

# MICRO & MACROECONOMIC DETERMINANTS OF NAV OF ISLAMIC EQUITY UNIT TRUST FUNDS IN MALAYSIA: QUALITATIVE APPROACH

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## *Abstract*

*This study aims to explore through a qualitative study the factors that influence the net asset value of Islamic equity unit trust funds in Malaysian unit trust industry. A phenomenology method through an in-depth interview was carried out with six informants using the convenience sampling method. After the transcription of the interview data and detailed analysis using the thematic technique, the finding indicated that there are sixteen themes that found have influence on the variance of the net asset value of Islamic equity unit trust fund in Malaysian unit trust industry. These themes categorized into internal and external factors: external factors (Macroeconomics) include economic growth, interest rate, inflation, money supply, foreign exchange rate, crude oil price, local stability, global stability, and regulatory environment. While internal factors (Microeconomics) are fund manager experience, reputation and historical performance, shariah compliant aspect (Islamic law), size of the fund, capital appreciation, income distribution and risk.*

**Keywords:** Islamic Equity Unit Trust Funds, Net Asset Value, Microeconomic, Macroeconomic.

## I. INTRODUCTION

Islamic unit trust funds in Malaysia have observed remarkable growth during the past decades and continue to the present era, this is reflected by huge number of the units in the circulation. According to the Securities Commission (SC) of Malaysia, the number of Islamic unit trust funds launched in Malaysia as at December 2004 was 65 funds with RM13.155 billion of units in circulation. By

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December 2011, the number of funds grew up to 164 funds with 61.212 billion of the units in circulation. During the same period, the net asset value of Islamic unit trust surged from RM9.761 billion at December 2004 to RM 27.860 billion at December 2011. This is equivalent to a growth of 185.42 percent during the period 2004-2011 or approximately 26.49 percent per annum (SC Report, 2011).

The idea of the unit trust fund is to pool the capital of several investors and subsequently employ the experiences of the fund managers to trade the securities. The unit trust fund is a collective investment scheme that pools money from different investors and invests it in various investment instruments, such as, stocks, bonds, money market investments and other securities (Keng, 2000). According to the SC of Malaysia, the net asset value is the fund's price per share market value or the exchange-traded fund's per-share value. Based on this price, investors can buy unit trust fund shares from a fund company and sell them back (redeem) to the company. From the perspective of the unit trust fund, the net asset value per share is calculated on a daily basis based on the closing market price of the securities in the fund's portfolio. The buy and sell order of all the unit trust funds are processed at the net asset value of the traded date (Othman, 2011).

From the Islamic point of view the Islamic unit trust is an investment establishment that pools money from the unit-holders in order to invest in a group of assets with particular conditions that are in line with the *Shariah*. The funds collected are invested in shares, *sukuk* and other securities which are *Shariah*-compliant (Othman, 2011). "The concept of the Islamic equity unit trust fund is based on the *Musharakah* principle whereby, the fund managers buy the shares from different companies to become the partner in the capital of the companies thereby sharing the profit or loss with the investors. The investors can realize the profit (or loss) from the fluctuations of the fund's net asset value" (Othman, 2011).

While the Islamic unit trust is similar to the conventional unit trust investment in many ways, there is a specific requirement that the Islamic unit trust must conform to the *Shariah* investment principles. According to the Securities Commission (SC) of Malaysia, there are three screening criteria being adopted in determining the *Shariah* compliancy of a company, namely, the core activity of the business, the mixed activities of the business, and the benchmarks of tolerance (Khatkhatay and Nisar, 2006). The core activity criterion means the company's major activity should not be *Shariah* incompatible. A mixed activity criterion applies to companies that are commercially active both in the permissible and the non-permissible elements. The last screening criterion is a benchmark of tolerance, which is applicable in the case of mixed activities. If the contributions in turnover or profit before tax from the non-permissible activities of a company exceed the benchmark, the securities of the company are classified as *Shariah* non-approved (Khatkhatay and Nisar, 2006).

