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Do mutual fund managers exploit the Ramadan anomaly? Evidence from Turkey

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ABSTRACT

Recent literature shows that the holy month of Ramadan exerts a positive influence on investor sentiment in predominantly Muslim countries. This anomaly has been found to be particularly pronounced in Turkey. We therefore examine whether mutual fund managers investing in Turkish stocks are able to benefit from the Ramadan effect. We find that risk-adjusted performance of domestic institutional funds, hybrid funds and foreign Turkish equity funds is substantially higher during Ramadan compared to the rest of the year. By contrast, domestic index funds fail to deliver higher abnormal returns as they are adversely affected by increased money inflows during Ramadan.

1. Introduction

Portfolio managers of actively managed mutual funds are expected to use their expert knowledge and skills to identify wealth-enhancing investment opportunities. In order to fully justify their remuneration

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packages, they should strive to find mispriced securities, successfully time the market and uncover any existing market anomalies. The overarching objective of this paper is to examine whether they are indeed able to achieve such ambitious goals in practice. More specifically, we consider the behavior of Turkish mutual funds in relation to the Ramadan stock market seasonality. Astute managers should have been able to spot the market inefficiency arising during the ninth month of the Islamic lunar calendar and to design trading strategies capable of exploiting it. In doing so, they would have arbitraged away this seasonal effect and made the market more efficient.

The existence of the Ramadan effect is well-documented in the extant literature. By considering a large sample of predominantly Muslim countries, Białkowski et al. (2009, 2012) show that stock returns are significantly higher during the Muslim holy month and the subsequent *Eid al-Fitr* festival. At the same time, stock investments exhibit less risk, as the volatility of returns is significantly reduced (see also Seyyed et al., 2005). These results have been further confirmed in a recent study of Middle East stock markets conducted by Al-Hajieh et al. (2011).

Rationalizations offered for the existence of the seasonality have been essentially behavioral in nature. The collective experience of Ramadan has the potential to affect the mood of its observers, to enhance their sense of belonging and to promote solidarity in the Muslim world (Al-Hajieh et al., 2011; Białkowski et al., 2009, 2012; Odabaşi and Argan, 2009). Not only do religious convictions affect the psychology of the public, but they may also have ramifications for tangible economic outcomes. Baele et al. (2012), for instance, report that default rates on Islamic loans in Pakistan are only half of those on conventional loans. Interestingly, the authors document that defaults on Shariah-compliant loans are less likely to occur during Ramadan. In their ethnographic study, Sandikci and Omeraki (2007) reflect on the increasing commercialization of the holy month in Turkey. By drawing parallels to Christmas, they note that consumption patterns and marketing communications are noticeably altered during Ramadan. In a similar vein, Odabaşi and Argan (2009) argue that Ramadan has a deep social, cultural and economic impact on the daily life of Muslims in Turkish society. They emphasize that Ramadan has changed from a religious ritual to a holiday marked by feelings of nostalgia, a strong sense of communality and significantly higher consumer spending. We therefore expect the holy month of Ramadan to have a pervasive effect on the decision-making of Muslims, who constitute 99.8% of the Turkish population (CIA World Factbook, 2011). As Turkey is usually seen as a collectivistic country (Ayçiçegi-Dinn and Caldwell-Harris, 2011; Chui et al., 2010), we assume that Turkish investors are more consensus-oriented and inclined to carefully consider the opinions of their peers rather than relying solely on their own private information. Cultural collectivism generally strengthens social interdependence and thus plays a crucial role in further enhancing the upbeat sentiment during Ramadan.

This paper contributes to the existing literature by being the first to examine the response of mutual funds to the occurrence of the Muslim holy month.[4] While previous research has merely documented the existence of the Ramadan anomaly for a number of Middle East stock markets, our study goes one step further and investigates whether mutual funds investing in Turkey are able to benefit from this seasonality. We chose Turkey as our sample country for several reasons. First, Turkey has the second largest stock market in the Middle East region after the *Tadawul* in Saudi Arabia (FEAS, 2010; WFE, 2010) and exhibits a particularly pronounced market upturn during Ramadan (Al-Hajieh et al., 2011; Białkowski et al., 2009, 2012). With reference to the Istanbul Stock Exchange, Oğuzsoy and Güven (2004) also report strikingly high returns prior to religious holidays, such as *Eid al-Fitr*. Second, the literature on Turkish mutual fund performance, especially with respect to risk-adjusted timing ability, is still relatively scarce, even though the first mutual fund was launched as early as 1987. Interestingly, the domestic mutual fund sector gained considerable momentum at the beginning of the 2000s and still has untapped growth potential in the coming decades. Third, due to the country's close ties with Europe and the Middle East, many Western European institutional investors focus on Turkey to gain access to the MENA capital markets and to benefit from the international portfolio diversification generally offered by emerging market countries. While there have been restrictions on foreign equity ownership in a number of Muslim countries, the Turkish securities market was extensively liberalized and fully opened to foreign investment in 1989. Last, the choice of Turkey is also motivated by data

[4] Menkhoff and Schmidt (2005) and Wright et al. (2008) are other examples of studies that examine whether mutual fund managers trade on behavioral anomalies.