuy (1966) model. Their result show that the on the average performance of the unit trusts in terms of selectivity is positive, while in terms of timing is negative. They also find that the unit trusts have not achieved the expected level of diversification and risk-return characteristics of the trusts are generally inconsistent with their stated objectives. The findings imply that most unit trust fund managers do not possess market timing ability.

Leong (1997) investigates the performance of 13 unit trust funds in Malaysia from January 1992 to December 1996. He uses KLCI as market's proxy within the framework of APT and Capital Asset Pricing Model (CAPM). He also attempts to evaluate the trust performance before and after 19th March 1994 when the SC announced the new guidelines and regulations for unit trust industry after the stock market crash in 1993. The findings of the study indicate that during the first sub-period and the full period, most of the unit trust funds are superior to the market as compared to second sub-period. Conclusion confirms that the bull market drive in the year 1993 causes most of the local capital assets to perform exceptionally well. Whereas the announcement of new guidelines and regulations for unit trusts and bear capital market conditions which commenced at the end of year 1993 could be the reason that not many unit trusts could beat the market portfolio.

Mohd Nawawi et. al. (1999) evaluate the performance of local unit trust funds over period 1984-1994. Their study focuses on the performance of unit trusts in comparison with unmanaged portfolios consisting common stock and evaluation of the management style in relation to governance, personality, economic consideration and controlling factors.

Evidences from this study on price changed show that in general, unit trusts funds could not outperform the market. However some trends are found that in bullish condition, performance of unit trust could not beat the market but in bearish conditions most of the funds experience lower losses than the market. This result seems to contradict with that recorded by Leong (1997).

Shamsher et. al. (2000) conduct a study on the performance of 41 active and passive non-government funds in Malaysia over a six-year period, January 1995 to December 2000. Their objectives are to determine any significant difference between active and passive unit trust funds performance, to seek whether managers of active funds have greater selection and market timing ability compared to passive fund managers and to know the performance of active and passive unit trust funds in term of level of diversification. The dividends-adjusted return of the KLCI is used as a proxy for the benchmark market portfolio return. Treynor and Sharpe Index are used to measure returns per unit of risk, the Jensen's Index is used to estimate the difference between the actual and expected performance of unit trust funds. While, Fama's (1972) approach is used to determine the active fund-manager's selection capability, and the Treynor and Mazuy (1966) nonlinear model is used to examine fund manager market-timing skill. The diversification level of these funds is less than 50 percent of KLCI diversification level. The findings reveal that there is no significant difference in the performance of these funds. Moreover, the returns of these funds are lower than the returns on market portfolio. Both passive and active managed funds have the same level of diversification and not even 50 percent as diversified as the KLCI. In terms of risk per unit of return, the passive funds performed 4.5 times better than active funds. They conclude that fund managers have significantly inferior selection skills and poorer market timing abilities. This paper also highlights that the regulatory environment could also affect the performance of unit trust.

Mohammad Badri et. al (2006) examines the market timing and security selection performance of 102 equity-based unit trust funds. The monthly data over a 10-year period of January 1995-December 2004 are used for this study. The performance comparison is analyzed based on the fund's investment objectives include growth, income and balance. By using the Treynor and Mazuy (1966), they find that selectivity and timing performance of all

unit trust funds are negative. They conclude that the fund managers possess inferior selection and poor market timing abilities.

Fauziah and Mansor (2007) investigate the aggregate performance of Malaysia unit trust. This paper seeks to analyze the performance of Malaysian unit trusts performance against a market benchmark and their persistence over the period 1991 until 2001 and the dynamics of the funds during shorter sub period from 1991 to 2001. The sample consists of 110 open-ended funds out of which 91 falls under equity type of fund, 12 are balanced funds while the remaining 7 are bond funds. They select a one month Kuala Lumpur Inter Bank Offer Rate (KLIBOR) as a proxy for risk free and present monthly return of KLCI as a benchmark for the market portfolio. In order to measure the performance, three standard performance measures namely Jensen's Alpha, Sharpe and Treynor Index are used besides raw return, market adjusted return, adjusted Jensen's Alpha and adjusted Sharpe Index.

The statistical results point out that the sample has not performed well over the period of study except during the crisis period (1997-1998) when the unit trust market adjusted returns produce positive results. The returns of the funds in entirety are no better than the market. However, the bond funds show better performance than the over and above the market and equity unit trusts due to high interest rate offered during the crisis period (1997-1998). The results also reveal that the there is no significant association between current performance and past performance and thus there is no persistency in performance of the funds.

