PERFORMANCE EVALUATION OF MALAYSIAN ISLAMIC UNIT TRUST FUNDS: A CRITICAL REVIEW

Mohamed Sharif Bashir
Sultan Sharif Ali Islamic University, Brunei Darussalam

ABSTRACT

This paper conducts an intensive review and then critically evaluates the findings of previous studies on the topic of Islamic trust fund performance in Malaysia. It also examines the comprehensiveness of each previous study in terms of its approach, its methodology, its data and its interpretation of previous findings that other studies have used to measure unit trust fund performance. This paper aims to identify the strengths, weaknesses and shortcomings of previous studies. The findings of this paper show that most empirical works on Malaysia's unit trust funds have contributed to the present body of knowledge by offering detailed performance evidence of an emerging market that has strong government support. Specifically, the present paper attains a better understanding of the approaches and methodologies used to measure the performance of Islamic unit trusts in Malaysia.

Keywords : Islamic unit trust; performance management; financial risk; Islamic finance; Malaysia.

Introduction

The performance issue of the mutual fund, more popularly known as the unit trust fund or simply the unit trust, has gained considerable attention among researchers due to its strategic implications for investment decisions. A number of studies have assessed the investment performance evaluation of the funds in Malaysia and other developing countries, but none have compared Islamic and conventional unit trusts (Low et al., 2007).

Basically, a unit trust is a form of investment that provides a simple and affordable investment as it applies to the collective investment scheme that pools money from several investors who share a common investment strategy, financial objective and risk tolerance (Choong, 2001). In addition, unit trusts play a significant role in the capital market by attracting small investors and providing them with a wider investment base (Leong, 1997).

It seems that the emergence of Islamic unit trusts as an alternative for investment has promoted the growth of unit trusts locally and globally. Investors need unit trust performance information in order to chart the progress of investments so that they can identify suitable funds, maximize profits and minimize the risks of their investments. Toward that end, studies that examine unit trust performance are invaluable. Furthermore, comparing conventional and Islamic unit trusts is vital and interesting, because conventional and Islamic unit trusts are fundamentally different in terms of investment principles and capital market laws (Abdullah et al., 2007).

Historical Background of Unit Trusts in Malaysia

British investors first established the unit trust industry in Malaysia in 1959 when they introduced the Malayan Unit Trust Ltd. This type of investment is called a unit trust instead of a

instead of a mutual fund, because the ownership of the fund is divided into units of entitlement. Initially, the growth of the unit trust in Malaysia was very slow due to lack of public interest. The turning point for the unit trust industry came in 1981 when the Malaysia government decided to enter the industry by launching a government sponsored unit trust known as Amanah Saham Nasional (ASN). The government's initial intention of launching this unit trust was to help improve the indigenous Malay's (Bumiputera's) social-economic status (Taib & Isa, 2007). As a result, the period from 1991 to 1999 witnessed the fastest growth of the unit trust industry, aided also by the peak economy of that decade. After the financial crisis in 2001, the unit trust industry experienced another year of strong growth. Moreover, as a result of Bank Negara Malaysia's (Central Bank of Malaysia) liberalization of overseas investment rules, numerous offshore funds have been established that also contribute the growth of the Malaysian unit trust industry.

Growth of Malaysia's Unit Trust Industry

The rapid growth of the unit trust industry can be illustrated simply through the growth of management companies, which tripled from 13 in 1992 to 39 in 2010. Similarly, the number if funds approved also increased-from 39 in 1992 to 584 in 2010 (Bank Negara Malaysia, 2009; 2011). The total net asset value (NAV) of unit trust funds in Malaysia as of 31 December 2008 was RM134.4 billion-RM117.2 billion in conventional unit trust funds and RM17.2 billion in Islamic unit trust funds. The total NAV of unit trust funds at the end of December 2008 represented 20.3% of the market capitalization of Bursa Malaysia, significantly higher than their representation of 15.2% in 2007. A number of factors have jointly contributed to the rapid expansion of the industry, including strong economic performance, good stock market performance, expansion of the local stock market and the successful privatization of companies. As a result, recent statistics released by Security Commission Malaysia (SCM) report that the total NAV of unit trust funds in

Malaysia reached RM249.9 billion as of 31 July 2011-RM223.5 billion in conventional unit trust funds and RM26.4 billion in Islamic unit trust funds. The total NAV of unit trust funds at the end of July 2011 represented 18.7% of the market capitalization of Bursa (Securities Commission Malaysia, 2009; 2011).

Establishment of Islamic Unit Trust Funds

Islamic unit trust funds are funds that a unit trust company operates in compliance with *Shariah* principles (Islamic law). From an Islamic perspective, investing in Islamic unit trusts involves a contractual relationship (*'aqd*) between a unit trust company and the investors. All investment companies with Islamic unit trust responsibilities have their own *Shariah* boards to advise, monitor and ensure that the investment operation and portfolios are managed in compliance with *Shariah* principles.

In May 1996, Securities Commission Malaysia (SCM) established a *Shariah* Advisory Council (SAC) to oversee the operation of the Islamic capital market (ICM) in Malaysia to verify that it fulfilled the *Shariah* principles. The SAC applies some standard procedures for its approval of *Shariah*-compliance securities. Any non-compliance securities are excluded from the approved securities list.