In particular, the selections of the *Shariah*-compliant companies are based on the screening process using two approaches, namely, the qualitative and the quantitative parameters (Sadeghi, 2008). The qualitative parameter involves the screening of the business that are prohibited by the *Shariah*, such as, the conventional financial services which are based on *riba* (interest), gambling, manufacture or sale of

non halal products, conventional insurance, entertainment activities that are non-permissible according to the *Shariah* law and any other activities which are deemed as non-permissible according to the *Shariah* principle. On the other hand, quantitative parameter is used to measure the level of mixed contributions of the permissible and the non-permissible activities towards the revenue and the profit of the company. This method also requires that the contribution of a non-permissible activity must not exceed a permissible benchmark. However, if it exceeds the benchmark, the company will be considered as non-*Shariah* compliant (Sadeghi, 2008). Furthermore, many multinational companies receive very small proportions of their revenue from the forbidden activities. However, *Shariah* scholars tend to allow investment in stocks with acceptable proportions of the revenue from the prohibited activities under the condition of haram (forbidden) purifications. This condition requires that, investors must donate the equivalent proportion of their distributions from such companies to charities in order to purify their earnings from the non-halal activities (Hoepner *et al.*, 2009).

In terms of investment technique, the fund management companies of the unit trust normally adopt a combination of two approaches, which are the top-down approach and the bottom-up approach. The top-down approach generally looks at the top-level first, where the fundamental analysis starts on a global macroeconomic level, moving to consecutively narrower economic levels to reach at the individual business itself (Ozbay, 2009). The top-down approach believes that both the economy and industry significantly affect the stock, regardless of the qualities of a firm (Ozbay, 2009). Therefore, the top-down approach takes into account the macroeconomic factors, such as, inflation, consumer price index, industrial production index, money supply, interest rate, foreign exchange rate and the global oil price.

In contrast, the bottom-up approach argues that it is possible to find stocks that provide superior returns regardless of the economy and the industry outlook (Ozbay, 2009). The bottom-up approach is exactly the opposite of the top-down approach and the analysts using this approach generally pick a company and then check how that company is performing without having any particular concern of the state of the economy (Yu, 2007). This approach takes into consideration the microeconomic factors, such as, the company management, size, credibility, volatility, liquidity, financial track record, dividends and the market share (Ali, 2011). Accordingly, there are numerous and infinite factors that may affecting asset prices. These factors can be categorized into economic and non-economic factors such as country, industry, firm, and international. Thus, the factors affecting the price of an equity share can be summarized and viewed from the micro and macroeconomic perspectives (Shubiri, 2010).

In light of the differences strategic between Islamic equity unit trust fund which is subjected to both *shariah* law as well as the capital market law and the conventional counter-party which is subjected only to the capital market law. Further, an increasing demand for the alternative investment vehicles which conform to the *Shariah* principle, has prompted the banking sectors and financial industry as a whole to offer new Islamic financial products, including unit trust funds which have become

a successful investment instrument as reflected by the huge amount of the net asset value in circulation. It is therefore, important to have an in-depth understanding about the trend of Islamic equity unit trust fund investments. This study hence, explores the factors that have influence on the net asset value of Islamic equity unit trust funds in Malaysian unit trust industry. The current study thus came-up with the following research questions:

- i. What are the macroeconomic factors that can influence the net asset value of the Islamic equity unit trust funds in Malaysian unit trust industry?
- ii. How do changes in the macroeconomic factors give impact on the net asset of Islamic equity unit trust funds in Malaysian unit trust industry?
- iii. What are the microeconomic factors that can influence the net asset value of Islamic equity unit trust funds in Malaysian unit trust industry?
- iv. How do changes in the microeconomic factors give impact on the net asset of Islamic equity unit trust funds in Malaysian unit trust industry?

### **Objectives of the Study**

Based on the stock valuation model, the microeconomic factors may have influence on the stock (equity) prices via some issues that related to company itself. For example dividend provided, dividend yield, dividend announcement, earning per share, management performance, liquidity, risk's volatility, credibility, size and capital growth, supply and demand of the securities in the market and other factors the effect the investor's decisions (Irmala *et al*, 2011 and Ali, 2011). While the macroeconomic factors such as overall economic growth, inflation, monetary policy, interest rates, foreign exchange rates, government fiscal policy, public indebtedness, and taxation policies may have systematic influences on the equity price via their influences on the expected discounted future cash flows (Agu and Chukwuma, 2010). Therefore, this study aims to explore and understand the determinants of net asset value of the Islamic equity unit trusts in Malaysian unit trust industry. The specific objectives of this study are:

- i. To explore and understand the relationship between the net asset value of Islamic equity unit trust fund and macroeconomic factors.
- ii. To explore and understand the relationship between the net asset value of Islamic equity unit trust fund and microeconomic factors.

