

Currency Based Mutual Funds' Performance in Saudi Arabia: Individualistic Approach

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Abstract

The Mutual funds market has been growing considerably in Kingdom of Saudi Arabia in the last couple of years especially with the massive Saudi budget surplus in 2004-2005 and the availability of ample liquidity in the market. Although the mutual funds as a percentage of the gross domestic product (GDP) and bank deposits are still relatively low, recent researches has shown that investors are more keen in investing in all types of Mutual funds. This study focuses on the returns of all the fund categories in KSA in this economic condition where Crude Oil and Gold price is all time low. The Base currencies of the fund and different types of the Funds are compared with tools such as T Test, One way ANOVA to analyze the Fund performance. This study will enable the individual investor to identify the right kind of mutual fund for the current economic conditions.

Keywords- *Currency Base Mutual Funds, Shariah and Non Shariah Compliances*

I. INTRODUCTION

The Mutual funds market has been growing considerably in Kingdom of Saudi Arabia in the last couple of years especially with the massive Saudi budget surplus in 2004-2005 and the availability of ample liquidity in the market according to Mohamad H. Al-Sewilem, head of marketing for investment services at the National Commercial Bank (NCB) in his interview to Arab News on 13 June 2015. According to Siddiqi (2002), since the mid 1980s, there were serious doubts that investing in the stock market is not “Islamically” acceptable. However, in the early 1990s, the Saudi Arabian Fiqh Academy, the leading authority on religious issues in the Muslim world, issued a decree ruling that within certain conditions, investing in equity is permissible under the Shariah law. This has brought in an acceleration in the Capital Market and economy of Saudi Arabia. According to the published reports of SAMA (Saudi Arabian Monetary Agency) and CMA (Capital Market Authority) the number of Mutual Fund traded in Saudi Arabia has been increasing. According to a McKinsey Management Consulting Firm report, “Islamic finance is the new force in the financial market place.” Islamic banking, growing at a rate of 15% in the mid-1990s is expected to be a dominant growth engine in finance and banking in this millennium (Hamid and Azmin, 2001). The past decade witnessed a rapid growth in the Islamic banking and finance market making it one of the fastest growing niches in global finance (Aggarwal and Yousef, 2001). Only a small portion of the pooled funds are invested in Shariah based funds by the Fund managers. Hassan (2001) stated that only a small portion of the available funds are invested in Islamic products, which is indicative that this market is, for the most part, unexploited”. The Saudi Mutual funds are based on Shariah and other Multi National Banks introduced both Shariah and Non Shariah based Mutual funds. According to Hussein (2005), Islamic equity funds witnessed strong expansion in 1990s and most of the Islamic funds do not aim at high net-worth individuals; they look for minimum investment ranging from \$2000 to \$5000. Usmani (2002) explained the differences in opinion among Muslim scholars pertaining to the permissibility if the investment in companies which are involved in a halal business but nevertheless have a portion of their transactions involving Shariah noncompliance also like in Equity funds. Usmani (2002) also explored the principles of Shariah governing Islamic funds. He defined the types of investment funds that can be brought under the precepts of Shariah Compliances. This makes it very clear that most of the studies are focusing on the individual investors. The parameters analyzed by many researchers in the past were on the Duration and Performance of the Mutual funds, Shariah compliances and based on Fund classifications.

A. Scope and Need of the study

The Mutual Fund market is one of the fastest growing segment in the financial system of Kingdom of Saudi Arabia. The investment in Mutual Funds has been increasing year after year in Saudi Arabia. The number of Fund Managers and Fund types are also increasing. It has been considered as a lawful business and legal activity. The income generated from the dividends has been purified according to Islamic values and culture. As most of the Mutual funds in Saudi Arabia are following several laws and following the principles of Shariah many individuals are investing in Mutual funds today. The price fall in crude oil price has a drastic impact on the financial system of Saudi Arabia. The researchers wants to investigate on the returns of the Mutual funds during this year where there is lot of economic volatility.

TABLE 1.1 WORLD BANK DATA ON MUTUAL FUNDS

Month	Price	Change
Apr 2015	215.33	-
May 2015	234.38	8.85 %
Jun 2015	229.88	-1.92 %
Jul 2015	204.11	-11.21 %
Aug 2015	171.45	-16.00 %
Sep 2015	173.59	1.25 %
Oct 2015	176.10	1.45 %

Source: World Bank Data November 2015

YTD (Year to Date) gives a clear idea on the returns of the mutual fund for one year. This paper focuses on the YTD starting from the 1 January 2015 to 28 November 2015 for the sake of convenience and availability.

The fund categories that are available for individual investors in Saudi Arabia are Growth Funds, Income Funds and Capital Preservation funds.