While most researchers use KLCI as the market benchmark, Leong and Aw (1997) are the first to use different benchmark portfolios, which are KLCI and the Exchange Main Board All-Share Index (EMAS) to study the sensitivity of fund performance. They find that based on risk adjusted performance measures, more funds exhibit better performance than the market when the EMAS index was used. In addition, EMAS index is also shown to produce higher R-squared than the KLCI. Based on their study, they conclude that the choice of market benchmark is important in measuring the performance of Malaysian unit trust funds. Nevertheless, their study focuses on the overall fund performance but they do not evaluate the separate contribution of market timing and selectivity to the fund's overall return.

Soo-Wah Low (2007) uses similar benchmark portfolio as Leong and Aw (1997) when he conducts a study on Malaysia unit trust funds performance during up and down market conditions based on a comparison of market benchmark. His study examines how the market benchmark affects the selectivity and timing performance of the funds by using the KLCI and EMAS Index. He seeks to investigate whether selectivity and timing performance is sensitive to the market benchmark. The data in this study is collected from 40 Malaysian unit trust funds which monthly price records and distribution information were available for a 5-year period from January 1996 to December 2000. Sow applies Jensen's (1968; 1969) model to estimate the overall fund performance and Henriksson and Merton's (1981) model to separate the fund manager's investment performance into selectivity and market-timing components.

The findings reveal that, on average, the funds show negative overall performance with the market benchmark. In conclusion, the market benchmarks do not affect much on the investment components (timing and selectivity) and this concludes that timing and selectivity are not too sensitive to the market benchmarks. His findings are of contradict to the Leong and Aw's (1997).

Huson Joher (2007) studies whether a single and multi index model serves a better proxy for unit trust performance evaluation focusing on selectivity and diversification. He also analyzes timing ability of fund manager using quadratic regressions of Treynor and Mazuy. The sample size chosen was from 1998 to 2004, which includes 50 unit trust funds (25 income funds, 25 growth funds and 10 balanced funds). These funds were classified according to its investment objectives and risk levels. Bursa Saham Malaysia Composite Index is used as a benchmark portfolio and three-month Treasury bills act as a proxy for risk free rate. The findings show that there is an evidence of difference in the performance (selectivity). He concludes that in general, fund managers perform poorly in security analysis and market timing but perform fairly in maintaining well-diversified portfolio.

2.2 Islamic Unit Trust Studies

Previous studies by western researchers on Islamic unit trust funds were quite limited compared to the studies done by Malaysian researchers. Most of the western scholars did a study on the performance of ethical funds as compared to Islamic mutual funds. According to

Zurina and Mohd Azlan (2004) all Islamic unit trusts funds are ethical funds however, not all ethical funds are Islamic.

Ethical fund is defined as one of the socially responsible investment platforms. Ethical funds are becoming popular and highly demanded especially in the developed countries such as the United States, United Kingdom and some European countries. Investment activities of the ethical funds attracted many investors whereby they do not invest in companies whose activities create damages, whose products include alcohol, tobacco, gambling, armaments, exploitation of animals, and who deal with oppressive government regimes (Zurina and Mohd Azlan, 2004).

While in the domestic market Malaysia, the Islamic unit trusts funds performance was examined by Arbi (1999), Shariff (2002), Fikriyah et. al. (2004), Abdul Ghafar and Mohd Saharudin (2003), Mohamed Azlan Shah et. al. (2004) and Zurina and Azlan (2005). These studies provided some insights into performance of Islamic trust funds in Malaysia by measuring the nature and characteristics of these Islamic trust funds.

Azwani (2002) examined the performance of 14 Islamic unit trusts in Malaysia for the six years period from 1996 to 2001. His results have shown generally that Islamic unit trusts performed better than the market especially during the bear period. The risk-adjusted performance measure showed that Islamic Unit trusts not only performed better than market, but it also performed significantly better than the risk-free investments. Conversely the findings confirmed that the risk undertook by Islamic unit trust was not congruent with the stated objective of the fund in the prospectus. The Islamic unit trusts failed to provide diversification in investment even through diversification is one reason why investors invest in unit trust. The mangers of Islamic funds showed negative timing ability during the bear period. This indicated that the fund managers failed to shift their portfolio betas to be consistent with the direction of the market portfolio. Generally, Azwani's study showed that the investors are better off investing in Islamic unit trust as compared to the "naïve buy and hold" investment strategy, particularly during the bear period.