## **II. LITERATURE REVIEW**

The theoretical framework of equity market and economic activity is based on Ross (1976), who establishes the Arbitrage Pricing Theory (APT) that links equity price or returns to several factors that characterize several causes of income volatility

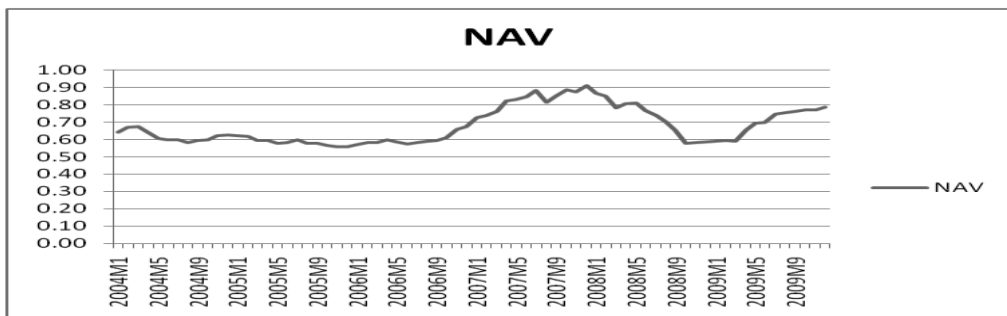
(Rahman,2009). The arbitrage pricing theory hypothesizes that a security price and its return is a linear function, not only of one factor, but also a set of common factors (Iqbal *et al*, 2005).

Research into the relationship between the net asset value of the Islamic equity unit trust funds and the economic factors (micro and macroeconomic) can be derived from the studies on the relationship between the stock (equity) market and the micro and macroeconomic indicators in Malaysia. This is due to the fact that the Islamic equity unit trust funds basically invest in the stock market. In particular, the fund portfolio structures that are up to 95 percent of the net asset value invest in securities and securities relating to companies that have a high growth potential as indicated by the Graphs 1 and 2 below. This emphasizes that the Islamic equity unit trust primarily invests in the stock market, while the remaining 5 percent of the net asset value invest in liquid assets including money market instruments and deposits with the financial institutions. Thus, the equity unit trust funds are also known as the stock unit trust funds, whereby the unit trust can be considered as a basket of various stocks. Low and Ghazali (2007) study the price linkages between stock market and the Malaysian unit trust funds. The outcomes of the study show that, in the short run, one-way Grange causality test shows that changes in the KLCI Granger causes changes in the movement of unit trust funds.

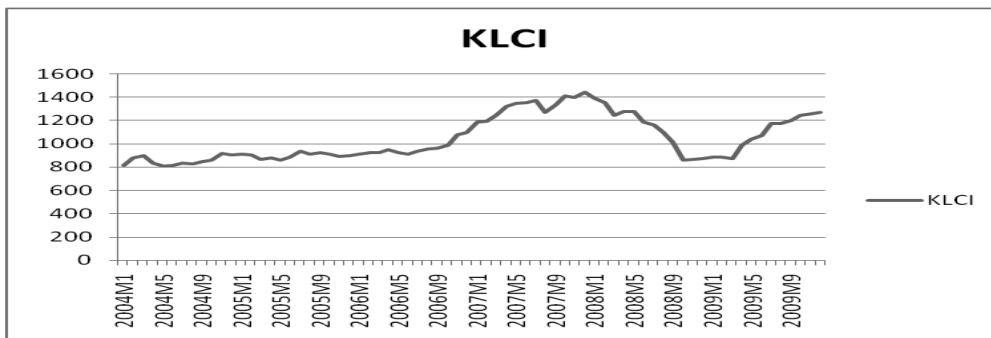
These graphs show the movement of the NAV of the Islamic equity unit trust funds and the KLCI for the period from January 2004 to December 2009.

