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Sukuk Investors' Confidence Following the 2008-Crisis: A Perspective From Maqasid Shariah for the Covid-19 Pandemic

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Abstract

Changes in investors' confidence may trigger changes in asset prices. Investor sentiment may be an essential factor in the market pricing process to explain changes in the stock market index. The purpose of this study is to look into the confidence effects on Sukuk investors in Malaysia following the COVID-19 pandemic using the impact of the global financial crisis of 2007/2008 as a reference. The confidence effect will be measured using an Equity Market Sentiment Index (EMSI). This study focuses on FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBMKLCI), FTSE Bursa Malaysia Emas Shariah Index (FBM EMAS), FTSE Bursa Malaysia Hijrah Shariah Index (FBM HIJRAH), and Dow Jones Islamic Market (DJIM). The sources of data include Datastream, Bloomberg database, Securities Commission Malaysia, and Bursa Malaysia. The investors' confidence to issue Sukuk increased after the crisis. The investors' behaviour showed that they avoided risks in their portfolio, but they tend to seek chances when they are confident. Therefore, intelligent investors are those who accept higher risks with higher returns. Concerning the objective, Sukuk investors did not display high risk-seeking behaviour before the 2008 crisis. The Sukuk investors during the COVID-19 pandemic have also referred to this situation of the 2008 global financial crisis to seek chances and confidence to issue and invest in Islamic bonds, where there are higher risks with higher returns. This analysis provides valuable information and guidelines to issuers, policymakers, regulatory bodies, and investors, both Muslim and non-Muslim, and can draw them to Islamic bonds, Sukuk.

Keywords: EMSI, Sukuk, Confidence Effect, Stock Market, 2008-Crisis, COVID-19 Pandemic

Introduction

One aspect of the Sukuk industry that has been thoroughly researched is risk. The Sukuk market has exploded in popularity, attracting investors from all over the world. The capital

markets, an essential source of capital, are not immune to the impacts of COVID-19. Is the coronavirus (COVID-19) pandemic forcing Islamic capital market innovation, especially in social and sustainable Sukuk issuance? The subject of Sukuk risk, specifically the risk structure, must be revealed and aligned with Shariah values. According to Hancock and Meussa (2009), Sukuk investors discovered that they are unexpectedly competing with a general body of creditors, rather than simply enforcing against, or taking possession of the assets to support their Sukuk when some originators run into financial trouble, or worse, become insolvent. The research issue arises from the growing number of defaulted loans. Sukuk should be one of the main concerns because it is closely associated with risk, which will affect investors' willingness to invest in Sukuk. In the Sukuk market, investor confidence is important because it influences the number of issuances and returns. This becomes the impetus for researching the risk profile of Sukuk investors.

Economic and financial fluctuations are influenced by public confidence in the economy, particularly in the Islamic capital market. When investors gain confidence in the strong economic conditions, they would want to buy securities and invest at current prices. Otherwise, as seen in the global financial crisis of 2008, their risk-taking tends to decline as confidence declines. Since the beginning of the crisis, confidence has deteriorated, and changes in confidence can be linked to a variety of economic variables and events (Dailami & Masson, 2009). Investor confidence is defined as the expectation of future stock market stability, which is a key factor in determining stock market volatility. In the stock market or securities exchange market, investor confidence is an important topic. The ability to issue securities without withholding material facts from public security holders is critical to public confidence in the securities market (Dante, 2004).

The purpose of this study is to look into the confidence effects on Sukuk investors in Malaysia following the COVID-19 pandemic using the impact of the global financial crisis of 2007/2008 as a reference. This study adds to the literature because empirical research on Sukuk investors' confidence is scarce. The remainder of the paper is organised in the following manner: the second section discusses related literature and gives some background on investor confidence; the theoretical framework is discussed in the third section; the research methodology is highlighted in section four; the findings are discussed in section five; and the study is concluded in section six.

Literature Review

Introduction To Sukuk Investment

Sukuk is an Arabic word that means ’legal instrument, deed, or check’, and is the plural of ’sakk’. Sukuk are Shariah-compliant bonds, which are long-term debt obligations secured by a specified asset or a promise to pay (Al-Amine, 2008). Sukuk are ’certificates of equal value that evidence undivided ownership or investment in the assets using Shariah principles and concepts approved by the Shariah Advisory Council (SAC)’, according to the Securities Commission Malaysia (2011).

Sukuk are certificates of equal value that represent an undivided interest in the ownership of an underlying asset (both tangible and intangible), usufruct, services, or investments in specific projects or activities (AAOIFI, 2008). Sukuk is the most important and well-known component of the Islamic financial system, accounting for roughly 90% of the Islamic capital market (Haider & Azhar, 2010). The Islamic Development Bank (IDB) defines Sukuk as ’an asset-backed bond designed or structured in accordance with Shariah and capable of being traded in the market’ (IDB, 2006). Sukuk are ’certificates of equal value representing

undivided shares in the ownership of tangible assets, usufructs, and services or (in the ownership of) the assets of particular projects or special investment activity', according to the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI, 2008).
The Islamic Financial Services Board (IFSB, 2007) defined Sukuk as 'certificates that represent the holder's proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such asset' in its Capital Adequacy Standard (IFBS-2). Sukuk are 'certificates of equal value that evidence undivided ownership or investment in the assets using Shariah principles and concepts approved by the Shariah Advisory Council (SAC)', according to the Securities Commission Malaysia (2011). The Securities Commission Malaysia's definition of Sukuk will be used in this research.
Abdel-Khaleq and Richardson (2007) noted that Sukuk structures vary, such as Sukuk Murabahah (trade with mark up or cost-plus sale), Sukuk Ijarah (rental or lease agreement), and Sukuk Musyarakah (profit and loss sharing). This research focuses on these three types of Sukuk structures, namely Murabahah, Ijarah, and Musyarakah, by 50 listed firms in Malaysia, although there are 14 types of Sukuk listed by AAOIFI (Noriza & Azhar, 2012). Securities Commission Malaysia (2010) categorised them as sale-based Sukuk, lease-based Sukuk, and equity-based Sukuk. Figure 1 illustrates the different types of Sukuk based on Shariah contracts.

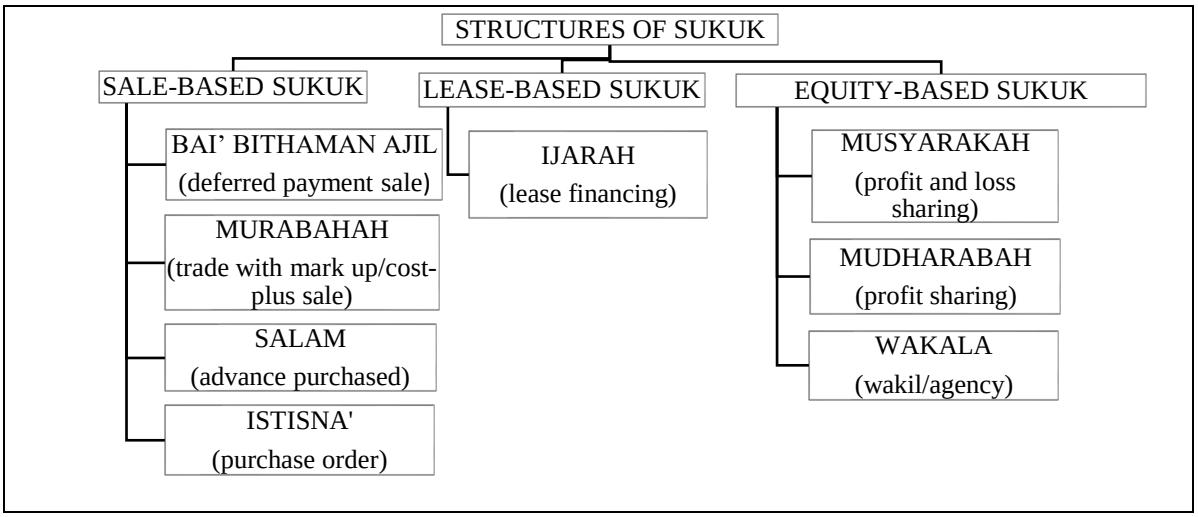

Figure 1. Selected structures of Sukuk based on Shariah contracts (*Securities Commission Malaysia, 2010*).