Abdul Ghafar and Mohd Saharudin (2003) conducts a study to investigates the relationship between return and beta for Islamic unit trust using the cross-sectional regression analysis,

examines whether beta play a role in explaining cross-sectional differences in Islamic unit trusts returns and makes a comparison between conditional and unconditional relationships based on the adjusted R-square and the standard error statistics. Their results show that there is a significant positive relationship in up-market and significant negative relationship in down-market, beta could be used as a tool in explaining cross-sectional differences in Islamic unit trusts' returns and a measure of market risk and the adjusted R-squared and standard error of the conditional relationship is higher in down-markets than in up-markets. They conclude that investors in Islamic unit trusts are risk averse because they choose to invest in Islamic unit trusts, which have a lower level of risk.

Fikriyah et. al. (2004) analyze performance of Islamic unit trusts funds by measuring the risk associated with the investment and to evaluate the degree of diversification of Islamic unit trusts funds. This paper applies Treynor's index to measure the excess return per unit of systematic risk. Sharpe's index measures the reward/risk ratio with the fund's standard deviation as a measure of total risk. Jensen's index measures the difference between the actual and expected performance of unit trusts funds. The total risk on the investment was measured using the standard deviation.

Both non-risk adjusted performance and risk adjusted performance of Islamic unit trusts funds were outperformed by the market portfolio. The level of unit trusts is also low as compared to the market. The diversification level of Islamic unit trust funds is low and not even 50 percent of the market. This paper contributes to identify the weaknesses and strengths of the Islamic unit trusts funds. Thus, the Islamic unit trusts funds performance can be improved with necessary rectification action.

Mohamed Azlan et al. (2004) study the performance of Islamic unit trusts funds in Malaysia. The purpose of their study on unit trusts funds based on *Shariah* principles has gained tremendous acceptance from the day of their introduction in Malaysia and eagerly sought after by the investors mainly Muslims. This fact is substantiated by the data collected on the number of unit trusts funds, units in circulation and the net asset value of private Islamic trusts funds. Although the Islamic trusts funds can be deemed as successful in gaining the investors' attention to participate in the *Shariah* permissible investment portfolios, this criteria of growth alone is not sufficient to be the guiding principle in selecting which funds to

commit. Potential investors will commonly make an investment in unit trusts, which they reasonably believe show good and persistence performance. Previous studies in Malaysia conducted on the performance and persistence in performance of unit trusts mainly focused on the conventional trusts funds or focused only on one period of time. In this article, the authors seek to examine the Islamic trusts funds' performance and their persistency in performance through the differing time intervals and on year-to-year basis starting from 1999 to 2003.

Regarding methodology adopted in this paper, 12 Islamic unit trusts funds out of 44 funds available in the market at the time the study was conducted, were evaluated using raw return, Sharpe index, Treynor index and Jensen Alpha index. The paper focused on weekly closing prices from May 1999 to the first week of May 2003 and selects the Kuala Lumpur *Shariah* Index as a benchmark for the market return and in computing betas based on the CAPM. Apart from the said benchmark, the authors also present the KLCI as the market benchmark. The risk-free rates are also taken into consideration in evaluating the performance whereby the authors have selected the Islamic weekly Inter Bank Rates (IIBR) as the indicator.

The following findings are made by the authors after thorough evaluation, persistence in performance measured by average raw returns and the risk adjusted returns of all the 12 funds cannot be proved in the differing time periods. The funds outperform the market at one time but fail to persist at other time. This study indicates the average raw returns of all funds in each year and in several time intervals against the market benchmarks (the KLSI and the KLCI) and the risk free rates. On average, the funds raw returns were positive and above both the market rates as well as the risk free rates in 1999. However the performance did not persist, since in 2000 and 2001, the returns were below the market rates. In 2002, there were above the market rates again even though in negative sign and in 2003, there were the worst with the average of -0.2585 percent weekly. The similar trend is also found in Table 2 wherein the performance of the trusts funds against the market was up and down given the average returns were calculated in time interval of one to five years.

