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Evidence from international markets

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Dynamic correlations and volatility linkages between stocks and *sukuk*: evidence from international markets*Alex Sclip***Alberto Dreassi**, *Stefano Miani** and *Paltrinieri Andrea*[#]**** University of Udine, Italy****Abstract**

An understanding of volatility and co-movements in financial markets is important for portfolio allocation and risk management practices. The current financial crisis caused a shrinkage in values of most assets, an increased volatility and a threat to the survival of several institutional investors. Managing risks and returns within the classic portfolio theory, when correlations across securities soar, is increasingly challenging. In this paper, we investigate the volatility behavior and the co-movements between *sukuk* and international stock indexes. Symmetric multivariate GARCH models with dynamic conditional correlations (DCC) were estimated under student-t distribution. We provide evidence of high correlations between *sukuk* and US and EU stock markets, without finding the well-known *flight to quality* behavior affecting Islamic bonds. We also show that volatility linkages between *sukuk* and regional market indexes are higher during financial crisis. We argue that investors could obtain diversification benefits including *sukuk* in a well-diversified equity portfolio, given their lower volatility compared to equity. But higher volatility linkages and dynamic correlations during financial crises show that they are hybrid instruments between bonds and equity. Our findings are relevant for institutional investors and asset managers, that include Islamic bonds in a diversified portfolio.

JEL Classification: G11-G12**Keywords:** *Sukuk*, dynamic correlations, volatility linkages, Asset allocation, DCC GARCH

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