Figure 1 shows eight types of Sukuk structures that are popular in Malaysia. The Bank Negara Malaysia and Securities Commission Malaysia (2009) report that Islamic securities are securities issued according to any Shariah principle and concept approved by the SC's Shariah Advisory Council (SAC). The approved Shariah concepts and regulations for structuring, documenting, and trading of Islamic securities are:

i. Musyarakah (Profit and Loss-sharing)
This is a partnership arrangement between two or more parties to finance a business venture, where all parties contribute capital either in cash or in-kind to fund the business venture. Any profit derived from the experience will be distributed based on a pre-agreed profit-sharing ratio, but a loss will be shared based on equity participation.

ii. Mudharabah (Profit-sharing)

Mudharabah is a unique partnership where one partner gives money to another for investing in a commercial enterprise. The parties are a rabb al-mal or investor, who solely provides the capital; and a mudharib or entrepreneur, who solely manages the project. If the venture is profitable, the profit will be distributed based on a pre-agreed ratio. In the event of a business loss, the loss is borne solely by the capital provider.

iii. Ijarah (Leasing)

This is a manfaah (usufruct) type of contract, where a lessor (owner) leases out an asset or equipment to its client at an agreed rental fee and pre-determined lease period upon the 'aqad (contract). The ownership of the leased equipment remains in the hands of the lessor.

iv. Bai' Bithaman Ajil or BBA (Deferred-payment Sale)

This contract refers to the sale and purchase transaction for the financing of an asset on a deferred and instalment basis, with a pre-agreed payment period. The sale price will include a profit margin.

v. Istisna' (Purchase Order)

This is a purchase contract for an asset, where a buyer will place an order to purchase the asset that will be delivered in the future. In other words, the buyer will require a seller or contractor to provide or construct the asset that will be completed in the future, following the sale and purchase contract terms. Both parties in the contract will decide on the sale and purchase prices as they wish, and settlement can be delayed or arranged based on the schedule of work completed.

vi. Murabahah (Cost-plus Sale)

This contract refers to the sale and purchase transaction for the financing of an asset, where the cost and profit margin (mark-up) are made known and agreed to by all parties involved. The purchase price settlement can either be on a deferred lump sum basis or an instalment basis, which will be specified in the agreement.

There are three parties to a Sukuk arrangement for the process of Sukuk issuances in general (Tariq & Dar, 2007). They are the Sukuk (the obligor) originator, the Special Purpose Vehicle (SPV) as the issuer of the Sukuk certificates, and the investors who buy these certificates. The SPV is a separate bankruptcy-remote legal entity from the originator. At the end of the Sukuk's term (and lease of the assets), ownership of the asset will be transferred to the collective Sukuk holders. Figure 2 shows the basic arrangement of the Sukuk structure.

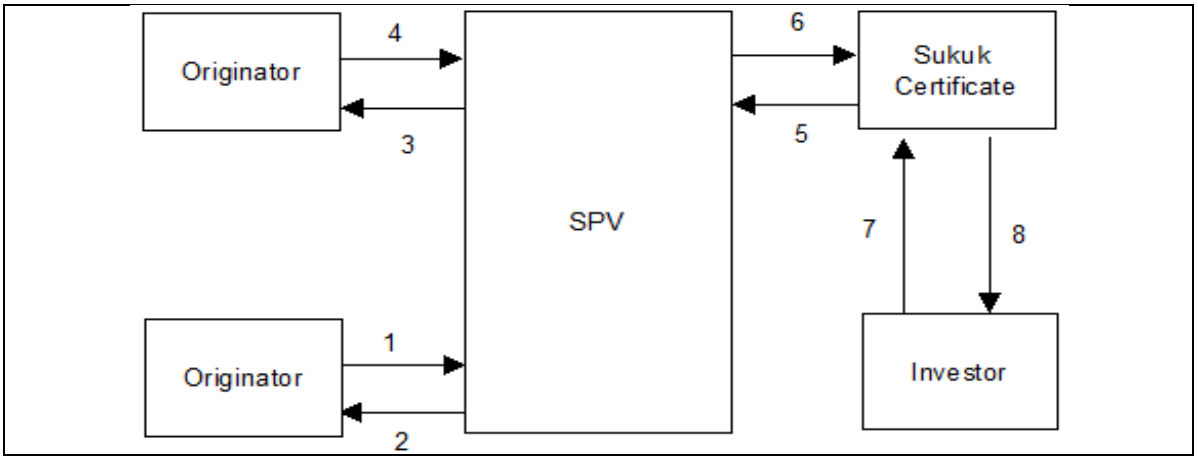

Figure 2. Arrangement of Sukuk structure (*Tariq & Dar, 2007*).

There are three parties involved in Sukuk issuance: the originator; the Special Purpose Vehicle (SPV); and the investors. The steps involved in the process of Sukuk issuance are explained below:

1. Originator sells assets to be leased to the SPV.
2. The originator receives payment for assets sold.
3. The SPV leases assets back to the originator.
4. The SPV receives rent payments from the originator under a term-specified contract.
5. The SPV collects funds from the issuances of Sukuk certificates to finance the purchase of assets from the originator.
6. The SPV utilises the rent payments from the originator to disburse distributions on the Sukuk certificates.
7. Investors, both conventional and Islamic, secure the Sukuk certificates.
8. The investors are reimbursed periodically by the distributions from the SPV, which are funded by the originator's rental payments on the leased assets.

Figure 3 below indicates the green Sukuk issuing process.

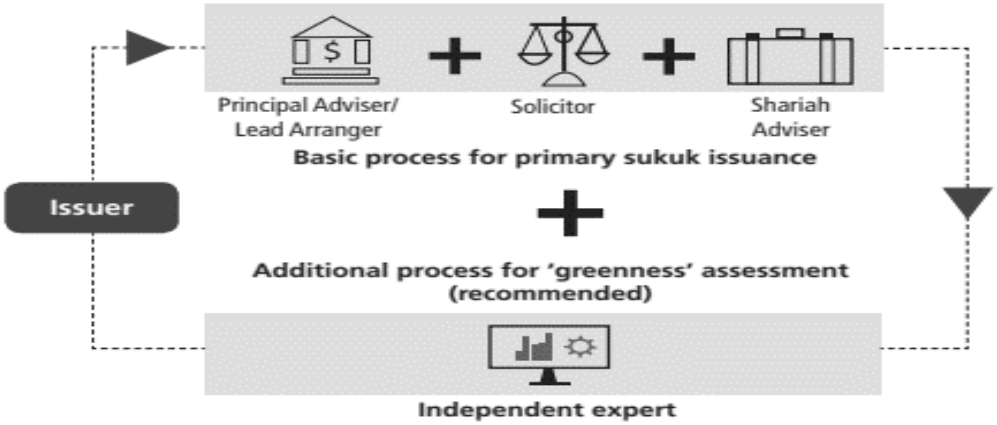

Figure 3. Green Sukuk issuing process (*Securities Commission of Malaysia, 2019*).