The criteria for non-compliant securities are as follows (Securities Commission Malaysia, 2002):

a) Operation based on interest (*riba*), such as activities of commercial banks, merchant banks, finance companies and investment funds;
b) Operation involving gambling (*gimar or maisir*);
c) Activities concerning the sale and/or production of forbidden (*haram*) products, such as *non-halal* food; and

d) Operations containing element of uncertainty (*gharar*), such as a conventional insurance business.

The Islamic unit trusts have been in the Malaysian unit trust industry since the launch of the first Islamic equity fund, Tabung Ittikal Arab-Malaysian, on 12 January 1993 (Barom, 2004). Since then, Islamic unit trusts have grown steadily and significantly. Data released in January 2009 and January 2011 show that several new Islamic funds have been launched, bringing the total number of funds to 149 as of December 2008 and 160 in July 2011 (Bank Negara Malaysia, 2009; Securities Commission Malaysia, 2011). The growth of the NAV of *Shariah*-based unit trust funds was at a compounded annual growth rate of 33.8% from 1997 to 2008, outshining the industry growth rate of 19.5%. This growth shows strong latent demand for Islamic investment products. Although the growth of the Islamic unit trust market has shown positive results, this market still leaves a lot of room for development and expansion. For instance, Islamic unit trusts are not limited to Muslim investors but are also available to non-Muslim investors, and the percentage of the Muslim population that invests in Islamic unit trusts is still small. Hence, the investment opportunity in Islamic unit trusts market is huge.

The purpose of this paper is to present empirical studies that theoretically and conceptually assess Malaysia's Islamic and conventional unit trust fund performance. It also aims to evaluate previous empirical works that are related to this topic. The remainder of paper is organized as follows: the next section present a detailed review of the previous literature with respect to unit trust funds in Malaysia. Section 3 offers a critical analysis of performance evaluations of Islamic and conventional funds. Finally, section 4 gives the summary and conclusion and offers some recommendations.

Past Studies on Unit Trust Performance

This section provides a review of current and related theoretical and conceptual works of Malaysia's Islamic and conventional unit trust performance. All the studies that are reviewed and evaluated here are relevant to each other, although each study has a unique area of investigation, period of time and approach. The previous studies can be categorized into three types, according the analysis approach that they adopted. Some studies perform a comparison analysis, whereas others focus on studying Islamic or conventional funds separately. In other words, some researchers conducted conventional unit trust studies, others conducted Islamic unit trust studies and still others made comparative studies on unit trust funds, as detailed in the following sections. Table 1 (Appendix 1) provides the summary of empirical studies on Malaysia's unit trust funds from 1995 up to the start of 2011.

Conventional Unit Trust Studies

The performance of the unit trust industry has attracted intense examination by researchers and policymakers since the mid-1990s. as shown in Table 1, earlier studies were done by Shamsher and Nasir (1995), Tan (1995), Leong (1997), Leong & Aw (1997), Nasir et al. (1997) and Mohd Nawawi et al. (1999), while recent studies have been done by low & Ghazali (2005, 2007), Taib & Isa (2007), Low (2007) and Nawang et al. (2008). The most recent have been conducted by Rahimie (2010), Saad et al. (2010) and Mansor & Bhatti (2011). The majority of the empirical works focused on the performance of conventional unit trust fund in comparison with stock market performance. With respect to methodology and performance measurements, most of the studies have used standard measures including Sharpe, Adjusted Sharp, Jensen Alpha, Adjusted Jensen and Treynor Indices. In contrast, Low & Ghazali (2007) used cointegration and causality tests, Saad et al. (2010) used the Data Envelop Analysis, and Rahimie (2010) used the Triangulation Data Analysis. In terms of

Sample size, the smallest sample was gathered by Arbi (1999), followed by Ismail & Skakani (2003) and Zaidi et al. (2004) at 9, 12 and 12, respectively. The largest sample was gathered by Mansor & Bhatti (2011), followed by Hussin & Rashid (2005) and Taib & Isa (2007) at 487, 182 and 110, respectively. In addition, Shariff (2002) and Saad et al. (2010) covered a limited time period of no more than four years compared to the 18 years covered by Rahimie (2010). On the other hand, all previous studies further classfied most of the selected samples based on the type of funds, such as equity, balanced funds and income funds. In addition, the majority of the studies used several market portfolios as benchmarks, namely, the Kuala Lumpur Composite Index (KLCI), Kuala Lumpur Emas Index (EMAS), RHB Islamic Index and Shariah Index.

Specifically, Shamsher and Nasir (1995) studied the performance of 54 unit trusts in Malaysia from January 1988 to December 1992. They further classified their sample based on the type of funds and divided them into Malaysian and foreign-managed funds. The results of their study showed that growth funds had the highest returns per unit of risk (measured in terms of standard deviation), whereas the balanced funds ranked highest in terms of the risk-per-unit of return.