However, if each individual fund is analyzed, it is found that some funds can persist over time than the others. Result also lists out ranking performance of each trusts fund based on the raw returns. It indicates the performance of each fund against the market (KLSI). The figures

reveal that the performance of some funds can persist over time while others do not. Investigating through different time horizons, ABRAR Investment Fund (AIF), Tabung Amanah Bakti (TAB), BHLB Pacific Dana Al-Ihsan (BHLBPDI) and Kuala Lumpur Ittikal Fund (KLIF) are able to perform above the market at all time while Amanah Saham Wanita (ASW) fails to do so over the same period thus, the persistence in performance does exist in individual fund.

Another study by Zurina and Azlan (2005) on Islamic unit trusts as ethical funds in Malaysia. Regarding the purpose of the study the introduction of ethical funds in US and some European countries serves as an alternative avenue for those with social responsibility inclination to put their money in. Malaysia is of no exception when it comes to the establishment of such funds. However, in this paper it has been pointed out that the development of the funds is still in the state of infancy unlike the Islamic funds, which receive a phenomenal increase in demand since their introduction. Both funds share some similarities, which attract this paper to focus on one vital question, which is whether the ethical funds can be regarded as Islamic funds or vice versa. Besides the main question being thoroughly analyzed, the paper also focuses on examining the development and performance of the ethical funds in US, UK and several European countries as well as in Malaysia.

In relation to methodology, the authors have adopted a comparative study whereby the criteria of two Malaysian ethical funds are selected namely Mayban Ethical Funds and Phillip Master Fund Ethical Fund to be analyzed and compared with the general criteria of the Islamic Funds. In comparing the funds, the authors have focused on the investment objective of the funds, the investment process of the funds and the guidelines and principles of the funds.

On the findings part, the analysis reveals that the investment criteria of the ethical funds in some aspect is still not inconformity with the *Shariah* principles of the permitted investment parameters thus rejecting the idea that the ethical funds can be regarded as Islamic funds. However, the avoidance or negative criteria adopted by the ethical funds where certain objectionable activities and products made by companies are avoided from the investment portfolios, is in accordance with that of the Islamic funds. Unlikely, this sole resemblance cannot in any way justify the idea that both funds are similar in overall characteristics

although the Islamic funds can be said as ethical since the funds meet the avoidance criteria adopted by the ethical funds.

2.3 Comparative studies on Unit Trusts Funds

Mallin et. al (1995) analyzes the comparative performance of ethical and non-ethical mutual funds in United Kingdom. They find that fund size and fund age may have an effect on financial performance. By matching the ethical funds with the non-ethical funds using fund size and formation age, they conclude that the ethical funds tend to outperform matched non-ethical funds.

Beuer et. al (2003) investigates the performance and risk sensitivities of Canadian ethical mutual funds vis-a-vis their conventional peers. In order to cope with the methodological deficiencies most prior papers suffered from, they use enhanced performance measurement approaches in the spirit of Carhart (1997) and Ferson and Schadt (1996). Using these approaches they are able to investigate aggregate performance and investment style of ethical funds relative to their conventional counterparts. After controlling for style tilts and allowing for time variation in factor loadings and expected return, the Canadian results are consistent with the general perception that any performance differential between ethical mutual funds and their non-ethical peers is statistically insignificant. Furthermore, examination of the difference in factor exposures reveals evidence suggesting that Canadian ethical mutual funds do not follow significantly different investment styles.

Bauer et. al (2005) extend their earlier findings by examines the ethical mutual funds performance using an international database containing 103 German, UK and US ethical mutual funds . By applying a Carhart multi-factor model (1997) they overcome the benchmark problem most prior ethical studies suffered from. After controlling for investment style, they find no evidence of significance differences in risk-adjusted returns between ethical and conventional funds for the period from 1990 to 2001. Their results also suggest that ethical mutual funds underperformed the conventional funds, which perhaps indicating a learning phase. Finally, the financial performance estimates are robust to the inclusion of ethical indexes, which, surprisingly, are not incrementally capable of explaining ethical mutual fund return variation.