Figure 3 shows the structure of Shariah compliance, which is one of the most essential features in financial obligations and relationships between issuers and investors. The most common underlying Shariah contracts used in Sukuk structuring are lease-based, agency-based, sale-based, and partnership-based contracts. All Sukuk transactions must follow Shariah principles and rules at all times. As it is available to both conventional and Islamic

investors as well as green investors, Green Sukuk has the potential to appeal to a broader range of investors (Figure 4). For Islamic investors, the principles and values that underpin both green and Islamic financing are strikingly similar. Green finance is very similar to Islamic finance in terms of promoting positive values such as social responsibility, shared prosperity, and long-term growth. Green Sukuk would give green investors a new way to achieve their green investment goals. Green Sukuk could bring more investors into Sukuk markets from Western countries with sustainable investment mandates. Figure 4 shows that Green Sukuk attracts a broader investor base.

Figure 4. Green Sukuk attracts wider investor base (*Securities Commission of Malaysia, 2019*).

Shariah Aspect in Islamic Capital Market

The Shariah Advisory Council (SAC) had their third meeting to discuss Shariah research guidelines in the capital market and passed a resolution to accept all the esteemed Islamic jurist sources and methodology. These sources of research consist of primary and secondary sources adopted in Islamic jurisprudence. The primary sources used by the SAC in researching the capital market are the Quran, Sunnah, ijma', and qiyas. The SAC also passed a resolution to use secondary sources and other Islamic jurisprudence methodologies such as maslahah, istihsan, istishab, sadd al-dhariah, urf, and maqasid al-shariah. The Islamic capital market is different from the conventional capital market which always takes interest or profit from one party to another. This is contrary to Islamic principles. The primary sources used by the SAC in conducting research on the capital market are stated in Quran:

إِنَّ اللَّهَ يَأْمُرُكُمْ أَنْ تُؤَدُّوا الْأَمَانَاتِ إِلَىٰ أَهْلِهَا وَإِذَا حَكَمْتُمْ بَيْنَ النَّاسِ أَنْ تَحْكُمُوا بِالْعَدْلِ ۚ إِنَّ اللَّهَ نِعِمَّا يَعِظُكُمْ بِهِ ۗ إِنَّ اللَّهَ كَانَ سَمِيعًا بَصِيرًا

Indeed, Allah commands you to return trusts to their rightful owners; and when you judge between people, judge with fairness. What a noble commandment from Allah to you! Surely Allah is All-Hearing, All-Seeing. (an-Nisa' 4:58)

يَا أَيُّهَا الَّذِينَ آمَنُوا أَوْفُوا بِالْعُقُودِ ۚ

O you who have believed, fulfill [all] contracts. (al-Maidah 5:1)

وَأَوْفُوا بِالْعَهْدِ ۖ إِنَّ الْعَهْدَ كَانَ مَسْئُولاً

And fulfill the promise; surely (every) promise shall be questioned about. (al-Isra' 17:34)

According to Rashid (1967) in tafsir al-Manar, the above verse shows that Allah SWT ordered to complete the agreement absolutely and clearly. Hence, it shows that indeed the origin of the law is permissible and should not be forbidden. These visions deeply follow the objectives of Shariah, also known as Maqasid al-Shariah, which is to serve the public interests and to prevent harm. These principles are based on Qawaid fiqhiyyah by al-Shatibi (2008):

الأصل فى الأشياء الإباحة حتى يدل الدليل على تحريمه

The original law in all matters (except for special worship and relationships between men and women) is permissibility, unless there is clear evidence otherwise (al-Shatibi, 2008).

The Islamic capital market includes a system that provides justice because it is guided by Islamic law that is free from the elements of riba (usury), gharar (uncertainty), and maisir (gambling). According to Sanusi, Draman and Matraji (2013), the Islamic capital market in Malaysia became strong due to the performance of the Sukuk market achieved today which is enough to reflect the rapid growth. This is because it is supported by a favourable economic environment, liberalisation of the financial system, and human intellectual capital which lead in a fair financial industry. The Islamic capital market is a solution to the conventional capital market, which encourages progress in the shariah-compliant Muslim economic system. In addition, it is also regulated and monitored by the Shariah Supervisory Board.

Comparison Between Sukuk and Bonds

The differences between Sukuk and Bonds are examined from the formations of both. The Bond settlement process is simpler than the Sukuk process. Bond formation directly requires only three stages: asset securitisation; issuance of bond certificate; and bond certificate trading in the market. According to Dogan and Sagir (2014), Sukuk is more stable because it is based on a particular asset, business, or project from a price point of view. In contrast, bonds are priced more elastically and prone to drastic declines as well as increases as they are not asset-backed. In addition, the calculation of profit is also different because a Sukuk is a claim on a specific asset that is clear, while a bond is a claim on cash flow alone or the ownership of an entity as a whole (general) because it is a debt. The issue price for Sukuk is based on the market price of a particular asset or project while the issue price for conventional bonds is based on the value set by the issuer of the bond. Tahmoures (2013) states that bond prices are influenced by various factors including interest rates, inflation, maturity dates, and credit quality. If interest rates rise to a level higher than the bond coupon, then the bond price will fall to a level lower than the principal value. Since bonds are easily influenced, it creates ‘gharar’ and speculation or gambling, according to Islam. From the investor's perspective, the difference between Sukuk and bonds is that Sukuk provides opportunities to all types of investors; whether conventional investors who are non-Muslims and Muslim investors who want to follow Islamic guidelines in seeking profit. However, conventional bonds only involve non-Muslim investors. Here, we can see that Sukuk (Islamic bonds) are more open than conventional bonds because Islamic investors are not allowed to engage in conventional bonds. Hence, Sukuk has an advantage when compared to bonds.

The calculation of profit is different between Sukuk and bonds because Sukuk is a claim on a specific asset that is clear, while a bond is a claim on cash flows alone or the ownership of an entity as a whole (general) because it is a debt. The structure of Sukuk and issuance is not just an exchange between money and certificates. It is based on the exchange of assets (asset-backed), where investors can claim their investment by pledging assets that are collaterals for Sukuk. While the bond structure is based on debt (debt-claim), where the debt is traded and not based on real business (real-economy). This is contrary to Islamic shariah on the prohibition of debt transactions or rights transactions (Nafis et al., 2019).

