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Hidden Cointegration Reveals Hidden Values in Islamic Investments

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Highlights

We employ hidden cointegration for Islamic and conventional stock market indices

Cointegration dynamics are different for the positive, negative and cross price components

Investors may decode information differently in positive and negative markets

An Islamic Index offers risk reduction especially in negative markets

Abstract

We explore long-run relationships between Islamic and conventional equity indices for the period 2000-2014. We adopt a hidden co-integration technique to decompose the series into positive and negative components; thus allowing the investigation of the indices during upward and downward markets. We find evidence of bi-directional dynamics during upward, downward and some mixed market movements. However, after adding control variables to our models, only the relationship for the negative components retains its significance; indicating that the Islamic index is the least responsive during bad times. This highlights the robust nature of Islamic investments and a possible differentiated investor reaction to

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