

IMPORTANCE OF ISLAMIC STOCK INDICES FOR THE COUNTRY'S FINANCIAL MARKET

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Abstract— This research focuses on the vital role of Islamic fund indices in aligning investments with Sharia principles. These indices offer diverse ethical investment options, driving the growth of the Islamic capital market. In the changing global financial landscape, they also influence corporate ethics. This study underscores their crucial role in integrating beliefs with modern investment practices for a fair and prosperous financial ecosystem benefiting all stakeholders.

Index Terms— Islamic finance, Islamic stock indices, Sharia principles, ethical investments, growth, integration.

I. INTRODUCTION

Stock indices, also known as stock market indices, are numerical measures that track the performance of a specific group of publicly traded companies or a section of the stock market. These indices act as indicators of the overall health and performance of the stock market or a particular sector within it. They are essential tools for investors, financial analysts, and policymakers to gauge the market's movements, make investment decisions, and assess economic trends.

Stock indices are usually calculated using a weighted average of the prices or market capitalization of the constituent stocks. The calculation methodology varies depending on the index provider and the specific index being tracked. Some well-known stock indices include the S&P 500, Dow Jones Industrial Average (DJIA), NASDAQ Composite, FTSE 100, and DAX 30, among others.

Overall, stock indices play a vital role in the financial world, aiding investors in understanding market movements and guiding their investment strategies.

II. LITERATURE REVIEW

Research on Islamic stock indices has increased significantly in recent times.

A team led by Nafis Alam at the International Centre for Education in Islamic Finance [1] asked: do Islamic stock indices perform better than conventional counterparts? This study analyzes the efficiency of Islamic sector indexes compared to conventional sector indexes. The analysis is conducted over 18 years and reveals that in the shorter horizon, efficiency tends to follow a similar pattern between the two types of indexes. Islamic sector indexes generally exhibit higher efficiency in the last decade.

A group at the University of Sfax led by Hedi Haddad [2] described common shocks, common transmission mechanisms and time-varying connectedness among Dow Jones Islamic stock market

indices and global risk factors. This study examines the co-movements and integration of Islamic stock markets, as well as the spillover effects and predictive power of global risk factors. The results show that both common shocks and transmission mechanisms contribute to business cycle co-movements in Islamic stock markets. Additionally, the study explores the role of Fourth Industrial Revolution assets and global commodities in portfolio diversification. The findings provide insights for investors and policymakers.

In addition, S. Abrorov, as an author, has published a number of scientific articles on Islamic finance, Islamic securities and other related topics [6] [7] [8] [9].

III. DISCUSSION

Islamic stock indices, also known as Shariah-compliant stock indices, are specialized indices that track the performance of stocks of companies that comply with Islamic principles and guidelines. These indices are designed to cater to the needs of Islamic investors who seek to invest in accordance with their religious beliefs and avoid non-compliant business activities.

The construction of Islamic stock indices involves a rigorous screening process to ensure that the constituent companies adhere to Shariah principles. The screening criteria typically include:

Business Activities: Companies involved in prohibited industries, such as alcohol, gambling, pork-related products, conventional banking and finance (with interest-based transactions), and other non-compliant activities, are excluded from the index.

Debt Levels: Companies with excessive debt ratios or those involved in interest-based borrowing are generally avoided.

Financial Ratios: The financial ratios of the companies are analyzed to ensure they meet specific Islamic finance requirements.

Interest Income: Companies that derive significant income from interest or non-compliant financial activities are excluded.

Purification of Income: Companies with non-compliant income sources can undergo a purification process, where a portion of their income is donated to charitable causes.

Islamic stock indices are commonly used as benchmarks for Shariah-compliant investment funds and financial products. They provide a reference point for investors looking to assess the performance of their investments in line with Islamic principles.

Some well-known Islamic stock indices include:

Dow Jones Islamic Market Index (DJIM): This index is a family of Islamic indices provided by S&P Dow Jones Indices. It includes regional and country-specific indices, such as the Dow Jones Islamic Market World Index and the Dow Jones Islamic Market Malaysia Index.

FTSE Shariah Global Equity Index Series: Offered by FTSE Russell, this series includes various indices covering global markets that meet the criteria for Shariah compliance.

S&P Shariah Indices: Provided by S&P Dow Jones Indices, these indices cover various regions and countries, including the S&P Shariah 500 Index.

MSCI Islamic Indices: Offered by MSCI, this series includes regional and country-specific indices, such as the MSCI ACWI Islamic Index.