Strong Liquidity Position: Sukuk Issuances Following Covid 19

Several governments have frequently provided domestic Sukuk as part of their public finance borrowing strategies, demonstrating the value and appeal of Sukuk as COVID-19 mitigation financing in the global Sukuk sector since the beginning of 2020, especially in response to COVID-19 disruptions and other significant events such as the worldwide oil and gas price and

output slump. Among them are Saudi Arabia, Turkey, Bahrain, Nigeria, and Indonesia. For example, Saudi Arabia issued consecutive monthly Saudi riyal-denominated Sukuk issuances in the first five months of 2020, totalling US$10,134.94 million, according to the National Debt Management Center of the Ministry of Finance (BERNAMA, 2020).
The pricing is exceptionally tight, suggesting a high demand for the papers in a market devoid of AAA-rated sovereign debt securities. Investors have reaffirmed their confidence in market growth and sustainability mandate as well as our AAA-rated paper, which offers best-in-class, risk-adjusted returns. They will seek to ensure that this lower cost of funding contributes to the Member Countries receiving better financing terms to meet their urgent and emergent needs during this pandemic. The Islamic Development Bank (IsDB) will continue to meet its funding goals, as shown by the size and lowest overall price for a public USD Sukuk ever. Since their last general trade in February, investor understanding of the Sukuk has greatly improved, and they will continue to work on it upon their return to the markets later. The investor diversification demonstrates that the IsDB's sustainable finance story gains traction in new markets and expects to keep this momentum going in future issuances (BERNAMA, 2020).

Malaysia has an active sovereign Sukuk and bond issuance program for reserve, liquidity management, and interbank money market transactions, both Shariah-compliant and traditional. The most common ones are Malaysian Government Securities (MGS), Malaysian Government Investment Issues (MGII), and Mudarabah Certificates. It will be interesting to see how much of the RM35 billion the Malaysian government wishes to raise through Shariah-compliant issuances. If the issuances lean towards Islamic debt securities, their favourable pricing and uptake and the ICM already hold a majority market share. The Malaysian Sukuk market, which has been declared the world's largest in recent years by the Saudi Sukuk market, could see a significant boost (Securities Commission Malaysia, 2020).
The Sukuk is relevant and significant because, according to Jakarta, by designating the five-year tranche as a Green Sukuk for climate change financing, it demonstrates its dedication, leadership, and contribution to sustainable financing. The five-year tranche Green Sukuk is the third global Green Sukuk, following the retail Green Sukuk issued at the end of 2019. The transaction is consistent with the government's financial objectives, including funding fiscal expenses related to the COVID-19 pandemic, strengthening Indonesia's role in the global Shariah market, and promoting Shariah financing in Asia. However, it is unknown whether the entire issuance will be included in COVID-19 mitigation and sustainability programmes (BERNAMA, 2020).

Investors' Confidence Towards Negative News

Dante (2004) defined investors' confidence as the expectation of future stock market stability, which is an essential factor in determining stock market volatility. Investor confidence is a subject that is important in the stock market or securities exchange markets. Meanwhile, Julius et al (2011) defined investor confidence as an attitude; that nothing can go wrong with the investment, with gains and losses considered normal. It is a significant investor attitude and opinion commonly remarked by observers of speculative markets as having changed in important ways through time. The changes have substantial consequences for the markets. Hancock and Meussa (2009) said that when the market decides to focus on the positive or negative aspects of Islamic finance, the market can determine how helpful Sukuk will be in the construction industry in the coming years. When some originators found themselves in

financial trouble or worse and became insolvent, Sukuk investors found themselves unexpectedly competing with the general body of creditors, rather than simply enforcing against, or taking the ownership of the assets supporting their Sukuk.

Eichengreen and Mody (1998) suggested that a change in asset prices, especially in the short run, triggers changes elsewhere. A change produces shifts in the market's attitude towards risk because there is a change in investor sentiment. If the risk appetite grows and economic risks are unchanged, investors will feel overcompensated for these risk levels. Thus, the sense of overcompensation will grow as the level of risk grows. As investors take advantage of what they see as an improving risk-return trade-off, currency values will change in line with their risk. As a result, high-risk currencies should appreciate more than low-risk ones, and the riskiest currency should rally the most. Besides, many investors make the decision of issuance based on information. Syed et al (2009) argued that investment decisions are based on quicker and more reliable information from the environment, either positive or negative news. Hence, the confidence levels and confidence intervals have an inverse relationship; as confidence intervals decrease, confidence levels increase. Levels and intervals are often used as alternative measures of a one-dimensional uncertainty construct.

In previous studies, De Bondt (1993), Fisher and Statman (2000), and Brown and Cliff (2004) addressed the predictability issue and found that the sentiment of small investors, measured by the American Association of Individual Investor survey, could partially be explained by stock market returns. De Bondt (1993) measured the individual investor sentiment and showed that the sentiment of individual investors was affected by past returns of the Dow Jones Industrial Average (DJIA). Fisher and Statman (2002) studied investors' intelligence and the sentiment of individual investors as well as Wall Street strategists. They found both sentiments to be statistically significant contrary indicators for Standard and Poor's 500 (S&P 500) returns for the subsequent month. On the other hand, investors' intelligence was not a statistically significant indicator of S&P 500 returns for the subsequent month. None of the sentiments was able to forecast the future returns of small-cap stocks for subsequent months. Small investors were also found to increase their stock allocation after a positive change in their sentiment and vice versa.

Lee et al. (2002) measured investors' intelligence. They recorded that a change in sentiment had a statistically significant positive impact on excess returns of the Dow Jones Industrial Average (DJIA), Standard and Poor's 500, and Nasdaq. Additionally, positive (negative) change in the sentiment significantly decreased (increasing) effect on volatility. Jansen and Nahuis (2003) studied consumer confidence and found that changes in stock return Granger caused changes in consumer confidence in 8 out of 11 European countries in the short term, and not vice versa, except for a few instances. Fisher and Statman (2002) found in their study that consumers grew confident when investors grew bullish. Consumer confidence declined when stock prices declined, but investors did not need to fear that low stock returns would follow a decline in consumer confidence. Low consumer confidence was followed by high stock returns more often than low stock returns followed it. Consumer confidence increased simultaneously with positive returns from stock markets. In general, an increase in consumer confidence forecasted negative returns for one, six, and twelve months ahead.

Brown and Cliff (2004) measured individual investors' sentiment and investor intelligence. They found that individual investors and investment intelligence sentiment were related to other sentiment measures and market returns. Furthermore, some evidence was found that market returns could partially explain the view. Overall, neither the sentiment level nor the changes in the sentiment were found to have much predictive power over future market

returns. Brown and Cliff (2004) said that only investors' intelligence sentiment had some predictive power over future market returns of large stocks. When sentiment is low, the average future returns of speculative stocks exceed those of bond-like stocks. When sentiment is high, the average future returns of speculative stocks are lower than bond-like stocks' returns. The fact that riskier stocks (at least, stocks that are riskier by all outward appearances) sometimes have lower expected returns is inconsistent with the classical asset pricing. Investors bear risk because higher expected returns compensate them. The higher the risk, the higher the expected return.

According to Dante (2004), determining changes in investor confidence is problematic because it requires knowledge of investor psychology and attitudes. The coordination problem of trading is usually the focus of current market psychology and stock market psychology models. Duffer's model looks at how investors' market psychology is affected by anticipating future volatility rather than current volatility. As a result, changes in market psychology over time can affect overall stock return volatility. The greater their risk appetite and confidence were, the more assets they were willing to allocate to equities.

According to Ahmad and Radzi (2011), governments have failed to provide the best solutions for reducing the impact of Sukuk default and protecting the parties involved. This will also harm Islamic finance's reputation. In addition, investors' confidence in the Islamic financial system will be severely damaged due to such events. According to Ilias (2009), the international Sukuk market experienced lower liquidity following the 2008 financial crisis due to lower oil prices and investor confidence. As a result, Rabindranath and Gupta (2010) discovered that pricing issues and a scarcity of committed investors resulted in lower Sukuk issuance.