Growth Funds focus on capital appreciation and most of the time do not focus on dividends and pay outs. Income fund is a fixed income investment and gives fixed income through bonds and Capital Preservation are safe havens to invest, most of the investors who wants to preserve their capital choose these mutual funds. The return is almost fixed and assured. In most of the countries Pensioners prefer Capital preservation mutual funds as it gives fixed amount to support their monthly expenditure.

The researchers wants to study the performance of the Currency Base: US \$, EURO, JAPANESE YEN, POUNDS, SAR (Saudi Arabian Riyal). Within the Currency base there is yet another classification of Mutual fund which are Common Fund Types in both US \$ and SAR : Balanced International Funds, Bond International, Stock Arab, Money Market Local, Stock International.

There are also Fund types that are not available in US \$ based funds: Trade Finance local, Balanced Local, Real Estate Local, Stock Local which are very popular in Saudi Arabia.

Fund types that are not available in SAR based funds: Money Market International, Money market local, stock Asia, Stock Europe, Stock US, Trade finance international are also taken into consideration for the study. Irrespective of the Mutual funds following Shariah and Non-Shariah are also taken for the study.

B. Hypothesis of Study

H₀₁: There is No difference between the performance of mutual funds based on fund categories.

H_{A1}: There is difference between the performance of mutual funds based on fund categories.

H₀₂: There is No difference between the Performance of all Mutual funds based on all different Currency Base.

H_{A2}: There is difference between the Performance of all Mutual funds based on all different Currency Base.

H₀₃: There is No difference between the Performance of Shariah and Non Shariah Mutual funds.

H_{A3}: There is difference between the Performance of Shariah and Non Shariah Mutual funds.

C. Methodology

In order to test all above mentioned hypothesis, Research has used independent Sample T Test and One way ANOVA. The mutual funds are all traded currently and data is collected from the Taduwul website and world bank data base. Performance was analysed by using short term period of 1 year.

D. Limitations

The study is geographically restricted to Kingdom of Saudi Arabia and for a period of 1 year – Starting from 28th November 2014 to 28th November 2015.

II. LITERATURE REVIEW

The study of Literature has enabled the researchers to classify the previous studies based on

- Islamic Mutual Funds Performance
- Geographical strengths and weaknesses
- Shariah and Non Shariah based Mutual Funds' Performance over a period of time
- Risk and Return Based Fund Classification

Islamic Mutual Fund study investigated for a period of six years starting from 2001 to 2006 by Abderrezak (2010), Kräussl, & Hayat (2008) and Islamic Mutual Funds' Financial Performance and International Investment Style: Evidence from 20 Countries by Hoepner & Rammal (2009), were not very much representative of the Saudi mutual fund population. This is because these studies were examining Islamic mutual funds in general and not Saudi Islamic mutual funds in particular. Therefore, Saudi mutual funds were only considered a subset in their entire sample set. As a result, conclusions and assertions from these studies that pertained to Saudi Islamic mutual funds cannot be generalized on the entire Saudi mutual fund population. They used tools such as Risk Adjusted measure, Jensen's Alpha Index, Sharpe Ration, Treynors's ration, Modigliani & Modigliani and Capital Asset Pricing Model.

Second these are the pioneers to do research on Saudi Arabia Mutual Fund Performance measuring using 4 Factor Model – Ahmed (2001), Dabbeeru (2006b), Dabbeeru (2006c) and Dabbeeru (2006a), were among the first to provide a primer analysis on the performance of Saudi Arabia mutual funds, but, their studies very much lacked statistical sophistication. This paper, however, overcomes this issue by employing commonly widespread methods, models, and statistical tests. This paper studies the overall impact of the conventional mutual funds in Saudi Arabia Money Market.

Richard Fu and Swasti Gupta mukherjee, (2014) in their research paper titled Geography, Informal Information flow and Mutual fund Portfolio discusses how the informal information channels impact mutual fund performance. The researchers measured the strengths of two location-based information channels: 1) information transfers among fund managers (fund-fund links) and 2) transfers between managers and the companies in which they invest (fund-company links). They identified that each channel increases investment performance in the absence of the other, but decreases it when acting in combination. Stock selection associated with the presence of one channel, but the absence of the other, earns positive future returns. Their results indicate that the economic benefits of informal information channels depend critically on the nature of their interactions.

Reference Abdullah, F., Hassan, T. and Mohamad (2007) used a sample 65 Malaysian unit trust funds (only 14 were Islamic) from 1992 to 2001 to compare the performance between Islamic and conventional unit trust funds in Malaysia. They also employed different risk-return measures, such as the adjusted Sharpe ratio, Treynor ratio, adjusted Jensen's alpha index, Modigliani and Modigliani (MM) measure, and the information ratio. They found that during bullish economic conditions, conventional funds performed better than Islamic funds. But during bearish economic conditions, Islamic funds performed better than conventional ones. Thus, they found that Islamic funds can help "hedge the downside risk in an adverse economic situation."

