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Does ethics improve stock market resilience in times of instability?

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Abstract

This paper compares the resilience of ethical (Islamic and socially responsible) indexes among five developed (US, UK, Japan, Canada, Australia) and three emerging markets (Brazil, India, South Africa) during the period following the 2008 subprime crisis. It relies on a multivariate CAPM-EGARCH model that accounts for sudden changes in volatility through the application of an iterated cumulative sums of squares (ICSS) algorithm on daily data over the sample period 2008-2014 to model time-varying volatility and ensure reliable estimates. The study confirms the lower systemic risk associated with Islamic indexes during the bearish period and reports that SRI, despite being more subject to systemic risk, offered higher alphas in highly integrated markets, while Islamic indexes performed better in less integrated ones. The evidence also reveals a very limited increase in the models' predictability power from the integration of sudden changes in volatility into the EGARCH models during the full sample period. This limit is more marked during the bearish sub-period. Our findings have important implications for international investment and portfolio diversification perspectives in times of financial downturn.