Since the investment portfolios of the Islamic equity unit trust funds basically invests in stock market, therefore, it is a well-established fact that Islamic equity prices are influenced by micro and microeconomic fundamentals conferring to the rich literature of storing correlation between equity market and economic fundamentals. This section therefore, reviews the existing literature on the

**GRAPH 1**  
**Trend of NAV of Islamic Equity Unit Trust Jan-2004 to Dec-2009**



**GRAPH 2**  
**Trend of KLCI : Jan-2004 until Dec-2009**



relationship between the equity market price and the (micro and macro) economic variables. The growing linkages among the micro, macroeconomic indicators and the movement of the equity market price have captured the interests of researchers and practitioners as reflected in the rich literature of the studies on the relationship between the (micro and macro) economy factors and the stock market

Specific studies on the relationship between the net asset value of the unit trust funds and the macroeconomic variables have been rather limited. In the case of Malaysia, there is only one study done by Fadhil and Azizan (2007), which also relies on the literature on the relationship between the net asset value of unit trust and the macroeconomic variables. The results of this study reveal that changeability of the net asset value of the unit trust funds has been influenced by the macroeconomic variables behavior. Dash and Kumar (2008) found similar findings in the case of the Indian mutual funds, where the macroeconomic indicators in the Indian capital market have influenced the net asset value of the unit trust.

Study conducted by Rahman *et al.* (2009) providing an assessment of the stock market behavior and the various macroeconomic variables on the Malaysian stock market covering the period from January 1986 to March 2008. The findings of the study illustrate that the Malaysian stock market is sensitive to the changes in the macroeconomic variables. Reserves and industrial production index were also found to have stronger dynamic interactions with the Malaysian stock market as compared to the interest rate, the exchange rate and the money supply. Similarly, Ameer (2007) examined the impact of the macroeconomic variables on the stock and bond market activities in two Asian countries, namely, Malaysia and South Korea. The study focuses on the influence of the interest rate changes, the expected inflation rate and the stock returns on the aggregate stock and bond issuance in both countries. The results of study show that the macroeconomic variables have significant influence on the aggregate stock market and the bond issuance.

Thaker *et al.* (2009) analyzed the interaction between the stock price and the selected macroeconomic variables, namely, the inflation, the money supply and

the nominal effective exchange rate in the pre – crisis period (January 1987 - January 1995) and the post – crisis period (January 1999 - January 2007) in Malaysia. The findings show that there is a co-integration between the stock price and the macroeconomic variables. The results also suggest that the monetary system (money supply, inflation, and exchange rate) has a significant effect on the KLCI, which may be considered as the policy instrument that can effectively help the government to stabilize the stock price.

The finance literature contains a large number of studies that examine the stock price behavior with some emphasis on the determinants of the relationship between the equity prices and the economic activities. Most of these studies have paid attention on the developing country and emerging market, such as Bangladesh stock market, Indian stock market, Pakistan stock market, Nigeria stock market, and Turkish stock market. In general, the results of these studies revealed that there are significant short and long-run relationships among the stock price, the stock return and the microeconomic variables (Size, Liquidity, Volatility, Income distribution) (found by Ali (2011), Irmala *et al.* (2011), Shubiri, (2010), Nazir *et al.* (2008)). Further, another study done for the macroeconomic said, where the findings of the study conclude that a number of macroeconomic factor (Consumer Price Index, Industrial Production Index, Interest Rate, Money Supply, Oil Price, and Foreign Exchange Rate) significantly influence the stock returns and equity price (found by Shubiri (2010), Pilinkus (2010), Ali *et al.* (2011), Nazir *et al.* (2008), and Buyuksalvarci (2010)).

**Consumer Price Index:** the effect of the consumer expectation with regard to the inflation risk is incorporated into the study analysis. Barrows and Naka (1994), Wongbangpo and Sharma (2000), concluded that the inflation has negative effects on the equity market. The negative effect of the inflation may be due to the consumers' desire for a lower risk resulting in a general movement of the funds into the bond markets during crucial inflationary period, which in turn leads to the lower stock returns (Buyuksalvarci, 2010).

**Industrial Production Index (IPI):** the IPI can be used as a proxy for the economic activities in the economy and can affects the net asset value of Islamic equity unit trust through its influence on the expected future cash flows. Fama (1990) stated that industrial production index indicates a measure of a total economic activity in the economy and influences the equity prices by affecting on future earnings. The existing literature, such as, Chen *et al.* (1986) and Ibrahim and Aziz (2003) found a positive relationship between the IPI and stock returns.

