Pacific-Basin Finance Journal 34 (2015) 192–204

Contents lists available at ScienceDirect

Pacific-Basin Finance Journal

journal homepage: www.elsevier.com/locate/pacfin

Sharia compliant gold investment in Malaysia: Hedge or safe haven?☆

Mohd Fahmi Ghazali [a,b], Hooi Hooi Lean [a,*], Zakaria Bahari [a]

[a] *Economics Program, School of Social Sciences, Universiti Sains Malaysia, Penang, Malaysia*
[b] *Labuan Faculty of International Finance, Universiti Malaysia Sabah, Labuan, Malaysia*

A R T I C L E I N F O

Article history:
Received 25 August 2014
Accepted 24 December 2014
Available online 30 December 2014

JEL classification:
C22
G11
G14
G21

Keywords:
Gold
Hedge
Safe haven
Sharia
Malaysia

A B S T R A C T

This paper studies the hedge and safe haven characteristics of *Sharia* compliant gold in Malaysia. Specifically, we would like to know whether the official gold and gold account traded, which complies with Islamic principles, can be used as a hedge or a safe haven for the Malaysian market. To answer this question, we examine both constant and time-varying relations between domestic stock and gold returns. The notable finding is that the official gold standard of Malaysia can act as a strong hedge relative to the use of the Islamic gold account. On the other hand, the domestic gold, in particular the Islamic gold account, does not perform attractively as a safe haven during the episodes of extreme drops in stock market. These findings show that gold does not play a major role during the stock market declines in Malaysia. Nevertheless, we note that the official gold standard performs better than the gold account.

© 2014 Elsevier B.V. All rights reserved.

1. Introduction

Despite the advantages of gold as a hedge and a safe haven against stock market uncertainty, investigation on this issue is relatively scarce in small emerging countries, particularly using different types of gold. We are also unaware of any studies that examine the issue from the Islamic product perspective. This study bridges the gap by investigating the official gold bullion of Malaysia and gold account that complies with *Sharia* principles on its hedging properties. This is crucial because it helps the investors to decide the best alternative

☆ The authors would like to acknowledge the Fundamental Research Grant Scheme 203/PSOSIAL/6711417 by the Ministry of Education Malaysia and the Universiti Sains Malaysia.
* Corresponding author. Tel.: +60 4 6532663.
E-mail address: hooilean@usm.my (H.H. Lean).

http://dx.doi.org/10.1016/j.pacfin.2014.12.005
0927-538X/© 2014 Elsevier B.V. All rights reserved.

when dealing in gold investment. The research is also important in generating awareness within the Muslim community toward gold investment which is free from the elements of usury, uncertainty and gambling (*maysir*).

While our main purpose of this study is on the relationship between gold returns and stock return under time-varying conditions, it is worth mentioning that investigating asset market relations under extreme conditions is related to behavioural finance, in particular the Ellsberg paradox (Ellsberg, 1961) and prospect theory (Kahneman and Tversky, 1979; Tversky and Kahneman, 1974, 1992). Both models break the traditional assumptions by incorporating human behaviours into investment decisions. The main idea of Ellsberg paradox is about uncertainty aversion. Specifically, it describes an attitude for known risk over unknown risks. When uncertainty is high, investors give greater weight to their "worst case scenario" in choosing their optimal portfolio. As gold is a physical asset, and its value is noncontingent to the decisions of a single government or central bank, it is plausible that investors view gold as the best alternative in a "worst case scenario". Coates and Herbert (2008) demonstrate the neuro-scientific basis, where in times of greater market uncertainty, investors withdraw from risk, favouring a relatively safe asset. In addition, there are also likely to be emotional factors in choosing safe haven assets. Loewenstein (2000) documents that visceral factors tend to dominate the decision making during high levels of uncertainty.

The prospect theory, on the other hand, is rather abstract, where the main idea is about loss aversion. The theory describes that investor evaluates gambles by thinking about gains and losses rather than the final wealth. They are more sensitive to losses than gains and, as such, will base decisions on perceived gains rather than perceived losses. Thus, if a person is given two equal choices, a possible gain and a possible loss, one would choose the former, even though they may get the same economic end result.

With the exception of Baur and McDermott (2010), no studies differentiate between strong and weak hedge (and/or safe haven). If gold is negatively correlated with stock on average, gold is a strong hedge of stock. Investors can enjoy positive return if the stock has negative return. However, this is not the case if gold is just a weak hedge of stock when both assets are uncorrelated. If there is a weak safe haven, gold will protect investors to the extent that it does not move in tandem with stock market in response to the negative shock. On the other hand, if there is a strong safe haven, the investors will enjoy positive return and move to gold during periods of market stresses. As a positive return of an asset in the time of turmoil can enhance the stability of market and economy by reducing total loss, a distinction of weak and strong properties of the asset is important.

We note that gold investment activities are picking up in Malaysia because more and more investors are becoming aware of the unpredictable phenomena in stock market. Gold investment becomes an alternative and popular solution to investors. This preference creates an opportunity for financial institutions and private companies to offer gold or gold-related products as one of their selling points. Many commercial banks in Malaysia, including both Islamic and conventional banks have introduced gold investment account as one of their investment products. Besides that, gold investment funds and gold-related investment funds are becoming attractive to the high-net-worth individuals. Along with these practical initiatives, work on creating awareness and educating the masses is kept going, with several high profile seminars and series of international conferences organized on the subject of gold and gold dinar (Ibrahim, 2012).

The former prime minister of Malaysia, Mahathir Mohamad, proposes the use of gold instead of US dollar particularly in international trade settlement (Song, 2010). The prices of commodity products for export and import purposes are quoted in the weight of gold and silver in order to hedge on price fluctuation. In this structure, the gold itself is used for pricing and not national currencies backed by gold (Sharif et al., 2008). On July 17, 2001, Malaysia became the 12th country in the world that issues its own gold bullion coin, namely, Kijang Emas. Its price is determined by the prevailing international gold market price.[1] This was followed by the issuances of gold dinar by the Royal Mint of Malaysia in 2003, the Kelantan state government in September 20, 2006, and the Perak state government in February 28, 2011.

The paper is organized as follows. We briefly discuss the *Sharia* compliance issue in the next section and review the literature in Section 3. Methodology and data are provided in Section 4. Section 5 presents and discusses the estimation results, and Section 6 concludes the study.

[1] Source: Central Bank of Malaysia.

Download English Version:

https://daneshyari.com/en/article/975315

Download Persian Version:

https://daneshyari.com/article/975315

Daneshyari.com