Said and M. Khabir (2005) conducts a comparative study on Islamic mutual funds and conventional mutual funds. Using 46 samples of Islamic mutual funds from the period starts on January 1, 1997 to August 31, 2002. These funds are classified into eight-sector based category, which are Global equity funds, American equity funds, European equity funds, Asian equity funds, Malaysian equity funds, Emerging market equity funds, Emerging markets-South Africa and Small cap/Technology funds. The NAV was calculated monthly for all these funds as well as the returns of the Standard and Poor (S&P) 500 Composite Index (as proxy for conventional funds) and the five FTSE Islamic Indices (Global, Americas, Europe, Pacific Basin and South Africa) and the Dow ones Islamic Technology Index (as proxy for Islamic funds benchmark). The performance measurements used are Sharpe, Treynor, Jensen, Fama and the Transformed Sharpe measure by Jobson and Korkie (1981). The period of study is divided into two equal sub period, the first 34 months ending on October 31, 1999 and the remaining 34 months to reflect the booming-slowing sub-periods.

The results of the study find that the performance of Islamic unit trusts funds is consistent across the difference used measures and benchmarks. The Emerging market funds category shows the best performance and the Asian fund category is the worst performer. In addition, the ANOVA test shows there is no statistically significant difference exists in the performance of funds compared to all used indices. Thus, they concludes that the behavior of Islamic mutual funds does not differ from that of conventional, with some *Shariah* compliant mutual funds over-performing their benchmarks and others under-performing them. Another finding is that, the first period of study witnessed a booming equity market while the second was a declining market. The performance during recession is better for Islamic mutual funds compared to the booming sub-period. This implies that the performance of the funds being studied is improving with time, as fund managers are gaining more experience and sense of the market. Another implication is that Islamic mutual funds might be good hedging investment for any equity investor, if used to hedge against market downturns and recessions.

In general, the major conclusion from this study is that the conventional investors can consider Islamic mutual funds in their portfolio collection especially during slow market periods, yet the onus remains on the investors to screen out various candidate mutual funds according to their performance regardless of whether the fund is conventional or Islamic or ethical or etc.

BIBLIOGRAPHY

Abdul Ghafar, I. and Mohd Saharudin, S. (2003), "The conditional CAPM and cross-sectional evidence of return and beta for Islamic unit trusts in Malaysia", *IIUM Journal of Economics and Management*, Vol. 11 No. 1, pp. 1-31.

Admati, A. R., Sudipto B., Pfliederer, P. and Ross, S. A. (1986), "On timing and selectivity", *Journal of Finance*, Vol. 41 No. 3, pp. 715-730.

Amanah Saham Kedah Berhad. (2004), "Uniquely Islamic", *UT Today Magazine,* FMUTM Publication. Vol. 2 No. 1.

Annuar, M. N., Shamser M. and Ngu, M. (1997), "Selectivity and timing: evidence from the performance of Malaysia unit trusts", *Pertanika Journal of Social Science and Humanities*, Vol. 5 No. 1, pp. 45-57.

Arbi, K. R. (1999), "The characteristics and performance of Islamic unit trusts funds in Malaysia within the Capital Asset Pricing Model Framework". Unpublished Master Dissertation, International Islamic University Malaysia, Kuala Lumpur.

Azwani, H. (2002), "The performance of Islamic unit trusts in Malaysia", Unpublished Project Paper, Universiti Putra Malaysia.

Baharuddin, M. H. & Azwan, A. R. (2006), "comparative performance of conventional fund with Islamic funds and between assets allocation types in Malaysia", *CD Proceeding of iBaf2006*, Universiti Sains Islam Malaysia.

Bauer, R., Koedijk, K. and Otten, R. (2005), "International evidence on ethical mutual fund performance and investment style", *Journal of Banking and Finance*, Vol. 29, pp. 1751-1767.

Bauer, R., Derwall, J. and Otten, R. (2003), "Canadian ethical mutual funds: performance and investment style analysis in a multifactor framework", Limburg Institute of Financial Economics Working Paper No. 03-001, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=420900, Retrieved on January 15, 2008.

Block, S. B. and French, D. W. (2002), "The effect of portfolio weighting on investment performance evaluation: the case of actively managed mutual funds", *Journal of Economics and Finance,* Vol. 26 No. 1, pp. 16-30.

Brown, S. J., Goetzmann, W. N. and Ross, S. A. (1995), "Survival", *Journal of Finance,* Vol. 50 No. 3, pp. 853-873.

Brown, S. J., Goetzmann, W. N. Ibbotson, G. R. and Ross, S. A. (1992), "Survivorship bias in performance studies", *Review of Financial Studies*, Vol. 5 No. 4, pp. 553-580.