Kräussl & Hayat (2008) in their Risk and Return Characteristics of Islamic Equity Funds paper has used a sample of 59 Islamic equity funds (IEF) to examine the performance of these funds relative to Islamic and conventional market benchmarks during the period from 2001 and 2006. They employed a set of risk-adjusted measures, such as the Jensen's alpha index, Sharpe ratio, Treynor ratio, Modigliani and Modigliani (MM) measure, TT measure, and the information ratio. They found that, on average, there were no significant performance differences between IEFs and the employed market benchmarks, both Islamic and conventional. Looking at the available statistics they documented that IEFs did significantly outperform the Islamic and conventional market indices using conditional Capital Asset Pricing Model. Analyzing the risk-return characteristics of IEFs, they found that IEFs possessed superior systematic risk-to return ratios.

Abderrezak (2008) examined the performance of 46 Islamic Equity Funds (IEF) relative to their conventional peer, Islamic and conventional market benchmarks, and ethical funds during the period from January 1997 to August 2002. He employed several methodologies such as the Sharpe ratio, one factor model, Fama and French 3-factor model. He found that IEFs are 40 basis points more expensive than their conventional peers. Further, he found that IEFs consistently underperformed their respective Islamic and conventional market benchmarks. Finally, he found that there was no statistical evidence that there existed any performance differences between Islamic and ethical funds.

Hence this paper intends to measure the performance of the Mutual fund based on the Currencies and Fund categories primarily and also analyze the returns in Shariah based mutual fund with non Shariah based mutual funds.

III. ANALYSIS AND INTERPRETATION

A. Difference Analysis of Mutual Funds Performance between Different Fund Categories

Table 3.1: Difference Analysis of Mutual Funds Performance between Different Fund Categories

F-Statistics	7.053 (0.001)	
(I) based on fund category	(J) based on fund category	Mean Difference (I-J)
Capital Preservation	Income	5.08549*** (0.011)
	Growth	7.95604*** (0.001)
Income	Capital Preservation	-5.08549*** (0.011)
	Growth	2.87055 (0.140)
Growth	Capital Preservation	-7.95604*** (0.001)
	Income	-2.87055 (0.140)

***The mean difference is significant at the 0.01 level

**The mean difference is significant at the 0.05 level.

*The mean difference is significant at the 0.10 level.

Three fund categories are being used in this analysis namely Capital Preservation, Income and Growth. Results in Table 3.1 show that the mean difference between Capital Preservation and Growth is 5.09%, whereas the difference between Capital Preservation and Income is 7.96% and these results are significant at 1%. This shows that the funds based on Capital Preservation performs well as compared to Income and Growth funds and these are most preferable funds for the Mutual fund investors.

While administering the test for Growth with Income fund there is no significant difference between the performance of the funds.

B. Difference analysis of Mutual Funds Performance between ALL US \$ and SAR based Funds

Table 3.2: Difference analysis of Mutual Funds Performance between ALL US \$ and SAR based Funds

Group Statistics			
Currency	N	Mean	Std. Deviation
US\$	73	-2.9071	6.74476
SAR	186	-5.3157	8.72683

Levene's Test for Equality of Variances		t-test for Equality of Means		
F	Sig.	t	Sig. (2-tailed)	Mean Difference
7.232	.008	2.122	.035	2.40858
		2.370	.019	2.40858

***The mean difference is significant at the 0.01 level

**The mean difference is significant at the 0.05 level.

*The mean difference is significant at the 0.10 level.

Results in Table 3.2 show that average YTD for US\$ based mutual funds was -2.9% whereas it was -5.32% for Saudi Riyal based funds. It shows that overall there was decrease in short term performance of funds based on both currencies. However mean difference between both categories was 2.41%, significant at 5%. Hence US\$ based mutual funds performed well as compared to mutual funds based on Saudi Riyal.

C. Difference analysis of Mutual Funds Performance between five common types of funds in US \$ and SAR

Table 3.3: Performance of Balanced international mutual funds based of US\$ and SAR

Group Statistics				
currency	N	Mean	Std. Deviation	
SAR	17	-3.2400	2.93484	
US\$	7	-3.2357	3.28188	

Levene's Test for Equality of Variances		t-test for Equality of Means		
F	Sig.	t	Sig. (2-tailed)	Mean Difference
.003	.956	-.003	.998	-.00429
		-.003	.998	-.00429

- ***The mean difference is significant at the 0.01 level
- **The mean difference is significant at the 0.05 level.
- *The mean difference is significant at the 0.10 level.

This section deals with the analysis which was carried out to check the performance of mutual funds based on five types of funds which were found common in both currencies i.e. US\$ and SAR. These common types are Balanced International Funds, Bond International, Stock Arab, Money Market Local, Stock International. However final analysis was carried out on three types because of limited data.