Because of the risks, investors' confidence may dwindle. Nevertheless, Sukuk is regarded as a relatively safe financial instrument, despite its inherent risks (Nanaeva, 2010). The following are the most common risks associated with a Sukuk issue:

i. **Default risk:** There is a possibility that the issuer will be unable to make regular payments (coupons) or repay the principal amount. While some financial institutions have dedicated departments to assess Sukuk issuers' credibility, the majority of investors rely on rating agencies.

ii. **Downgrade risk:** When an issuer downgrades, the price of a Sukuk can drop dramatically. As a result, an investor willing to trade Sukuk in the secondary market assumes a downgrade risk. In this regard, the role of rating agencies in the formation of bond prices and their failure to respond appropriately during the recent financial crisis should be mentioned. Some rating agencies take a long time to downgrade companies with serious financial problems, waiting until they declare bankruptcy.

iii. **Inflation risk:** As the bond is a fixed-income, the investor is exposed to the risk that inflation will outpace the coupon payment.

iv. **Liquidity risk:** Sukuk is regarded as a less liquid asset than stocks. Owing to a lack of potential buyers, Sukuk investors risk being unable to trade their securities.

v. **Foreign exchange risk:** Sukuk issued in a foreign currency are subject to this risk, as unfavourable currency fluctuations can reduce the initial value of investments.

Four dimensions of investor confidence have been proposed by Dailami and Masson (2009). First, they discovered a connection between investor and consumer confidence. They demonstrated that liquidity provision and interest rate easing had only a limited impact on financial market spreads during the crisis, arguing for additional measures to address the loss of confidence. The dimensions of investor confidence are depicted in Figure 5.

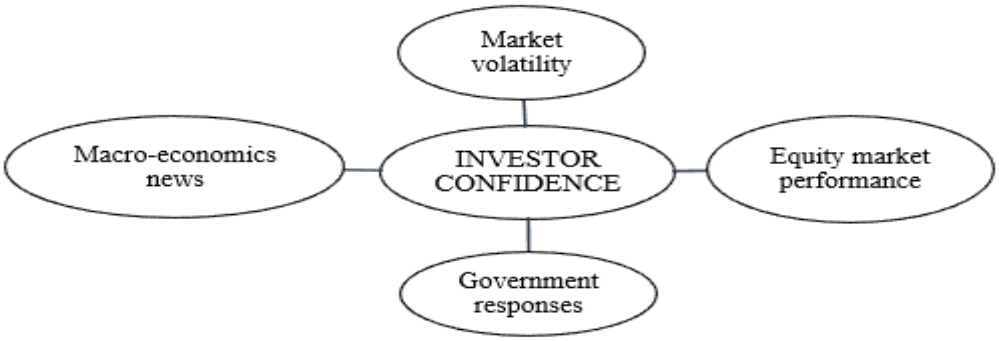

Figure 5. Four dimensions of investor confidence (Dailami and Masson, 2009).

The scale of abnormal volatility in the market significantly impacts investor psychology, especially when that volatility spans across multiple asset classes, signalling an overall climate of uncertainty and risk aversion. Second, investor confidence is linked to the success or failure of their investments, as measured by the amount of wealth created or destroyed. Third, macroeconomic news affects investors and traders by providing insights into economic fundamentals and shaping perceptions of the economy's future state. Fourth, market participants and traders pay close attention to government policymakers' positions and evaluate the credibility of their responses regularly. Governments can influence investor confidence in various ways, including through macroeconomic policy, regulatory policy, and other legislative actions that improve transparency and corporate financial disclosure (Dailami & Masson, 2009).

EMSI indicated high risk-seeking behaviour before the 2008 crisis, but not during or after the crisis, according to Rahim and Ahmad's (2014) research on the FTSE KLCI. As a result, it appears that Sukuk investors and issuers are looking for more volatility and uncertainty in Sukuk investments in exchange for higher expected returns. These Sukuk investors should seek risks, but only after the crisis has passed. They should not be afraid of taking risks because the higher the risk, the greater the reward. Furthermore, the loss-averse investor is more motivated to foresee bad news to avoid losses caused by these announcements.

Recently, The Edge Malaysia (2020) reported that the GDP-linked Sukuk is one method of converting debts into equity repayments based on the country's GDP results. In the sense that it has equity-like characteristics, such a growth-linked financial instrument is similar to a stock in a country. Similarly, when the result is better than anticipated, it pays more dividends to its owners, and when it is worse than expected, it pays less. The repayment on this Sukuk will be proportional to the country's GDP, with repayments falling when growth is slow, and rising when growth is high. As a result, an expected deep recession due to the global pandemic downturn would be less likely to cause a sovereign debt crisis. When growth slows and tax revenues fall, such a policy would offer an economic reprieve to the issuing government.

Furthermore, The Edge Malaysia (2020) mentioned that keeping GDP-linked Sukuk may provide diversification benefits to global investors. Given the low-interest rate setting, investors should consider this shared-risk instrument as an alternative asset class that includes exposure to the real economy. In addition, both sides are motivated by the debt-

stabilising impact of issuance, which reduces the likelihood of sovereign default and balance risk-taking.

In the Islamic capital market, investors' willingness to invest in Sukuk is crucial. Sukuk issuance will be influenced by this confidence, increasing or decreasing the number of issuances. This study will look at Sukuk investors' willingness to invest or take a risk in Sukuk, particularly during a crisis such as the COVID-19 pandemic.

Theoretical Framework

Theory of Rational Expectation

The rational expectation theory discusses how expectation is identical to an optimal forecast when all available information is used. According to Frederic S. Mishkin (2001), people often change their expectations quickly in light of new information. Therefore, an expectation is identical to an optimal forecast (the best guess of the future) that uses all available information. Adaptive expectation is a type of expectation that depends only on experience and changes slowly over time. There are two types of expectations, which are rational expectation and non-rational expectation. However, although a rational expectation is equivalent to an optimal forecast that uses all available information, a prediction based on the expectation may not always be perfectly accurate.

There are two reasons why an expectation fails to be rational, classifying the expectation as a non-rational expectation. The first reason is that people may decide that it takes too much effort to make their expectations the best guess possible even when they know all the information. The second reason is that people might be unaware of some available relevant information, so their best guess of the future is not accurate. Rational expectation implies that if there is a change in how a variable moves, there will be a change in how this variable's expectations are formed. As a result, the forecast errors of expectations will, on average, be zero and cannot be predicted ahead of time, making the mistakes unpredictable.

Confidence Theory

The confidence theory explains how the equity market sentiment index is calculated and how Sukuk investors react to various risk classifications. As defined by Dante (2004), investor confidence is the expectation of future stock market stability, which is a critical factor in determining stock market volatility. According to Pangano (1993), regulatory and institutional factors may impact the functioning of stock markets. Mandatory disclosure of reliable information about firms, for example, could increase investor participation, while regulations that instil confidence in brokers should encourage stock market investment and trading. According to Julius et al. (2011), investor confidence believes that nothing can go wrong with the investment, allowing the investor to sleep well at night because there is nothing to worry about. This is a significant investor attitude and opinion that observers of speculative markets frequently note as having the ability to change over time and have significant market effects. When confidence rises, investors want to invest at current prices, according to Micheal (2005). When one's confidence is low, one is less likely to take risks. When the news about the future is positive, and stock prices are rising, investors are optimistic. On the other hand, rising prices are linked to both good fundamentals, such as increased industrial production and productivity, and the underlying sentiment or mood of investors. Support and resistance are necessary for confidence. In a declining stock market, support is a point where buyers begin to buy. Resistance, on the other hand, is the point at which sellers begin to sell. Sometimes, the levels of support and resistance are precisely the same. At other times, they

are less precise and instead fall into a range of more robust support or resistance. A situation with high support and low resistance should correspond to high confidence. On the other hand, low confidence should be associated with a situation characterised by low support and high resistance.