Nasir et al. (1997) used Treynor and Mazuy's model to examine the selectivity and timing performance of 31 unit trust funds in Malaysia for the period from the first of July 1990 to the end of August 1995. On average, they found that the selectivity performance of the funds was positive but the timing performance was negative. Meanwhile, Leong (1997) investigated the performance of 13 unit trust funds in Malaysia from January 1992 to December 1996. He used the Kuala Lumpur Composite Index (KLCI) as the market's proxy within the framework of Arbitrage Pricing Theory (APT) and the Capital Asset Pricing Model (CAPM). He also attempted to evaluate trust performance before and after 19 March 1994, when the Malaysian Securities Commission announced its new guidelines and regulations for

the unit trust industry in response to the stock market crash of 1993. Mohd Nawawi et al. (1999) evaluated the performance of local unit trust funds over the period of 1984 to 1994. They focused on the performance of unit trusts in comparison to unmanaged portfolios that consisted of common stock. They also evaluated management styles in relation to governance, personality considerations, economic considerations and controlling factors.

Shamser et al. (2001) studied investment activity in unit trusts by following the performance of active and passive funds in Malaysia in order to determine any significant differences between active and passive unit trust funds' performances. Their study also aimed to find out whether managers of active funds possess greater selection and market timing abilities compared to managers of passive funds. Lastly, their study intended to discover the performance of active and passive unit trust funds in terms of level of diversification. Toward this end, they analyzed a sample of 41 non-government-based actively and passively managed unit trust funds for the period of 1995 to 1999. They used the dividends-adjusted return of the Kuala Lumpur Stock Exchange Composite Index (KLSECI) as a proxy for the benchmark market portfolio return. They also used the Treynor Index and Sharpe Index to measure returns per unit of risk and applied the Jensen Index to estimate the difference between the actual and expected performance of the unit funds. While Shamsher et al. Used Fama's (1972) approach to determine the active fund-managers' selection capability they also used Treynor and Masuy's (1966) nonlinear model to examine fund managers market-timing skills. The degree of diversification was measured relative to the diversification of the market portfolio. The KLSECI was used as a proxy for the return on the market portfolio in the Malaysian stock market. Their study suggested that active-managed funds seem to perform better than passive-managed funds on a non-risk-adjusted returns basis. On a risk-adjusted returns basis, both active and passive funds were out-performed by the benchmark portfolio returns. Thus, there was no significant difference between the returns of passive and active funds. In terms of risk-

per-unit of return, the passive funds performed 4.5 times better than active funds. Shamsher et al. also highlighted that the regulatory environment could also affect the performance of unit trusts. Both active and passive-fund managers have significantly poorer selection and market-timing capabilities, and both passive and active-managed funds have the same level of diversification and were not even half as diversified as the KLSECI.

Low (2007) studied Malaysia's unit trust fund performance during the up and down market conditions and examined whether selectivity and timing performance of Malaysia's fund managers are sensitive to the study's choice of market benchmarks. The market benchmarks that he used were the KLCI and the Exchange Main Board All-Share (EMAS) Index. The data in the study were collected from 40 Malaysian unit trust funds with monthly price records and distribution information available for the five-year period from January 1996 to December 2000. He applied Jensen's model to estimate the overall fund performance and Henriksson and Merton's (1981) model to separate the fund managers' investment performance into selectivity and market-timing components. His findings revealed that, on average, the funds showed negative overall performance with respect to the market benchmark. In conclusion, the market benchmarks did not have much effect on the investment components (timing and selectivity). This study thus concluded that timing and selectivity were not highly sensitive to the market benchmarks.

The conclusions from above mentioned studies are as follows:

1. The findings revealed by Shamsher and Nasir (1995) confirmed that none of the trust funds achieved an acceptable level of diversification. Therefore, their findings suggested that unit trusts were not able to generate an acceptably reasonable risk-adjusted return, regardless of their reliance on professional fund managers. Moreover, the study by Nasir et al. (1997) found a positive correlation

between selectivity and timing performances and showed that the funds did not achieve the expected level of diversification and that the risk-return characteristics of the unit trust funds were generally inconsistent with their stated objectives.

2. The findings of the study conducted by Leong (1997) indicated that during the first sub-period and the full period, most of the unit trust funds were superior to the market, but then they were inferior to the market during the second sub-period. The data confirmed that the bull market drive in 1993 caused 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 beat the market portfolio. Evidence from a study done by Mohd Nawawi et al. (1999) on price showed that, in general, unit trust funds could not outperform the market. However, some trends have indicated that the performance of unit trusts could not beat the market in bullish conditions; however, in bearish conditions, most of the funds experienced lower losses than the market. This last result seemed to contradict the result recorded by Leong (1997).

3. A study by Shamsher et al. (2001) found that both active and passive-fund managers have significantly poorer selection and market-timing capabilities, and both passively and actively managed funds have the same level of diversification and were not even half as diversified as the KLSECI. Low's study (2007) revealed that the funds showed negative overall performance on average with respect to the market benchmark. In conclusion, the market benchmarks did not have much effect on the investment components (timing and selectivity). This conclusion suggests that timing and selectivity are not too sensitive to the market benchmarks.

4. Most studies on the performance of Malaysia's unit trust funds focused their analyses on the overall fund performance, such as the studies by Tan (1995) and Leong and Aw (1997). Collectively, empirical findings on the overall fund performance indicate that on average, unit trust funds in Malaysia perform worse than the market. Only a few studies separate the overall fund performance into selectivity and market timing components, and they come from Nasir et al. (1997), Low & Ghazali (2005) and Low (2005). These studies show that on average, the timing performance of fund managers is negative. While there are many studies that investigate the investment performance of unit trust funds in Malaysia, Low & Ghazali (2007) present the first evidence on the pricing relationships between unit trust funds and the local stock market index. Their findings are important to investors' investment strategies.