Table 3.4 Performance of Bond international mutual funds based of US\$ and SAR

Group Statistics				
currency	N	Mean	Std. Deviation	
SAR	2	-1.1250	1.64756	
US\$	8	-1.6188	2.96507	

Levene's Test for Equality of Variances		t-test for Equality of Means		
F	Sig.	t	Sig. (2-tailed)	Mean Difference
2.320	.166	.220	.831	.49375
		.315	.773	.49375

- ***The mean difference is significant at the 0.01 level
- **The mean difference is significant at the 0.05 level.
- *The mean difference is significant at the 0.10 level.

Table 3.5: Performance of Stock Arab mutual funds based of US\$ and SAR

Group Statistics			
currency	N	Mean	Std. Deviation
SAR	27	-10.0393	6.69591
US\$	5	-8.7400	2.70402

Levene's Test for Equality of Variances		t-test for Equality of Means		
F	Sig.	t	Sig. (2-tailed)	Mean Difference
2.424	.130	-.423	.675	-1.29926
		-.735	.473	-1.29926

***The mean difference is significant at the 0.01 level

**The mean difference is significant at the 0.05 level.

*The mean difference is significant at the 0.10 level.

Results in Table 3.4, 3.5 and 3.6 could not found any significant difference in the performance of different types of funds for both currencies. It means that the performance of all type of funds i.e. Balanced international, bond International and Stock Arab mutual funds was not much different from each other, whether they are based on US\$ or Saudi Riyal .

D. Difference analysis of Mutual Funds Performance between Shariah and Non Shariah Funds

Table 3.6: Performance of Shariah and Non Shariah Capital preservation based funds

Group Statistics			
Type	N	Mean	Std. Deviation
Shariah	18	.4700	1.03731
Non Sahriah	10	.3630	.73501

Levene's Test for Equality of Variances		t-test for Equality of Means		
F	Sig.	t	Sig. (2-tailed)	Mean Difference
.855	.364	.287	.776	.10700
		.317	.754	.10700

***The mean difference is significant at the 0.01 level

**The mean difference is significant at the 0.05 level.

*The mean difference is significant at the 0.10 level.

The test was administered for Capital Preservation funds based on Shariah and Non Shariah. The outcome of the test shows that there is no significant difference in the performance of Mutual Fund.

Table 3.7: Performance of Shariah and Non Shariah based funds

Group Statistics

Total Shariah	N	Mean	Std. Deviation
Shariah	191	-4.8609	8.28259
Non Shariah	75	-2.7473	9.39669

Levene's Test for Equality of Variances		t-test for Equality of Means		
F	Sig.	t	Sig. (2-tailed)	Mean Difference
.066	.798	-1.802	.073	-2.11361
		-1.705	.091	-2.11361

***The mean difference is significant at the 0.01 level

**The mean difference is significant at the 0.05 level.

*The mean difference is significant at the 0.10 level.

After performing the previous test exclusively for Capital Preservation Fund, the researchers further analyzed for all the fund categories such as Growth, Income and Capital preservation. The mean difference between

both groups are 2.11% it is significant at 10%. The findings shows that Non Shariah based funds performs better than the Shariah based funds.

IV. FINDING, SUMMARY AND CONCLUSION

The overall findings from the study shows that

- The Capital preservation Mutual fund has significant relation with Income and Growth Mutual funds.
- There is significant difference in the performance of the Shariah and Non Shariah based Mutual funds when it comes to Growth, Capital Preservation and Income Mutual funds. Non Shariah Mutual funds performs well giving higher YTD.
- There are many Mutual funds that are popular in Kingdom of Saudi Arabia using base Currencies such as US \$, Euro, Japanese Yen, Pound, and SAR. Due to non-availability of data the researchers could not analyze Mutual funds based on Euro, Yen and Pounds.
- Currency Based mutual funds on US \$ performs well in Kingdom of Saudi Arabia.

To conclude, In Taduwul Stock Exchange , Kingdom of Saudi Arabia, though there are 264 Mutual funds, according to the researchers the best performing mutual funds during the study period are Capital preservation fund category, Non Shariah based Mutual funds and US \$ Currency based Mutual funds. As Saudi Arabia is one of the strongest economy and biggest market in Middle East, it attracts more players in the Mutual Fund market. The risk and return of the Mutual funds which are not based on Shariah plays a vital role in the selection of Mutual funds in Saudi Arabia. The other Mutual funds underperformed during the study period. The investors can choose the Capital preservation fund, funds that are using US \$ currency base Mutual Funds in today's adverse economic conditions so that they will get a better YTD.

The researchers will perform more in depth study applying many other relevant tools and also increase the data overage for a longer period of time in the near future.

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