Cesari, R. and Panetta, F. (2002), "The performance of Italian equity funds', *Journal of Banking and Finance*, Vol. 26, pp. 99-126.

Chang, E. C. and Lewellen, W. G. (1985), "An arbitrage pricing approach to evaluating mutual fund performance", *Journal of Financial Research*, Vol. 8 No.1, pp. 15-30.

Chen, C. R., Lee, C. F., Shafiqur, R. and Chan, A. (1992), "A cross sectional analysis of mutual fund's market timing and security selection skill", *Journal of Business Finance and Accounting*, Vol. 19 No. 5, pp. 659-675.

Choong, D. (2001), "Investor's guide to Malaysian unit trusts", SAGE Information Services, 2nd ed., Kuala Lumpur.

Christensen, M. (2005), "Danish mutual fund performance-selectivity, market timing and persistence", Aarhus School of Business, Finance Research Group Working Paper No. F-2005-1.

Connor, G. and Korajczyk, R. A. (1986), "Performance measurement with the arbitrage pricing theory: a new framework for analysis", *Journal of Financial Economics,* Vol. 15 No. 3, pp. 373-394.

Cornell, B. (1979), "Asymmetric information and portfolio performance measurement", *Journal of Financial Economics*, Vol. 7, pp. 381-390.

Dybvig, P. H. and Ross, S. A. (1985a), "Performance measurement using differential information and a security market line", *Journal of Finance*, Vol. 40 No. 2, pp. 383-399.

Dybvig, P. H. and Ross, S. A. (1985b), "The analytics of performance measurement a security market line", *Journal of Finance*, Vol. 40 No. 2, pp. 40-416.

Elton, E. J., Gruber, M. J. and Blake, C. R. (1996), "The persistence of risk-adjusted mutual fund performance", *Journal of Business*, Vol. 69 No. 2, pp. 133-157.

Elton, E. J., Gruber, M. J., Sanjiv Das, and Hlavka, M. (1993), "Efficiency with costly information: a reinterpretation of evidence from managed portfolios", *Review of Financial Studies*, Vol. 6 No. 1, pp. 1-22.

Fauziah, M. T. and Mansor, I. (2007), "Malaysian unit trusts aggregate performance", *Managerial Finance*, Vol. 33 No. 2, pp.102-121.

Fikriyah A., Taufiq, H. and Shamsher, M. (2007), "Investigation of performance of Malaysian unit trusts funds: comparison with conventional unit trusts funds", *Managerial Finance*, Vol. 33 No. 2, pp.142-153.

Fikriyah A., Shafie, M. Z. and Juhaida A. B. (2007), "The performance of Malaysian Islamic unit trusts", *CD Proceedings of iBaf2004*, Organized by Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM), Palace of The Golden Horses Hotel, Seri Kembangan, Selangor, 29 & 30 August 2006.

Grinblatt, M. and Titman, S. (1989a), "Mutual fund performance: an analysis of quarterly portfolio holdings", *Journal of Business*, Vol. 62 No. 3, pp. 393-416.

Grinblatt, M. and Titman, S. (1989b), "Portfolio performance evaluation: old issues and new insights", *Review of Financial Studies*, Vol. 2 No. 3, pp. 393-421.

Grinblatt, M. and Titman, S. (1992), "The persistence of mutual fund performance", *Journal of Finance*, Vol. 47 No. 5, pp. 1977-1984.

Grinblatt, M. and Titman, S. (1993), "Performance measurement without benchmarks: an examination of mutual fund returns", *Journal of Business*, Vol. 66 No. 1, pp. 47-68.

Gupta, F., Prajogi, R. and Stubbs, E. (1999), "The information ratio and performance", *The Journal of Portfolio Management*, Fall, pp. 33-39.

Huson Joher, A. A. (2007), "Malaysia unit trust performance: Comparative analysis of single and multi index model", *European Journal of Economics, Finance and Administrative Sciences*, pp. 22-31.

Jeffry A. Busse Emory. (1994), "A study of monthly mutual fund returns and performance evaluation techniques", *Journal of Financial and Quantitative Analysis*, Vol. 29 No. 3, pp. 419-444.

Jeffry A. Busse Emory. (1993), "Performance measurement without benchmarks: an examination of mutual fund returns", *Journal of Business*, Vol. 66 No. 1, pp. 47-48.