**The Interest Rate:** The level of interest rates has a negative impact on the value of the investments and the economic growth of a country. High interest rates damp down investments and an aggregate demand leading to slower economic activities (Othman, 2011). As a result, the equity and the debt securities of the conventional as well as the *Shariah*-based funds are affected by the increasing interest rates. Roselee and Fung (2009) supported the implication of the interest rate on the value

of the assets through the reliance on the discount rate to compute the present value of asset pricing. Thus, an increase in the interest rate raises the required rate of returns, which in turn inversely affects the value of the asset.

***The Money Supply:*** a money supply has ambiguous effects on the economy in the sense that, an increase in the money supply in the circulation will result in an inflation in the long run (Majid *et al.*, 2001 and Mohammad *et al.*, 2009). This means that people will maintain their real cash balance so that they can sell their shares and invest their money in the real market by purchasing the real assets, which finally lead to an increase supply of the shares in the stock market that eventually causes the decline in the share prices (Othman, 2011). However, an increase in the monetary growth reduces the interest rate resulting in a reduced cost of the capital and increasing the earning of the corporation (Mohammad *et al.*, 2009). Thus, an increase in the money supply is positively related to the net asset value of the Islamic equity unit trust.

### **III. METHODOLOGY**

The research method adopted in this study is a qualitative research approach. “The research approach derived from phenomenology assumes that the meaning of phenomena (unit trust funds investment and the fluctuation of its net asset value in this case) can only be explored by asking individuals who have experienced the phenomena to describe their experiences” (Jasper, 1994). This study therefore, has obtained data from interview with individual respondents using semi-structured face-to-face in-depth interview. Semi-structured interview is a qualitative data collection strategy whereby the researcher asks the informants a series of predetermined but open ended questions, (Given, 2008). According to Given (2008), semi-structured interview is more flexible technique and reveal further and more detail about certain issue by give the interviewee certain degree of freedom to explain their thought and to be questioned in-depth. The convenient sampling technique was adopted to select the informants. Though, six informant interviews were conducted with academic members at international Islamic university Malaysia (IIUM), 4 male and 2 females. All of them were full time lecturers in finance and economic departments, as well as four of them have an investments in Malaysian unit trust industry.

All interviewees chose to be interviewed at work (in their offices). They carry on 20-25 minutes, with an average duration of 22.50 minutes. Informants were asked three questions. First, what are the micro and macroeconomic factors that impact the Islamic equity unit trust funds in Malaysian unit trust industry? Second, which one of these factors has more impactful on the net asset value of Islamic equity unit trust funds, and finally how would you describe this relationship. All six interviews were audio-taped and transcribed *in verbatim* in Microsoft Word and the transcription progress yielded 36 pages as attached in appendixes (1). Reducing codes to themes strategy was used to note the patterns and themes.



#### IV. FINDING AND DISCUSSIONS

After the transcription of the interview data and detailed analysis, the findings indicate that, there are external and internal themes (factors) that have impact on the net asset value of Islamic equity unit trust funds. The external factors are related to economy of the country as well as to the global financial market in general. However, the internal factors are related to the funds' management, characteristics and performance. Sixteen themes have been identified from the data. A summary of those themes are shown in the table below, and are further discussed in the following part.