Islamic Unit Trust Studies

All Islamic unit trusts funds are ethical funds, but not all ethical funds are Islamic. An ethical fund is defined as a socially responsible investment platform. Ethical funds are becoming popular and are currently in high demand, especially in developed countries such as the United States, the United Kingdom and some European countries. Ethical funds do not invest in companies whose activities cause damage, such as companies whose products involve alcohol, tobacco, gambling, armaments or exploitation of animals. Damaging companies also include any companies that deal with oppressive government regimes (Zaidi et al., 2004).

Previous empirical research that studied the performance and the persistence of performance of unit trusts in Malaysia mainly focused on conventional trust funds or focused only on one period of time. These researchers sought to examine the Islamic trust funds' performance and their persistency in performance through the differing time intervals and on a year-to-year basis from 1999 to 2003. As shown in Table 1,

the Malaysian Islamic unit trust funds' performance was examined by Arbi (1999), Shariff (2002), Hanafi (2002), Ismail and Shakrani (2003), Abdullah et al. (2004), Zaidi et al. (2004), Ahmad and Haron (2006), Abdullah et al. (2007) and Nawang et al. (2008). These studies provided some insights into the performance of Islamic trust funds in Malaysia by measuring the nature and characteristics of these funds.

Hanafi (2002) examined the performance of 14 Islamic unit trusts in Malaysia for the six-year period from 1996 to 2001. His results showed that Islamic unit trusts generally performed better than the market, especially during the bear period. Hanafi's risk-adjusted performance measure showed that Islamic unit trusts not only performed better than the market, but they also performed significantly better than the risk-free investments. Conversely, the findings confirmed that the risk undertaken by Islamic unit trusts were not congruent with the stated objective of the fund in the prospectus. For example, Islamic unit trusts failed to provide diversification in their investments, even though diversification is one reason why investors purchase unit trusts. In addition, 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 so that they were consistent with the direction of the market portfolio. Generally, Hanafi's study showed that investors benefit more by investing in Islamic unit trusts than by participating in a "naïve buy-and-hold" investment strategy, particularly during the bear period.

A study by Taib et al. (2002) seemed to indicate that the poor performance of unit trust managers continued into later decades. Their study was based on 78 unit trust fund companies that operated from 1990 to 1999. They found that unit trust returns were not significantly higher than risk-free and market returns. They also discovered that unit trusts did not exhibit consistent investment performance over time and that there was no evidence to indicate that Malaysian fund managers had superior forecasting abilities than foreign fund managers. However, their study lacked rigorous

statistical testing and the conclusions that they reached mainly resulted from individual fund observations and analyses. Therefore, caution should be exercised while interpreting their results, as the period of their study includes the 1997–1998 financial crises. It is possible that the severity of this crisis influenced their statistical results.

Shariff (2002) evaluated 14 Islamic trust funds in Malaysia over the period of 1999–2002. He investigated further the nature and the characteristics of Islamic funds in addition to assessing the return and risk profiles of the funds. His study showed that the monthly returns of all funds were losers, since they were unable to outperform market and risk-free returns. Contrastingly, the risk-adjusted returns of the majority of the funds portrayed superior performance in comparison to the market, which was inconsistent with most prior studies on funds in Malaysia and countries all over the world. Shariff further concluded that the funds' performance rankings were not consistent over the period under consideration. Nonetheless, the risk profiles were apparently steady, since the portfolios exhibited superior performance in the long run. The steadiness may have been the result of ethical screening of *Shariah*-approved portfolios, as this screening may have made the *Shariah*-based trust funds more reliable. Shariff's result support the study of Arbi (1999), which found that the average Islamic unit trust fund is less risky than the market portfolio. The results of Arbi's study also corroborate the findings of Mohd Nawawi et al. (1999).

Abdullah et al. (2003) analyzed the performance of Islamic unit trust funds by measuring the risk associated with the investment and evaluating the degree of diversification of Islamic unit trust funds. They adopted Treynor's Index to measure the excess return per unit of systematic risk and applied Sharpe's Index to measure the reward/risk ratio with the fund's standard deviation as a measure of total risk. Both non-risk-adjusted performance and risk-adjusted performance of Islamic unit trust funds were outperformed by the market portfolio. The level of unit trust was also low

compared to the market's level of trust. The diversification level of Islamic unit trust funds was low, not even reaching 50% of the market's diversification. The researchers attempted to identify the weaknesses and strengths of Islamic unit trust funds and found that these funds' performance could be improved with necessary rectification action such as diversifying their stock selection.

Ismail and Shakrani (2003) investigated the relationship between return and beta for Islamic unit trusts by using a cross-sectional regression analysis. The estimation of return and beta without differentiating between positive and negative excess market returns produced a flat, unconditional relationship between return and beta. After using the conditional CAPM and cross-sectional regression analysis, Ismail and Shakrani produced evidence that tended to support a significant positive relationship in an up market and a significant negative relationship in a down market. Their strong evidence suggests that beta could be used as a tool for explaining cross-sectional differences in Islamic unit trusts' returns and could also be used as a measure of market risk.