Bond investors are looking for a higher level of security. They will lend money to a government or a large international corporation, confident that the organisation will continue to exist throughout the loan duration and will not default on its obligations. Investors are willing to accept a lower return on their investment in exchange for this security than what they might get from riskier investments such as equities. The higher the risk, the higher the return because the investor needs to be compensated for taking the risk (Todd, 2007).

These market players lend some capital to Sukuk issuance. As a reward for the use of their money, investors expect to receive regular interest payments throughout the loan period, and they expect the loan to be repaid at a specified date in the future. There are two main types of investors: (i) institutions; and (ii) individuals. Institutions are the most prominent investors in the Sukuk market, holding 80 percent of the market. These institutions have fund managers who look after large sums on behalf of individual investors, who are indirectly investing in the Sukuk market through the purchase of, for example, life insurance policies or pensions. High net worth individuals may invest directly in bonds to obtain a guaranteed income from their investment (Walter et al., 1999). According to Sniezek and Buckley (1991), investors either buy or sell more shares as their confidence increases. Investors' confidence in portfolio decisions is likely to depend on relatively good information about their abilities. If they are capable, they will be less overconfident and rely more on trading strategies. According to Hancock and Meussa (2009), some originators found themselves in financial trouble, or worse, became insolvent. Then, Sukuk investors found that they were unexpectedly competing with a general body of creditors, rather than simply enforcing against or taking possession of the assets to support their Sukuk.

As a result, both issuers and investors have a direct relationship between risk and return—investors in equities who put their money into a company run the risk of losing their money. As a result, they anticipate a high return, whether through the appreciation of their stock, the payment of a dividend, or both (Walter et al., 1999). There are a few different types of risks. When investors take risks, they have high confidence; when they are risk-averse, they have low confidence. Kahneman and Tversky's (1979) prospect theory is a psychology-based behavioural theory that emphasises on 'loss aversion'. According to the loss aversion feature, people are much more sensitive to reductions in wealth than increases in wealth. The maximisation of a weighted sum of utilities which are based on the probabilities of events, where the higher the risk, the higher the returns, is based on this theory. They will tend to assign a heavyweight to the event of speculative success in the stock market if they are successful in investment activities such as the property market. As a result, they will be more willing to take on more risks.

Why are some people more risk-averse than others? Thaler and Johnson (1990) explain why. After a significant increase in wealth, a loss is less painful. As a result, these individuals are less risk-averse and are willing to wager on higher-risk wagers. There is a link between a person's willingness to take on the additional risk over time and the amount of money they have amassed previously. The reasoning behind this is that the severity of pain or loss varies over time and is dependent on prior investment. People are more sensitive to a loss after another loss, whereas a loss following a significant gain is less painful.

According to Hillson and Murray-Webster (2007), there are three types of risk attitudes in risk theory: risk-averse, risk-neutral, and risk-seeking. The equity market sentiment index (EMSI), which is used to examine the categorisation of risks among Sukuk investors, can also produce these types of risks. Risk-averse is defined by Hillson and Murray-Webster (2007) as an investor who dislikes risk and will avoid adding high-risk stocks or investments to their portfolio. When an investor is risk-neutral, he or she is in the middle of a spectrum where risk-seeking investors are on one end, and risk-averse investors are on the other. Risk-neutral measures are commonly used in the pricing of derivatives. Finally, risk-seeking refers to an investor's desire for higher returns in exchange for greater volatility and uncertainty in their investments. On the other hand, risk-seeking investors should conduct even more due diligence when considering a riskier investment due to the increased implied risk. The fact that individuals tend to be risk-averse in the face of gains and risk-seeking in the face of losses can lead to some very poor financial decisions. The words 'averse', 'neutral', and 'seeking' represent a chosen response to the uncertainty that matters, driven by perception. Figure 6 below shows the risk attitude spectrum.

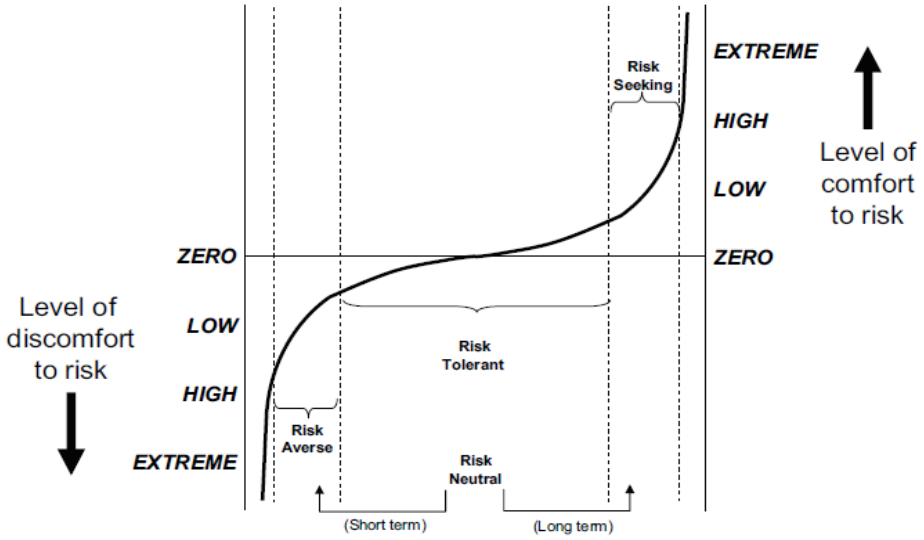

Figure 6. Risk attitude spectrum (Hillson & Murray-Webster, 2007).

The risk attitude spectrum is depicted in Figure 6 as risk-averse, risk-neutral, and risk-seeking. When an investor is risk-averse, he or she seeks out safer investments. Investors are hesitant to invest in this environment. When investors are risk-neutral, they are in the middle of the risk spectrum, with risk-seeking investors on one end and risk-averse investors on the other. Risk-takers seek investments with higher volatility and uncertainty in exchange for higher expected returns. They are a group of investors who have a high level of trust in each other and agree to invest as well as issue Sukuk. The issuers are also divided into three categories: construction, manufacturing, and services. As there is a scarcity of data on publicly traded companies that issue Sukuk, this study is limited to these industries. As a result, both issuers and investors have a direct relationship between risk and return—investors in equities who put their money into a company run the risk of losing their money. As a result, they anticipate a high return, whether through the appreciation of their stock, the payment of a dividend, or both (Walter et al., 1999). The graph of risk versus return is shown in Figure 7.

