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Review

Does hajj pilgrimage affect the Islamic investor sentiment?

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ABSTRACT

This paper investigates whether the celebrated Islamic hajj (the pilgrimage) can, through its impact on investors' sentiment, affect the performance of the stock market. By considering data of Saudi stock market, we estimate four indirect proxies of Islamic investor sentiment. We show that the Islamic investor's sentiment is significantly higher after hajj pilgrimage than that before this religious occasion. The study of the impact of hajj-pilgrimage practice on the Islamic investor sentiment and stock market return reveals important findings that add to Islamic finance researches. First, we find an increasing influence of the Islamic investor's sentiment on the stock market returns after hajj-pilgrimage. Second, we show a significant positive change in Islamic investors' mood after hajj-pilgrimage and Eid al-Adha holiday which leads to a significant relationship between the change in the Islamic investor's sentiment and stock market return. Third, the Islamic investor's sentiment is significantly affected by its own change, the current stock market return and the change in the stock market return. These findings are consistent with the notion that hajj pilgrimage positively influences the Islamic investor's emotions, as it endorses Muslims to be closer to Allah, which leads to an optimistic sentiment that affects investment decisions.

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1. Introduction

A growing majority of empirical researches document that the investor's sentiment largely affects the behavior of the stock markets (Edmans et al., 2007; Lee et al., 1991, 2002; Brown and Cliff, 2005; Baker and Wurgler, 2006, 2007; Ho and Hung, 2009). The presence of sentiment-driven investors can cause prices to deviate from the fundamental values mainly if rational traders cannot exploit the arbitrage opportunities. These researches are motivated by behavioral theories that focus on the influence of emotions and cognitive evaluation on people's judgments and decision making (Loewenstein et al., 2003). Indeed, the effect of emotional reactions on the investor's behavior has great influence on the eventual decision (Simon, 1967; Loewenstein et al., 2003). In this sense it has been documented that market prices can be influenced by the changes in the investor's mood. Indeed, investors in good moods tend to be more optimistic in their judgments than those in bad moods (Wright and Bower, 1992).

Despite these findings documented on conventional capital markets, the literature on Islamic finance has yet to examine the impact of the investor's sentiment on the returns and risk of the Islamic stock markets (Hussein and Omran, 2005; Yusof and Majid, 2009; Girard and Hassan, 2008; Kok et al., 2009; Perez and Soydemir, 2010; Alam and Rajjaque, 2010; Hayat and Kraeussl, 2011; Ferruz et al., 2010). The religious practices in the Muslim countries, such as fasting Ramadan and the hajj pilgrimage, can be identified as potential factors that influence the investor's mood. During the periods marked by religious phenomena, Muslims are urged to pursue "halal" (good deed) activities and abstain from "haram" (prohibited) activities to be closer to Allah. This behavior generates a positive mood and leads investors to be less discriminating in relation to their stock market investments. Consequently, there may be an increased tendency to invest in Islamic financial markets during the periods characterized by religious practices.

In this paper, we investigate whether the hajj pilgrimage ritual, through its impact on investors' sentiment can influence the behavior of Islamic stock market. To the best of our knowledge, this is the first study to examine the impact of Islamic religious practices on the relation between the investor's sentiment and Shariah-compliant equity returns.

The hajj which is the fifth pillar of Islam, consists in the annual pilgrimage to Mecca in Saudi Arabia. Muslims must make this practice at least once in their life if they can afford it and are physically able (*In it are clear signs [such as] the standing place of Abraham. And whoever enters it shall be safe. And [due] to Allah from the people is a pilgrimage to the House – for whoever is able to find thereto a way. But whoever disbelieves – then indeed, Allah is free from need of the worlds (Sura Al-Imran 97)*). The hajj

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