Zaidi et al. (2004) examined the performance of 12 Islamic unit trust funds out of the 44 funds available in the market at the time they conducted their study. They evaluated these unit trust funds by using raw return, and the Sharpe, Treynor and Jensen Alpha Indices. The study focused on weekly closing prices from May 1999 to the first week of May 2003 and selected the Kuala Lumpur *Shariah* Index as a benchmark for the market return and to compute betas based on CAPM. In addition to that benchmark, the researchers also presented the KLCI as the market benchmark. The authors also took the risk-free rates into consideration while evaluating the performance, whereby they selected the Islamic weekly inter-bank rates (IIBR) as the indicator.

Another study, conducted by Kefeli and Zaidi (2005), ranked the appeal of Islamic unit trusts as investments for ethical funds in Malaysia. Ethical funds in the U.S. and some European countries provide alternative avenues of investment for companies that are impassioned by social responsibility. Malaysia is of no exception when it comes to the availability of such funds. However, the authors pointed out that the development of ethical funds in Malaysia is still in a state of infancy, unlike most Islamic funds, which have received a phenomenal increase in demand since their introduction two decades ago. These funds do share some similarities, which motivated Kefeli and Zaidi to focus on one vital question: can ethical funds be regarded as Islamic funds and vice versa? In addition to thoroughly analyzing the main question, they also gave attention to the development and performance of ethical funds in the U.S., the U.K. and several European countries as well as in Malaysia.

In relation to methodology, Kefeli and Zaidi adopted a comparative study in which they analyzed the criteria of two Malaysian ethical funds, namely the Mayban Ethical Fund and the Phillip Master Ethical Fund. They compared the criteria of these two funds with the general criteria of Islamic funds. While comparing the funds, they focused on the investment objective of the funds, the investment process of the funds and the guidelines and principles of the funds.

Their analysis revealed that the investment criteria of the ethical funds are still not always in conformity with the *Shariah* principles of the permitted investment parameters, thus rejecting the idea that ethical funds can generally be regarded as Islamic funds. However, when investment portfolios avoid the negative criteria adopted by the ethical funds, such as certain objectionable activities and products made by companies, these portfolios fall into accordance with the criteria of the Islamic funds. This sole resemblance cannot in any way justify the idea that ethical and Islamic funds are similar in their overall characteristics. Nevertheless, the Islamic

funds can be said to be ethical, since all Islamic funds meet the avoidance criteria adopted by the ethical funds.

Ahmad and Haron (2006) examined the performance of Islamic trust funds in comparison with conventional trust funds in Malaysia over the period of 2000–2003. Their findings revealed that on average, the Islamic funds failed to outperform conventional funds. Even so, the independent sample test results showed that there was no significant difference in the mean performance of either type of funds. Based on their results, one can conclude that conventional fund performance is slightly more appealing to investors than Islamic fund performance. Most research done, including Ahmad and Haron's, observed that there was no consistency in either type of fund's temporal performance ranking over the period of 2000-2003.

Nawang et al. (2008) examined unit trust fund performance in Malaysia from 2002 until the start of 2006. They provided some evidence on the comparative performance between conventional and Islamic unit trust funds over three different periods of time by making monthly observations. Their study found that the average return of Islamic funds was lower than the average return of the market portfolio during the whole period, while conventional funds had a higher average return than the market in the same period. This indicates that conventional funds are better performers than Islamic funds in terms of rate of return. However, in terms of risk-return characteristics, conventional funds had the lowest standard deviation compared to Islamic funds. Generally, the returns of both funds were more dispersed than the returns of the market portfolio during all periods of time except for the sub-period of 2002–2003, when the Islamic funds exhibited less dispersed returns than the market. However, the beta values, which were less than one for both types of funds during the three study periods, indicated that the funds had lower non-diversifiable risks than did the market portfolio. Thus, unit trusts are less risky than the market portfolio. Nawang et al. have

thus recorded that Islamic funds were slightly closer to market risk-return during the sub-period of 2002–2003.

Comparative Studies on Unit Trust Funds

As summarized in Table 1, studies on Malaysia's unit trust fund performances have been extensively discussed for the last fifteen years. However, only a few studies have compared the performances of Islamic unit trust funds and conventional funds. Among these few studies include those by Hussin and Rashid (2005), Abdullah et al. (2007), Taib and Isa (2007) Karim (2010), Saad et al. (2010) and Mansor and Bhatti (2011).

Hussin and Rashid (2005) conducted a study comparing Islamic and conventional fund performances in Malaysia to determine whether asset allocation types and styles influence the funds' performance and to identify whether a fund's size and age influence its return performance. They used the Sharpe Index to evaluate the risk-adjusted performance, a geometric means returns to calculate the annualized return and the Mallin and Gregory models to estimate the coefficient of fund size and fund age.