**TABLE 1: Summary of Findings**

Themes	Particulars	Represented by
Economic Growth	GDP and unemployment of the country.	<i>Over all, when the economy growing and when the economy have strong fundamental, all sectors increasing and unemployment is low, companies are performing very well.</i>
Interest Rate	Cost of Fund	<i>When Bank Negara raises the interest rate, so will effect negatively on the company, because now the cost of fund is higher.</i>
Inflation	Increase of the price level	<i>Inflation may have mixed effect on stock prices and equity fund.</i>
Money Supply	Local currency (RM)	<i>When increase money supply in the country, the overall price goes up through inflation and through inflation the price of financial asset also goes up.</i>
Foreign Exchange Rate	FOREX Market	<i>The greatest threat to the prosperity in the including stock market is actually the volatility of the FOREX market</i>
Crude Oil Price	Oil price is the raw material for almost all productions.	<i>Crude oil price, definitely will effect the stock market and also unit trust market, because when the crude oil price increases it will effect all other prices.</i>
Local Stability	Elections, and index of corruption	<i>Also local sentiments, there is like elections and the index of corruption.</i>
Global Stability	Financial Crisis and war	<i>Nowadays there is worry about eminent war in Iranian nuclear facilities and Global stability can also be due to that financial crisis in Europe and also in the US.</i>
Regulatory Environment	Economic Structure of the Country	<i>In Malaysia, we have a lot of the companies listed as well as the government allows these funds to invest overseas as well.</i>
Fund Manager Experience	Characteristics of the manager	<i>I think the factors that influence the performance will be the ability of the fund manager to carefully invest the fund and the portfolio.</i>
Reputation and Historical Performance	Awards and Historical record	<i>If the company has got some awards consistently, like have got labor or from euro money.</i>
Shariah Compliant Aspect	Sharia approved	<i>This creates some challenges to fund management companies because; they have restricted the universe of investment. Or Securities in certain sectors like financial markets for example.</i>
Size of the Fund	Diversification I guess is the key	<i>It allows the fund management company to invest better the portfolio, and make trust for the new investor to invest that fund.</i>
Capital Appreciation	Price Fluctuations	<i>Then capital gain, price (la) will also be very important</i>
Income Distribution	Dividends	<i>Cash flow is definitely one of the factors in deciding the NAV in the future, where cash flow represents the income distribution.</i>
Risk	Volatility	<i>Depending on where and which sector they are investing, so if that sector is volatile then defiantly will effect the NAV.</i>

**Theme 1: Economic Growth:** This is represented by Gross Domestic Product (GDP) and unemployment of the country. Shapiro (1988) stated that “economic theory predicts that there should be a strong link between economic activity and asset value. The stock price is the discounted present value of the firm’s payout. Therefore, there is a link between real activity and stock prices”. This has been viewed by the first informant as:

*“Over all, when the economy growing and has strong fundamental, all sectors are increasing and unemployment is low, companies are performing very well, the political scenario is very stable, the government is seen pro-business supporting the businesses, investment from outside, foreign direct investment is coming, issues that the economy as a whole strong and capable of experiencing long term economic growth sustainability economic growth. Overall, these factors will increase the confidence of investors to invest in the companies”* (Informant 1).

*“If we say GDP it means economic growing, then you expect all sectors are growing and profitability of company is also growing. So, you can say in that sense the value of Islamic fund will increase. So, the net asset value will increase corresponding if the economy growing”* (Informant 5).

**Theme 2: Interest Rate:** According to the Islamic law, Islamic investment should be free interest rate. However, Islamic investment’s institutes are still using the interest rate as benchmark when they evaluate their asset (Roselee and Fung, 2009). Thus, an increase in interest rate will lead to a decrease in the present value of the equity unit trust funds. This has been viewed by the fourth informant as:

*“The basic calculation is still referring to basic lending rate, which is interest rate which set by the bank Negara. So, if bank Negara raises the interest rate, this will effect negatively on the company, because now the cost of fund is higher. So, if they want to borrow they have to pay more. So, again their profits will not so much because now the cost of fund is higher* (Informant 4).

**Theme 3: Inflation** has negative effects on the equity or stock market as indicated in the existing literature in the second section of this paper. The negative effects include a reduction in the real value (purchase power) of money and other monetary items over the time which may discourage investment in saving. Besides, uncertainty about inflation may cause reductions in investment of productive capital and increase savings in non-productive assets through the selling of stock and buying of goods (Othman, 2011). Further, it is argued that real interest rates are stable over a period of time, while the fluctuations in interest rates are caused by a change in the inflationary expectations, not by movements in the real interest rates (Ozbay, 2009). This has been viewed by the informant as:

*“If people predict or in the future In a year government is going to reduce the interest rate let us say, interest is going to be reduced. So what people may do is that, if they know then the price of bond and fixed income securities will go up. They might*

*move part of the money from equities market into bond market, so the equity price comes down, bond prices will go up” (Informant 2).*

*“if there is inflation the prices of goods and services goes up, the consumers may not need to consume that much, they decreases may be spending, if consumer decrease their spending it can effect the companies’ profitability at the end will effect negatively on the net asset value” (Informant 4).*

**Theme 4: Money Supply:** An increase in the money supply generates inflation as well as contributes to an inflationary uncertainty; this may generate risk premium such as an expectation of depreciation, and an eventual fall in the equity price (Mohammad *et al.*, (2009). This has been viewed by the second informant as:

*“when you increase money supply in the country, the overall price goes up through inflation, through inflation price of financial asset also goes up, will increase, normally the price of financial asset go up more than price of other things because the price of food and other things is controlled by the government, when the government controls the price of basic necessities and so on, all these increasing money supply will go into financial market so that the financial market will tend to increase the price. So, the NAV will look” (Informant 2).*

**Theme 5: Foreign Exchange Rate:** The influence of the changes in foreign exchange rate on the economy will depend on the huge level of international trade and the trade balance (Maysami, 2004). Thus, the effect will be determined by the relative dominance of import sectors and export sectors of the country. A depreciation of the Malaysian Ringgit will lead to an increase in demand for Malaysian’s exports and in this manner increasing cash inflows to the country, assuming that the demand for exports is sufficiently elastic (Mukherjee and Naka, 1995). On the other hand, if the Malaysian Ringgit is expected to appreciate, the market will attract investments. This rise in demand will boost the equity market level, implying that returns of stock market will favorably respond to the changes in the foreign exchange rates (Mukherjee and Naka 1995). This has been viewed by informants as:

*“Let us say if the value of Ringgit depreciate for example, it will cost more for the company to import from outside, so when cost of import is higher, then let say if the company cannot raise the price, so the profit margin will be lower, if the profit margin will be lower, the return will be lower, in the end this will effect in the NAV” (Informant 4).*

This argument is supported by informant 2 who stated that, *“the greatest threat to the prosperity in the including stock market is actually the volatility of the FOREX market” (Informant 2).*

**Theme 6: Crude Oil Price:** The equity market moves in the opposite direction with respect to the oil price. This is due to the fact that the crude oil price has direct effects on the economy, whereby any increase in the oil price usually leads

to the increase of the cost of input, such as, gas, electric, transportation and manufacturing resulting into the reduction of the return in the equity market (Othman, 2011). This is supported by study (Hasan and Nasir, 2008) that found a negative relationship between the equity return and the oil price. This has been viewed by informants as:

*“Oil price is very straightforward because oil price is the raw material for almost all productions, the machinery, electricity, and transportation. Thus, If the oil price goes up, will affect price of everything and it will lead to price of inflationary and how much certain product uses energy that much the price go up”* (Informant 2).

*“Oil price definitely will affect the stock market and also unit trust market, because when the crude oil price increases it will affect all other prices. Not only input of the commodities but also transportation, every things else will increase, so it has negative effect on NAV of unit trust* (Informant 4).

*“If oil price increase and your fund have invested in company world oil, then there market value will increase and the net asset value will increase, so increase in oil price will be beneficial, but if the investment is thing in which heavily depend oil coming input, then increase the price of oil will effect that company adversely at correspondingly effect the Islamic unit trust”* (Informant 5).

**Theme 7: Local Stability:** Local stability can be viewed from two perspectives, political and corruption indices that affect the investment decisions. Several studies have argued that political situation can influence economic outcomes, impact asset prices, and financial risk (Knack and Keefer, 2006). From the political aspect, in making investment decisions, management companies and fund managers rely less on stock prices during election years (Bialkowski *et al*, 2008). Thus, stock prices are likely to carry little meaning for investment decisions during election years because the newly elected government might sometimes initiate changes in tax, labor, and foreign trade policies that can impact future business performance (Snowberg *et al.*, 2007). Further, uncertainty with respect to future economic policies breeds uncertainty regarding firms’ future cash flows, leading to the loss of the quality of information contained in stock prices (Becker and Sivadasan, 2008).

In addition, an increase in the corruption indices affects negatively on the country’s economy. This is due to the fact that local investors are going to shift their capital and invest outside the country; at the same time, foreign investors will not be encouraged to come to invest in the country. This has been viewed by informant as:

*“Local sentiments, there is like elections, the index of corruption, we can also look at fundamentals like the retail figures, if there is increase in corruption levels issues of economy recovery from deep in consumption* (Informant 1).

*“Macro factors are quite ease, which face by all other investment, so for example political factors, if you do not have stable political environment for the business to operate, it is very chaotic, then people do not to invest, people will want to change the money to other asset class and move to another country. So first, political climate good but stability is important”* (Informant 2).