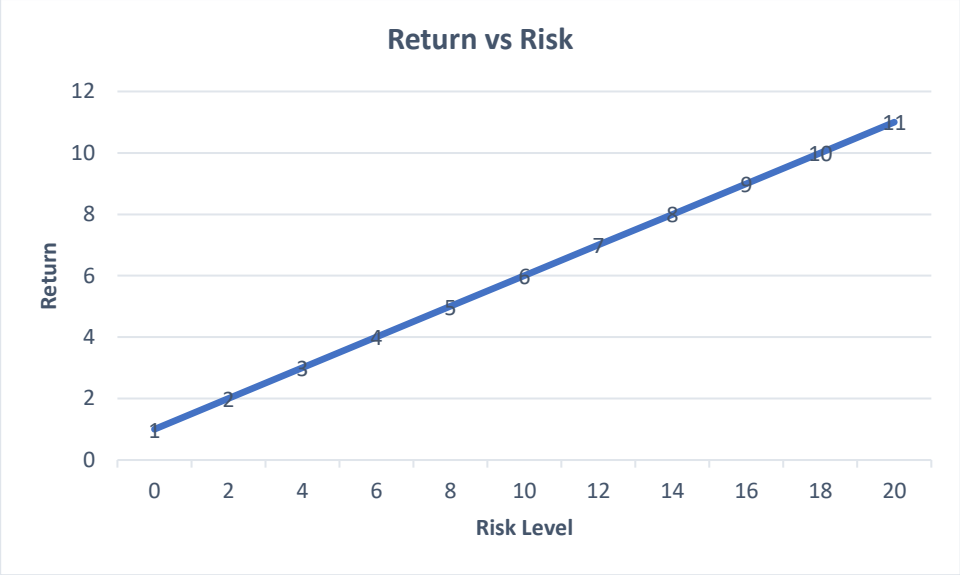

Figure 7. Return versus risk (Walter et al., 1999).

Risk comes in a variety of forms. Investors who take risks have a high confidence level, whereas risk-averse investors have a low confidence level. The prospect theory, developed by Kahneman and Tversky in 1979, is a psychology-based behavioural model that emphasises loss aversion. According to the loss aversion feature, people are much more sensitive to wealth reductions than gains. This theory is based on the maximisation of a weighted sum of utilities based on event probabilities, where the higher the risk, the higher the returns. They are more likely to place a high value on speculative success in the stock market if they have had success in investment activities such as the real estate market. As a result, they will be more willing to take more chances. The hypothesis in this research is as below:

Hypothesis

The risk category of Sukuk investors, measured by the Equity Market Sentiment Index (EMSI), positively correlates with confidence effects.

H_a : Sukuk investors display highly risk-seeking behaviour before the 2008 crisis.

H_b : Sukuk investors display moderate risk-averse behaviour during the 2008 crisis.

H_c : Sukuk investors display risk-neutral behaviour after the 2008 crisis.

Methodology

This research compares the reactions to Sukuk issuance in Malaysia between 2004 and 2011. This study also uses the Equity Market Sentiment Index (EMSI) to examine how a Sukuk issuance affects the confidence level of investors. The following sections will discuss the data collection process, the descriptive statistics, and the methodology used in this research.

Data Collection

Sukuk issuance data in Malaysia are obtained from the Bloomberg database, Securities Commission Malaysia, Bursa Malaysia, and Zawya Sukuk. The Sukuk data collected in this study are the listed companies that issue sukuk in Malaysia, the date of sukuk issuance, the date of maturity, and the amount, ratings, and structures of Sukuk. The data of stock markets are collected from the historical prices available in the DataStream database, excluding Saturdays and Sundays, giving about 265 days a year.

This research proceeds by investigating the stock market reactions in the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FTSEKLCI), the FTSE Bursa Malaysia Emas Shariah Index (FTSE EMAS), the FTSE Bursa Malaysia Hijrah Shariah Index (FTSE HIJRAH), and the Dow Jones Islamic Market Index (DJIM) to the issuance of Sukuk in Malaysia. This study compares the reactions of different stock markets using the domestic index, the global index, and the Islamic index. For the domestic index, this study uses the FTSEKLCI covering the period studied from 2004 to 2011. For the global Islamic index, this study uses the DJIM index. Finally, this study uses both the FTSE EMAS and the FTSE HIJRAH indices for the local Shariah index.
The KLCI is now known as the FTSE Bursa Malaysia KLCI after enhancements were implemented on Monday, 6 July 2009. It was enhanced to ensure that it remains robust in measuring the national economy with growing linkages to the global economy and global relevance, recognition, and reach. The FTSE Bursa Malaysia Index was launched on 26 June 2006, while the FTSE HIJRAH and the FTSE EMAS were launched on 22 January 2007 and 21 May 2007, respectively. The FTSE HIJRAH and the FTSE EMAS launches were in response to the increasing interest in Shariah-compliant investment. The FTSE EMAS comprises constituents of the FTSE Bursa Malaysia EMAS index that are Shariah-compliant according to the Securities Commission's SAC screening methodology and the FTSE's screens of free float, liquidity, and certainty. The FTSE HIJRAH is a tradable index that comprises the 30 largest companies in the FBM EMAS Index (Bursa Malaysia, 2012).

Measuring Confidence Effects

This study will use the Equity Market Sentiment Index (EMSI) to track changes in the market's underlying riskiness. It has no direct impact on the metrics. As a result, these measures more accurately reflect changes in the market's risk appetite. This study calculates daily returns for each of the Sukuk-issuing securities. This study computes the average standard deviation of daily returns over the previous days (the 'historic volatility') for each of the securities for each day of the sample period. The daily rate of return and historical volatility of the returns for each Sukuk issuance are then ranked, and the result is multiplied by 100 (to obtain the percentage).
Changes in investor sentiment may cause asset prices to fluctuate, and investor sentiment could be a key component of the market pricing process. By analysing the price movements of a group of Sukuk issuance from various companies, EMSI can be used in a stock market setting. Changes in this measure of investor sentiment quickly capture news events that affect the underlying market studied. The sentiment measure can explain a significant portion of the changes in the stock market index (Bandopadhyaya & Jones, 2005). On the date of Sukuk issuances, this methodology will be applied to stock markets from four indices: the FTSEKLCI, FTSE EMAS, FTSE HIJRAH, and DJIM.

The following formula is used to calculate the EMSI:

$$\mathrm{EMSI} = \frac{\sum(\mathrm{R_{ir}} - \overline{\mathrm{R}}_{\mathrm{r}})(\mathrm{R_{iv}} - \overline{\mathrm{R}}_{\mathrm{v}})}{[\sum(\mathrm{R_{ir}} - \overline{\mathrm{R}}_{\mathrm{r}})^2 \sum(\mathrm{R_{iv}} - \overline{\mathrm{R}}_{\mathrm{v}})^2]^{\frac{1}{2}}} \mathrm{X}\,100; \quad (-100 \leq \mathrm{EMSI} \leq +100)$$

Where $\mathrm{R_{ir}}$ is the rank of the daily return for Sukuk issuance, $\mathrm{R_{iv}}$ is the historical volatility of Sukuk issuance, $\overline{\mathrm{R}}_{\mathrm{r}}$ is the population Sukuk issuance's mean return, and $\overline{\mathrm{R}}_{\mathrm{v}}$ is the historical volatility rankings. The numerator and denominator of the fraction in the EMSI formula have similar variables. The only difference between the numerator and denominator is that;

(1) The denominator must be the square of the difference between the rank of the daily return for Sukuk issuance and the population Sukuk issuance mean return as well as the square of the difference between the value of historical volatility for Sukuk issuance and the historical volatility rankings; and

(2) The value of the denominator must be the square of the difference between the value of the historical volatility for Sukuk issuance. Then, to ensure that a denominator is a positive number, the denominator is squared, and the square root of the product of the two squares is used as the final value.