The performance of the conventional funds was better than the performance of Islamic funds for periods shorter than one year, but their performance difference was insignificant in the long run. One possibility for the short-term difference is the larger fund size and the higher diversification of conventional funds compared to Islamic funds. Hussin and Rashid also found that asset allocations, types and styles did influence fund performance in shorter periods but not in longer periods. They additionally concluded that fund size showed a significantly positive correlation with return performance for longer periods. As for the fund's age, a significant negative correlation was observed with the fund's performance for a one-year period. One can

conclude that this work has provided useful information regarding Islamic unit trust fund performance as compared to that of conventional unit trust funds. Hussin and Rashid also proved that asset allocation types, allocation styles and fund size influence the fund performance comparisons between conventional and Islamic unit trust funds, but the fund's age has no such influence.

Abdullah et al. (2007) attempted to find the differences between Islamic and conventional mutual funds in terms of performance from the perspective of the Malaysian capital market and monthly returns adjusted for dividends and bonuses by using the 10-year period from January 1992 to December 2001. Their sample consisted of 65 funds, of which 14 were Islamic funds. This study was divided into three different periods—before (1992–1996), during (1997–1998) and after (1999–2001) the financial crisis—to ascertain the impact of the economic conditions on the performance of unit trusts funds. They used the standard measures such as the Sharpe Index, Adjusted Sharpe Index, Jensen Alpha, the managers' timing ability and the managers' selectivity ability to evaluate the mutual funds' performances.

Their findings indicate that Islamic funds performed better than conventional funds during the bearish economic period. Conversely, during bullish economic conditions, the conventional funds showed better performance than did the Islamic funds. In terms of diversification, the research showed that neither conventional nor Islamic funds achieved at least 50% of the market's diversification levels. The findings also pointed out that both the Islamic and conventional fund managers exhibited weak stock selection abilities and poor market timing.

Taib and Isa (2007) investigated the aggregate performance of Malaysian unit trusts. The authors examined the performance of Malaysian unit trust performance by using different performance standard measures over the period from 1991 until 2001 as well as the dynamics of the funds during the shorter sub-period of 1991–2001. Their

companies, the more inefficient their performance. By comparing the efficiency of unit trust companies, their study found that some of the Islamic unit trust companies perform better than their conventional counterparts. Overall, they found that the efficiency of the Islamic unit trust companies is comparable to their conventional counterparts and they found, to a certain extent, that some of the Islamic unit trust companies were above average in total factor productivity (TFP).

More recently, Mansor & Bhatti (2011) evaluated the returns performance of the Islamic mutual funds relative to their conventional peers. They also evaluated the market benchmark covering bullish and bearish markets before and during the ASEAN in 1997-1998 and the global financial crisis in 2007-2008. Their study restricted the bullish market for a similar duration, from 1995-1996 and 2005-2006. Therefore, their overall sample is the average monthly data of 128 Islamic mutual funds and 350 conventional mutual funds that cover two market cycles from January 1995 to December 1998 and from January 2005 to December 2008.

Their main finding indicated that both Islamic and conventional funds performed better on average than did the market portfolios, proxy by the KLCI index. Their findings also suggested that the returns performance of the Islamic funds is no better than that of the conventional funds during the bullish and bearish market trends. However, on average, based on various measurement performances applied, the results reveal that the Islamic funds slightly outperformed their conventional counterparts.

Critical Analysis of the Performance of Malaysian Unit Trust Funds

After reviewing empirical studies on Islamic unit trusts separately or in comparison with their conventional counterparts, the current study presents the following critiques and evaluations:

1. Ahmad's and Haron's results are consistent with the results of most pioneer studies globally and locally, such as those by Sharp (1966), Treynor (1966) and Shamsher and Nasir (1995). These pioneer studies found that most of the Islamic unit trusts were unable to outperform the market. Moreover, Zaidi et al. (2004) and Abdullah et al. (2007) found that the Islamic funds in their sample were not well diversified, thus indicating a lack of stock selection skills among the Islamic fund managers.

2. Some studies, however, found results that are inconsistent with Chua's findings. These studies include those by Ewe (1994), Shamsher and Nasir (1995) and Tan (1995). Shamsher and Nasir (1995) focused their study on the performance of 54 conventional unit trusts covering the period from the late '80s to the early '90s. They found that the returns on investments in unit trusts were well below the returns from risk-free and market trusts. Furthermore, the results indicated that not only was the degree of portfolio diversification below expectation but the actual returns and risk characteristics of the funds were also inconsistent with their stated objectives. Consistent with Chua's findings, Tan (1995) concluded that government-sponsored funds perform better than private funds. It therefore seems that there exists a shift of performance over time. Fund managers seemed to be doing well in the '70s, but experienced performance problems in the '80s.

3. Nevertheless, other Malaysian studies provided contradictory findings on Islamic trust funds, such as those by Mohd Nawawi et al. (1999) and Arbi (1999). Others that were conducted on conventional unit funds, such as the study by Shariff (2002), also offered contradictory findings. All of these studies indicated that the funds were able to display superior performance in bearish periods, although some of these studies still indicate that the Islamic unit trust fund managers

possess poor market timing abilities. These results further suggest evidence of inferior selection abilities on the part of Islamic fund managers.