Islamic stock indices play a crucial role in promoting Islamic finance and attracting Islamic investors to the stock market. By providing a universe of Shariah-compliant investment options, these indices contribute to the growth and development of the Islamic capital market worldwide. They also enable investors to align their financial goals with their ethical and religious beliefs, fostering responsible and sustainable investment practices.

Table 1. Composition of the DJIM index by country (31.07.2023)

No	Country	Number of shares	Market capitalization (billion USD)	Weighted value in the index (%)
1.	USA	561	31 303,33	68,9
2.	Japan	308	2 139,01	4,2
3.	Switzerland	49	1 552,69	3,2
4.	China	999	5 050,31	3,2
5.	Great Britain	67	1 157,31	2,5
6.	Canada	74	973,95	2
7.	France	27	1 312,63	2
8.	India	258	1 871,24	1,8
9.	Taiwan	253	1 044,02	1,7
10.	Australia	71	697,59	1,5
11.	South korea	306	960,93	1,4
12.	Netherlands	13	651,14	1,3
13.	Germany	42	642,81	1
14.	Denmark	20	498,33	1
15.	Sweden	43	387,13	0,7
16.	Saudi Arabia	87	2 683,28	0,6
17.	Italy	18	229,89	0,3
18.	Finland	12	133,22	0,3
19.	Brazil	33	187,70	0,2
20.	Others (37 countries)	520	2 067,72	2,2

Dow Jones Islamic World Index (DJIM): This index is part of the family of Islamic indices provided by S&P Dow Jones Indices. It includes regional and country indices such as the Dow Jones Global Islamic Market Index and the Dow Jones Islamic Market Index Malaysia. When calculating DJIM, the Dow Jones Islamic indices of different countries (territories) are averaged. This index has been calculated since May 24, 1999.

As of July 31, 2023, the DJIM index consists of 3,761 components (Table 1), the largest 10 of which account for 26.7% of the index. In addition, the stocks used in calculating the weighting of the index are representative of 56 countries, and stocks traded primarily on U.S. stock exchanges represent the largest weighting in the index. This figure is 68.9 percent.

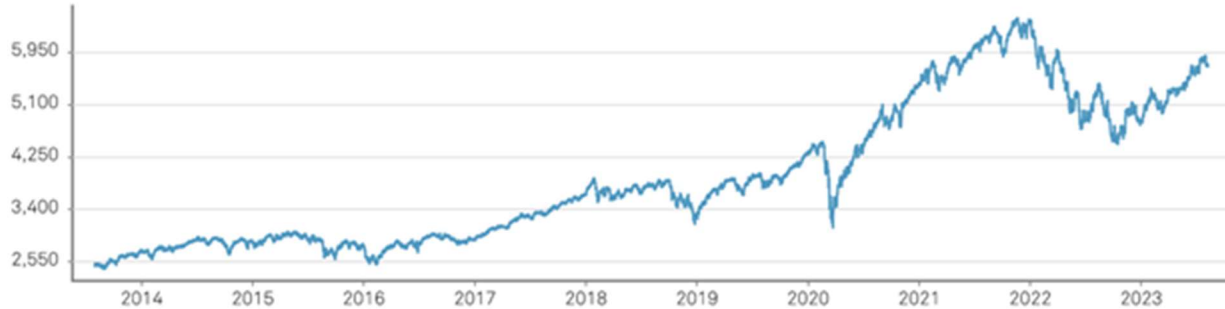


Figure 1. Dynamics of the DJIM index [10].

Although the DJIM index has shown overall growth dynamics over the past historical period, sharp declines can be observed in certain periods (Fig. 1). In 2020, a sharp decline in the DJIM index was recorded during the onset of the 2020 COVID-19 pandemic. This is because the pandemic situation was declared unexpectedly when the economic infrastructure was not ready. During this interval, there was a fall in all types of indices around the world. But within a short period of time, the economy recovered to its pre-pandemic level.