The calculated daily EMSIs are recorded in five different categories. Daily EMSIs may include all trading days between 2004 and 2011. EMSIs of -30 and below indicate highly risk-averse; -10 to -30 indicate moderately risk-averse; -10 to +10 show risk-neutral; +10 to +30 indicate moderately risk-seeking; and +30 and above indicate highly risk-seeking. A summary of the risk categories of daily EMSIs is presented in Table 1 below:

Table 1
Risk Categorisation of Daily EMSI

RANGE OF EMSI	CATEGORY
-30 and below	Highly Risk-Averse
-10 to -30	Moderately Risk-Averse
-10 to +10	Risk-Neutral
+10 to +30	Moderately-Risk Seeking
+30 and above	Highly Risk-Seeking

Using the EMSI method, this study can explain market reactions to Sukuk by considering the similarities between bonds and equity. Sukuks do not pay interest, but they do generate returns by commoditising capital gains. As it shares some stock characteristics, it cannot be classified solely as a debt instrument. This is one of the most common Sukuk and equity characteristics (Modirzadehbami & Mansourfar, 2011).

Results and Discussion

Table 2 shows the summary of risk categorisation by EMSI following Sukuk issuance on the four indices (2004 to 2011).

Table 2
Summary of Risk Categorisation by EMSI Following Sukuk Issuance on Four Indices

RISK CATEGORISATION BY EMSI												
NO.	CATEGORISATION OF RISK	NO. OF SUKUK ISSUANCE										
	EMSI	FTSE KLCI INDEX			EMAS SHARIAH INDEX			HIJRAH SHARIAH INDEX			DOW JONES ISLAMIC INDEX	
		2004-2006	2007-2008	2009-2011	2004-2006	2007-2008	2009-2011	2004-2006	2007-2008	2009-2011	2004-2006	2007-2008	2009-2011
1	(-30 and below) Highly Risk-Averse	0	7	72	FBM Emas Shariah index was launched on 21 May 2007	68	76	FBM Hijrah Shariah Index was launched on 22 January 2007	69	81	9	45	74
2	(-10 to -30) Moderately Risk-Averse	0	16	8		12	8		14	6	39	24	11
3	(-10 to +10) Risk-Neutral	9	33	13		16	11		13	11	34	27	7
4	(+10 to +30) Moderately Risk-Seeking	9	15	10		0	8		0	5	0	0	11
5	(+30 and above) Highly Risk-Seeking	64	25	0		0	0		0	0	0	0	0
TOTAL		82	96	103		96	103		96	103	82	96	103

Source: Author's calculation.

Sukuk Investors and Confidence Effects

The FTSE KLCI showed EMSI indicating high risk-seeking behaviour before the 2008 crisis but not during and after the crisis, thus rejecting the hypothesis. The EMSI results did not show moderate risk-averse behaviour during the 2008 crisis, and it also did not show risk-neutral behaviour after the 2008 crisis. The investors did not avoid risks before the crisis, but they were positive and sought risks. The investors were searching for greater volatility and uncertainty in investments in exchange for anticipated higher returns. The investors on FTSE KLCI were confident to invest in Sukuk during the crisis. This was perhaps due to a lack of information and the inefficient market, which took a long time to absorb the negative news

during the crisis. However, there was low confidence among the highly risk-averse investors to invest in Sukuk after the crisis.

Given the analysis results during and after the crisis of FBM EMAS, the hypothesis was accepted, where highly risk-averse behaviour had the maximum results during the crisis. After the crisis, highly risk-averse behaviour also showed the maximum results, followed by risk-neutral behaviour. This risk aversion meant that investors stayed away from adding high-risk stocks or investments to their portfolio. This change in investors' confidence potentially had significant financial and economic consequences. FBM EMAS also showed the deterioration of confidence that occurred as the crisis unfolded and the inadequacy of policy measures were taken at that point to reverse the deterioration of confidence fully. A loss-averse investor is more highly motivated to anticipate bad news to avoid losses incurred by these announcements.

The analysis of data both during and after the crisis of FBM HIJRAH resulted in the hypothesis being accepted, as it demonstrated that highly risk-averse behaviour had the highest results during the crisis. When investors dislike risks during a crisis, they will stay away from adding high-risks to their portfolio. This is important to avoid regret aversion among Sukuk investors on FBM HIJRAH as the new benchmark in Malaysia. The period after the 2008 crisis also showed that highly risk-averse behaviour had the highest results, followed by risk-neutral behaviour. These showed that the investors avoided risks during and after the crisis. Moderate risk-seeking after the crisis indicated that the market had recovered after the crisis. This means that the investors' confidence to issue Sukuk increased after the crisis.

The investors on the DJIM index did not seek risks before the crisis. During the crisis, the highly risk-averse behaviour had the highest result, which indicated that the Sukuk investors on the DJIM index avoided negative news during the crisis. After the crisis, results showed that the market recovered, and investors' confidence were restored. The results showed that during and after the situation, the investors avoided risks. Negative effects were associated with negative information during the crisis. These results showed that the DJIM index was an efficient market index in reacting to negative effects during and after the crisis, with no delays or overreactions. Having sufficient information on the market, the investors avoided and stayed away from adding higher risks to their portfolios.

Conclusion

Investors' confidence can predict the stock market, and EMSI can measure the confidence effect. The confidence effect among Sukuk investors indicates the categorisation of risk during the announcement of Sukuk issuance. When Sukuk issuances happen, markets will react to low or high returns. Only the FTSE KLCI indicates the results on highly risk-seeking, but the other indices show zero results on highly risk-seeking. All indices show that the investors were seeking risks after the crisis. Table 2 shows that the FTSE KLCI is the best compared to the other indices, which were inefficient. The FBM EMAS and FBM HIJRAH, as the new Islamic indices in Malaysia, reacted slowly and safely, avoiding risks. The DJIM index also shows low results in risk-seeking and that the investors avoided risks. When investors dislike risks, they will not add high risks to their portfolio. A deterioration of confidence occurred during the crisis. However, moderate risk-seeking and risk-neutral behaviour showed that the investors' confidence had slowly recovered after the crisis. This study has revealed the actual situation of Sukuk issuance in Malaysia, so that investors can make the right decision. This study can be used as evidence for Islamic and conventional issuers to prove that Islamic bonds can show good performance and even outperform the benchmark, even though the investment is

based on Shariah compliance. The analysis of the stock reactions by analysing Sukuk in terms of amount, structure, tenure, rating, and sector can be used as indicators to identify the best features of Sukuk issuance for selection by issuers. These are very important to local and international issuers and investors in Malaysia since it has been declared the biggest Sukuk market globally. Issuers can also determine the confidence effects on pre-, during, and post-crisis, whether at risk-seeking, risk-averse, or risk-neutral levels.

In conclusion, the investors' behaviour showed that they avoided risks in their portfolio, but they tend to seek risks when confident. Therefore, intelligent investors are those who accept the higher risk with higher returns. The Sukuk investors during the COVID-19 pandemic also refer to this situation of the 2008 global financial crisis to seek chances and confidence to issue and invest in Islamic bonds, where there are higher risks with higher returns. This analysis provides valuable information and guidelines to issuers, policymakers, regulatory bodies, and investors, both Muslim and non-Muslim, and can draw them to Islamic bonds, Sukuk.

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