4. Across the present work's entire review and evaluation, the study done by Abdullah et al. (2007) is considered the most comprehensive research compared to other research studies. Their research covered a 10-year period of time that also included three different economic conditions. Abdullah et al. also studied the level of diversification and the fund managers' timing and selection abilities. Nevertheless, other studies on performance persistency, asset allocation and style of Islamic unit trusts are also significant as investment guidelines. From the findings of Taib and Isa (2007), one can conclude that the Islamic and conventional unit trust funds each have their own advantages and disadvantages. Thus, fund managers can use Taib and Isa's findings as a guideline in their investments. Furthermore, their findings can serve as useful information for fund managers' investment planning, forecasting and timing.

5. Most of the previous research has shown mixed results on the performance of the Islamic unit trust funds in Malaysia, perhaps due to the fact that previous studies take into consideration all types of Islamic funds, which include bond funds, balance funds, fixed income funds and equity funds, when measuring their performance. While the existing portfolio valuation models are suitable to use for measuring the performance of conventional funds, the measurement models may not be appropriate for Islamic-based funds in light of the inability of the conventional portfolio valuation models to incorporate non-monetary motives into their variables. Therefore, researchers can justify the need to develop an alternative portfolio valuation model, specifically for measuring the performance of Islamic-based funds (Karim, 2010).

6. The study by Saad et al. (2010) has made a useful contribution by using a data envelope analysis to assess the efficiency of the two types of unit trust funds, which are both important and relevant to Malaysia. This significance of this study arises from the dual financial system, in which the Islamic unit trust companies operate in parallel with their conventional counterparts. Their comparison sheds some light on the performance of the Islamic unit trust companies, whose operations are based on profit-sharing, unlike the conventional unit trust companies.

7. Mansor & Bhatti (2011) provided the important finding that Islamic and conventional funds have positive returns during the bullish market periods in 1995-1996 and 2005-2006. The returns performance of Islamic funds is higher than conventional performance in 1995-1996 but vice versa in 2005-2006. However, both groups have negative returns during the bearish markets, implying that both Islamic and conventional fund portfolios followed the market movement and felt a direct impact from the crises. The Islamic funds, however, appear to be less affected than their conventional fund counterparts.

8. The issues addressed by previous studies include risk-return performance, selection abilities and market timing abilities of fund managers and the level of diversification of mutual funds. The most widely used performance evaluation method was based on Jensen's (1968; 1969) alpha, which is the intercept of a regression of the excess return of the fund (fund return minus risk-free rate) on the excess return of a market benchmark. There are many benchmarks available, and the problem of how to pick the most appropriate market benchmark largely remains an unresolved issue. Theoretically, the chosen market benchmark for measuring fund performance should reflect the investment characteristics of the evaluated mutual fund. Therefore, an improperly chosen proxy for the market

benchmark can have a dramatic effect on inferences about fund performance (Low, 2007).

9. The majority of the most current studies, including Malaysian studies, still utilize the theoretical frameworks of the pioneer studies, namely the frameworks by Sharp (1966) and Treynor (1966), as the basis of their analysis. But certain advances have been made in various aspects. For instance, Grinblatt and Titman (1989a) developed characteristic-based benchmarks to more efficiently mimic the trading environment of the portfolios. Bhattacharya and Pfleiderer (1983) extended Jensen's (1972) theoretical framework to capture more efficiently the market timing abilities of fund managers. Ferson and Schadt (1996) proposed a Conditional Jensen Measure to factor in time-varying economic variables. In addition, Grinblatt and Titman (1989b) proposed an alternative to the Jensen technique called the Positive Period Weighting Measure, which seeks to assign weights to portfolio returns depending on market returns from the same period. These developments in methodological approaches and measures should also be considered in future studies about Malaysian unit trust funds.

Conclusion

Mutual funds comprise a collective investment scheme that pools the financial resources of retail and institutional investors with similar investment objectives. The Malaysian unit trust fund industry has registered a phenomenal growth since early 2000 as the range of these unit trusts' products broadened tremendously. Extensive evidence shows that the unit trust investment is a good alternative vehicle for investors to consider. To analyze the performance of Islamic unit trusts and to compare it with conventional unit trust performance, most of the research has applied one or more of the three standard performance measurements: the Sharpe Index, the Treynor Index and the Jensen Alpha Index. In addition, NAV and returns of the unit

trust funds were widely used to examine the performance of unit trusts in the last 5 to 10 years.

Empirical studies have also found that the fund managers of Islamic trust funds have poor timing abilities, were unable to correctly identify good bargain stocks and were unable to forecast price movements of the general market. Therefore, fund managers should be given more room to plan the portfolios of investments that fit the objectives of the fund. In short, the performance of unit trust funds is somewhat satisfying, especially for conventional funds, but there is considerable room for improvement so that these funds can overcome their weaknesses and enhance their strengths. Given the strong interest of the Malaysian government in this area, as evidenced by its active promotion and offering of national unit trusts to the public, questions remain as to whether promoting unit trusts as a form of safe investment in Malaysia is warranted in terms of risk and return. Future research should look at unit trusts' performance with a bigger sample size and cover a longer time frame to assess the current status of the industry. Detailed studies can be carried out to compare Islamic and conventional funds by using more recent data at various time intervals and more innovative measures. Additional investigations into Islamic mutual fund performance and its determinants are suggested for further research.