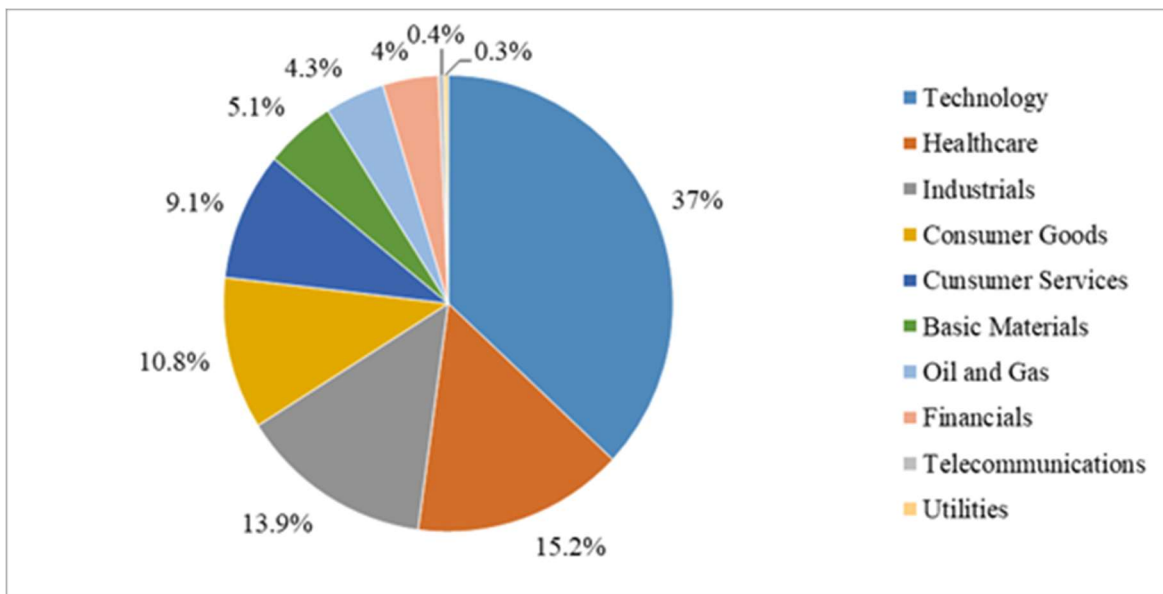


Figure 2. Composition of the DJIM index by sector [11].

If the composition of the DJIM index is examined by sector, it becomes clear that it has a clear advantage with a high share of high-tech enterprises. The share of technology enterprises in the index is 37 percent (Figure 2). These companies include Apple, Microsoft, Nvidia, Alphabet and Meta. Further, the share of enterprises in the healthcare sector (15.2 percent) and industry (13.9 percent) is high.

Table 2. Composition of the FTSE Shariah All World Index by country (31.07.2023)

No	Country	Number of shares	Market capitalization (billion USD)	Weighted value in the index (%)
1.	USA	219	19 683,81	59,93
2.	Japan	284	2 039,03	6,21
3.	Great Britain	59	1 431,51	4,36
4.	France	33	1 068,40	3,25
5.	Switzerland	35	887,85	2,70
6.	Germany	49	850,90	2,59
7.	Taiwan	65	793,91	2,42
8.	Australia	63	712,24	2,17
9.	South Korea	80	677,47	2,06
10.	China	580	590,85	1,80
11.	India	108	547,61	1,67
12.	Canada	14	471,35	1,44
13.	Netherlands	13	436,63	1,33
14.	Denmark	11	369,18	1,12
15.	Sweden	33	324,39	0,99
16.	Saudi Arabia	49	238,55	0,73
17.	Brazil	40	232,59	0,71
18.	Spain	12	232,03	0,71
19.	Italy	15	171,29	0,52
20.	Others (27 countries)	337	1 084,37	3,29

The entire FTSE world index is Shariah compliant. This index, offered by Yasaar Ltd, includes various indices covering global Shariah-compliant markets. FTSWORLDS was introduced on October 29, 2007 and contains 2099 tools (Table 2). As of July 31, 2023, the 10 largest enterprises accounted for 30.5 percent of the index value. Additionally, the stocks used in calculating the index's weightings come from 46 countries, and stocks traded primarily on U.S. stock exchanges represent the largest weightings in the index. This figure is almost 60 percent.

Like all Islamic stock indices, the FTSE Shariah All World Index reflects a long-term upward trend and a sharp decline during the onset of the COVID-19 pandemic (Figure 3). According to the law, the share of technology enterprises maintains a high share in the index (Fig. 4). After technology businesses, which accounted for nearly 36 percent, healthcare, industrial products and services, and consumer products and services accounted for about 15.9 percent, 15.7 percent and 13.7 percent, respectively.

If we compare the data in Table 1 and Table 2, it becomes clear that countries with advanced economies and high levels of development carry out more share transactions in accordance with Shariah than Muslim countries. This can be explained by the following several factors.