Jonathan B. B. and Richard C. G. (2004), "Mutual fund flows and performance in rotational markets", *Journal of Political Economy*, Vol. 112, pp. 1269-1295.

Kothari, S.P. and Warner, J.B. (2001), "Evaluating mutual fund performance", *The Journal of Finance*, Vol. 56, pp. 1985-2010.

Lehmann, B. and Modest, D. (1987), "Mutual fund performance evaluation: a comparison of benchmarks and benchmark comparisons", *The Journal of Finance*, Vol. 42, pp. 233-265.

Leong, L. H. (1997), "Unit trusts in Malaysia: can it outperform the Market?", Unpublished Master Dissertation, International Islamic University Malaysia, Petaling Jaya.

Mallin, C. A., Saadouni, B. and Briston, R. J. (1995), "The financial performance of ethical investment funds", *Journal of Business Finance and Accounting,* Vol. 26, pp. 57-70.

Maslina, A. and Razali, H. (2006). "The comparison of performance of Islamic and conventional unit trusts funds in Malaysia", *Conference Proceedings,* International Forum on Islamic Economic, Finance and Business for Young Scholars, Organized by Faculty of Business Management, Universiti Technologi MARA, Shah Alam, Malaysia and Islamic Development Bank, Jeddah. 18 - 20 April 2006, Langkawi, Malaysia. pp.121-142.

Mohamed, S. and Mohd Nasir, A. (1995), "The performance of unit trusts in Malaysia: Some evidence". *Capital Market Reviews.* Vol. 3. No. 2, pp. 51-59.

Mohammad Badri, R. and Fikriyah A. (2006), "Market timing and security selection performance of mutual funds: evidence from malaysia". *CD Proceeding of bai2006.*

Mohd Azlan Shah, Z., Zulkefly, A. K. and Zurina K. @ Z. (2004), "The performance of Islamic unit trusts funds in Malaysia: does persistence exist", *The Journal of Muamalat and Islamic Finance Research.*

Mohd Nawawi, A. H., Mehad, S., Hassan, R. and Abdul Rahman, H. (1999). "A performance of unit trusts industry in Malaysia, 1984-1994", Seminar Proceedings, Business and Research Center, Universiti Teknology MARA. Shah Alam. Malaysia.

Saiful Azhar, R. (2006), "Investing in Islamic unit trusts" *UT Today Magazine.* FMUTM Publication. Vol. 4. No. 1, June 2006.

Said Elfakhani and M. Khabir, H. (2005), "Performance of Islamic mutual funds", *Economic Research Forum,* Paper presented at the Economic Research Forum, 12th Annual Conference, Grand Hyatt Hotel, Cairo, Egypt, 19th – 21st December 2005.

Security Commission Annual Report (Malaysia), (2006).

Security Commission Annual Report (Malaysia), (2007).

Shamsher, M. and Annuar, M. N. (1995), "The performance of unit trusts in Malaysia: some evidence", *Capital Market Review*, Vol. 3, pp. 51-64.

Shamsher, M. Annuar, M. N. and Taufiq, H. (2000), "Investment in unit trusts: performance of active and passive funds", *Proceedings of FEP Seminar 2000: Issues in Accounting and Finance 2*, Universiti Pertanian Malaysia Press, Serdang, pp. 129-141.

Shariff, N. (2002), "The financial performance of Islamic unit trusts: a Malaysian perspective", Unpublished Master Dissertation, Universiti Teknologi MARA, Shah Alam, Malaysia.

Sharpe, W. F. (1966), "Mutual funds performance", *Journal of Business*. Vol. 39, pp. 119-138.

Soo-, W. L. and Noor Azlan, G. (2007), "The price linkages between Malaysian unit trusts funds and the stock market: short run and long run interrelationships", *Managerial Finance*, Vol. 33 No. 2, pp. 89-101.

Soo-, W. L. (2007), "Malaysian unit trusts funds' performance during up and down market conditions: a comparison of market benchmark", *Managerial Finance,* Vol. 33 No. 2, pp. 154-166.

Treynor, J. L. and Mazuy, K. K. (1966), "Can mutual funds outguess the market?", *Harvard Business Review,* July - August, pp. 131-136.

Zuraidah, O. (2005), "Unit trusts: its origins and development in Malaysia", *UT Today Magazine,* FMUTM Publication. Vol. 3 No. 2.