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Table 1: Summary of empirical studies on Malaysia's unit trust funds

Author/ (Year)	Period Covered	Performance Measurements/ (Sample Size)	Main Findings
Shamsher & Nasir (1995)	Jan. 1988- Dec. 1992	Standard measures*/ (54)	The returns on investment in unit trusts were below the risk free and market returns.
Tan (1995)	Jan. 1984- Dec. 1993	Standard measures/ (21)	Unit trusts performed worse than the market portfolio. Government sponsored funds performed better than private funds.
Nasir et al. (1997)	Jul. 1990- Aug. 1995	Standard measures/ (31)	Islamic funds did outperform their benchmark, but were poor at timing the market.
Leong & Aw (1997)	Jan. 1984- Dec. 1996	Standard measures/ (32)	The majority of funds performed worse than two different benchmark portfolios. The funds were not as diversified as the market portfolios.
Leong (1997)	Jan. 1992- Dec. 1996	Standard measures/ (13)	Most of the unit trusts were superior to the market during the first sub-period and the full period, but were not superior to the market during the second sub-period.
Arbi (1999)	Jan. 1992- Jun. 1998	Standard measures/ (9)	The Islamic funds were less risky than the market portfolio and quite well diversified; however, they were unable to outperform the market portfolio due to the market crisis in 1997.
Mohd Nawawi et al. (1999)	Jan. 1984- Dec. 1994	Standard measures/ (12)	Performance of unit trust funds could not beat the market, but in bearish conditions, most of the funds experienced lower losses than the market.
hamsher et al. (2001)	Jan. 1995- Dec. 1999	Standard measures/ (41)	No significant differences in the performance of actively and passively managed funds. Both types of funds managers had significantly inferior selection skills and poorer market timing abilities.
Hanafi (2002)	Jan. 1996- Dec. 2001	Standard measures/ (14)	Islamic unit trusts performed better than the market and performed significantly better than risk-free investments.
Taib et al. (2002)	Jan. 1990- Dec. 1999	Standard measures/ (78)	Unit trust returns were not significantly above risk-free and market returns. Unit trusts did not exhibit consistent investment performance over time.
Shariff (2002)	Jan. 1999- Dec. 2002	Standard measures/ (14)	The returns of all types of funds were losers, since they were unable to outperform the market and risk-free rates of return.
Abdullah et al. (2003)		Standard measures/ (67)	Both Islamic and conventional funds slightly underperformed the KLCI benchmark.
Ismail & Shakrani (2003)	May 1999- Jul. 2001	Standard measures/ (12)	There was a highly significant relationship between positive and negative beta coefficients during bull and bear phases. Islamic funds investors were relatively risk averse.
Zaidi et al. (2004)	May 1999- May 2003	Standard measures/ (12)	Persistence in performance of the overall funds cannot be proved in the differing time periods.
Hussin & Rashid (2005)	Jan. 2001- Jan. 2006	Standard measures/ (182)	Conventional funds significantly outperformed Islamic funds in the short run, whereas differences in the two funds' performances were statistically insignificant in the long run.
Ahmad & Haron (2006)	Feb. 2000- Jan. 2003	Standard measures/ (89)	Islamic funds failed to outperform the conventional funds. However, the Islamic funds seemed to have lower risks than the conventional funds.
Abdullah et al. (2007)	Jan. 1992- Dec. 2001	Standard measures/ (65)	Islamic funds performed better than conventional funds during bearish economic trends while conventional funds performed better during bullish economic conditions.
Taib & Isa (2007)	Jan. 1990- Dec. 2001	Standard measures/ (110)	The performance of unit trusts fell below market portfolio returns and risk free returns. There was no persistency in unit trust performance.
Low (2007)	Jan. 1996- Dec. 2000	Standard measures/ (40)	The unit funds display negative overall performance. Managers' poor timing ability contributed significantly to the funds' negative overall performance.
Low & Ghazali (2007)	Jan. 1996- Dec. 2000	Cointegration analyses & Granger causality/ (35)	The pricing performance of the unit funds differs significantly from that of the KLCI index. The Granger causality test shows that changes in the KLCI cause changes in the unit trust funds.
Nawang et al. (2008)	Jan. 2002- Dec. 2006	Standard measures/ (40)	Conventional funds outperformed the market while Islamic funds underperformed the market, as the Islamic fund managers had poor timing ability and lack of skills.
Rahimie (2010)	Jan. 1990- Dec. 2008	Standard measures & coding analysis and content analysis methods. (TDA**)/ (19)	Compared to conventional funds, Islamic funds are characterized by a lower return but with higher volatility, have limited numbers of profitable stocks and a smaller fund size.
Saad et al. (2010)	Jan. 2002- Dec. 2005	Malmquist index (DEA***)/ (27)	Some of the Islamic unit trust companies performed better than their conventional counterparts.
Mansor & Bhatti (2011)	Jan 1995- Dec. 1998 / Jan. 2005- Dec. 2008	Standard measures/ (478)	Both Islamic and conventional funds performed better than the market portfolio. The Islamic funds slightly outperformed their conventional counterparts. Yet the returns of Islamic funds were no better than the returns of conventional funds during particular market trends.

Notes: *Standard performance measures for funds known as Sharpe, Jensen Alpha and Treynor Indices.
**Refers to the Triangulation Data Analysis.
***Refers to the Data Envelopment Analysis.