Figure 3. Dynamics of the FTSE Shariah All World index [12]

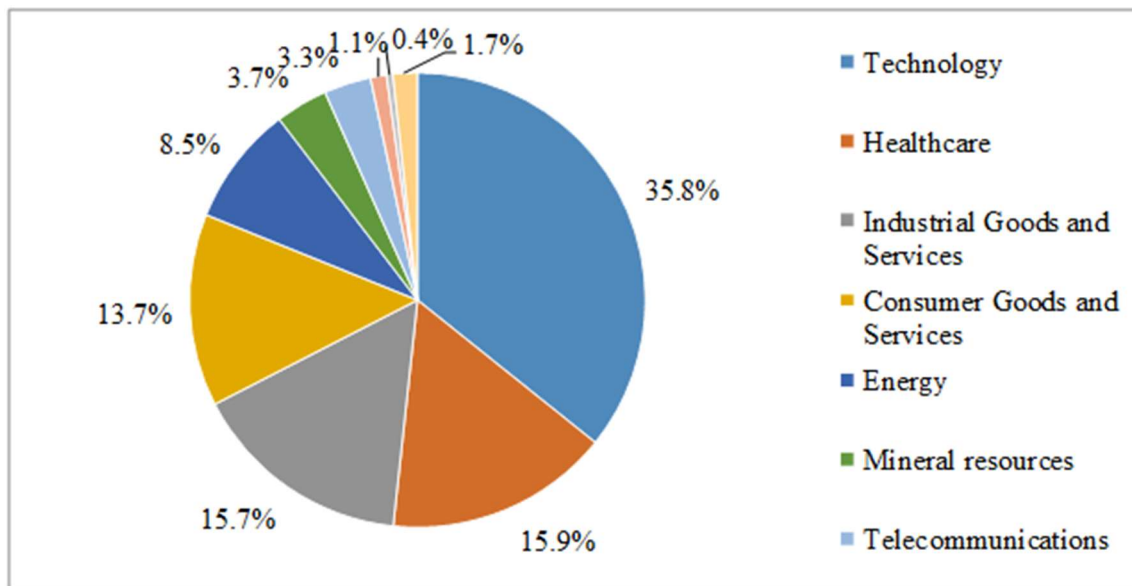


Figure 4. Composition of the FTSE Shariah All World index by sector [13]

Developed countries often have well-developed financial infrastructure, including advanced stock exchanges, regulators and financial institutions. This infrastructure provides an enabling environment for the development of specialized indices such as Islamic stock indices.

Developed countries have a very large investor base. Investors in these countries often perceive Islamic securities as a new diversification factor.

Many developed countries such as the UK, USA and Japan are major financial centers of the world. The development of Islamic finance products, including Islamic stock indices, can attract international investors and strengthen the country's position in the global financial market.

In some Muslim-majority countries, legal and regulatory issues may still arise when introducing and selling Islamic finance products due to various factors. Developed countries with well-developed regulatory frameworks may find it easier to introduce and regulate Islamic finance products.

Countries with developed capital markets have rich historical experience in this area. Given that Islamic stock indices have significant differences from traditional stock indices, the development of new forms of instruments by these market participants can be carried out without difficulty.

It should be noted that the development of the Islamic capital market is directly related to the level of development of the common market.

Islamic stock indices play a crucial role in attracting Islamic finance and Islamic investors to the stock market. By providing a wide range of Shariah-compliant investment opportunities, these indices contribute to the growth and development of the Islamic capital market worldwide. They also enable investors to reconcile their financial goals with their ethical and religious beliefs, while promoting responsible and sustainable investing.

Islamic stock indices have become an ethical investment tool. These indices serve as a bridge between Shariah principles and modern financial markets, allowing investors to participate in the stock market while remaining true to their religious and moral beliefs.

The rigorous compilation process of Islamic stock indexes, which includes due diligence and adherence to Shariah principles, ensures that only companies adhering to Islamic values are included. This review covers not only financial performance, but also business performance and debt levels, helping to take a holistic approach to ethical investing.

CONCLUSION

Islamic stock indices play a multifaceted role in the financial landscape. They provide investors with benchmarks by which they can evaluate the performance of their investments in accordance with Shariah principles. In addition, these indices contribute to the growth and development of the Islamic capital market by creating a wide range of Shariah-compliant investment opportunities.

As the global financial landscape continues to evolve, Islamic stock indices are expected to become increasingly important. Their role is not limited to financial markets, but also extends to promoting ethical behavior in the corporate world by encouraging companies to align their practices with Shariah principles.

In fact, Islamic stock indices are an example of the harmonious integration of faith and finance. They demonstrate the flexibility and relevance of Islamic principles in modern investment practice. As ethical investing gains momentum and responsible financial practices become more important, Islamic stock indices will grow in importance and further contribute to a stable and fair global financial ecosystem.

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