**Theme 8: Global stability:** Global stability influences the equity market due to the nature of international financial linkages among highly leveraged institutions as well as the global nature of international trade (Obstfeld and Rogoff, 2009). For example, the current global financial crisis has impact on equity market and the global economic activities. In addition, the war and political conflicts among the countries also give some effect on equity market because stock markets usually react to anything that happens in the world. Informant 1 has reviewed this as:

*“Stock market will also be influence by foreign sentiments for example, now-a-days there is worry about eminent war in Iranian nuclear facilities, global stability can also be such as financial crisis in Europe and also in the US”.*

**Theme 9: Regulatory environment:** In Malaysian, the capital market witness improvement in terms of regulatory environments, where there are three institutes organizes the equity market business, such as Bursa Malaysia, Securities Commission (SC) and Kuala Lumpur Stock Exchange (KLSE). These organizations have been improving standards on transparency (For example, daily stock price and daily NAV of equity unit trust), disclosure, and corporate governance. In addition, Malaysian government encourages local funds and companies to invest overseas, Malaysian unit trust operators looking to offer unit trust products to invest outside Malaysia such as in Southeast Asian region and Middle East (Mohd, 2007). Therefore, these regulations at the end will positively effect and attract foreigner investors to invest in Malaysia equity market. This has been view by informant as:

*“I think the most important is the regulatory environment of the country. For example, the economic structure of the country, the example in Malaysia, we have a lot of the companies listed. Ok, on top of that, we have 80% of these companies are sharia compliant. This creates a lot of opportunity for Islamic Funds to invest, and probably the government has also allowed those funds to invest part of their funds overseas, it creates more opportunities for our funds managers to invest” (Informant 1).*

**Theme 10: Fund Manager Experience:** The scheme of the unit trust investment is to pool the capital of several investors and subsequently employ the experiences of the fund managers to trade the securities (Keng, 2000). This indicated that manager characteristic is key point in explaining portfolio performance for the fund (Ding and Wermers, 2009). Baks (2003) study the performance of mutual fund managers, the result showed that up to 50 percent of mutual funds’ performance attributed to the fund manager. This has been supported by the first informant who states that:

*“Just my understanding is that, the NAV will represent the total value of the portfolio, right! And the total value of the portfolio depends on how the fund managers will invest this fund. I mean that, the most important factor which*

*influences the level of NAV of a company or of a fund is how well the manager manages the funds*" (Informant 1). Another informant also stated:

*"I would say that the fund manager will be very important factor for determining the price level of the fund in unit trust industry"* (Informant 3).

**Theme 11: Reputation and Historical Performance:** In selecting which funds to be purchased, investors usually looked at the past performance of the fund, brand reputation and editorials in the financial press. (Blake and Timmermann, 2003). It is seen from one of the interviewers, who stated that:

*"Reputation is most and very important factor. For example in Malaysia, if the company has got some awards consistently have got reward from labor or from euro money"* (informant 3). Another informant shared the same view, as he stated that: *Reputation of the management is important* (Informant 2).

Further explained by informant 1 about the tract record and past performance of the fund as *"One of the factors I can see is the tract records or the historical performance of the fund. If the fund is just launched, it is difficult for me to look at the previous performance. So normally, we will be looking at funds which have been launched quite some time"*.

**Theme 12: Sharia Compliant Aspect:** Islamic financial institutes apply Islamic screening approach to guarantee that the securities selected in Islamic fund portfolio are consistent with Islamic law, that make Islamic investment unique and demandable by Muslim investors (Hassan *et al.*, 2010). Screening method, which includes quantitative and qualitative approaches as, explained in the first section of this paper. Therefore, the *Shariah* Advisory Council of the Securities Commission may reconsider the *Shariah*-approved securities invested by the specific fund as *Shariah* non-approved securities. Accordingly, the performance of the fund may be affected as the fund then has to be disposed all such investments that have been reclassified (Othman, 2011). The informant 1 has viewed this as:

*"One of the important factors is the Shariah compliant aspect with the need to invest in companies that approved to be Shariah compliant. Therefore, this creates some challenges to fund management companies because they have restricted the universe of investment. For example securities in certain sectors like financial markets, and the universe of investment security can probably be very few, as well as probably just few of the Islamic banks in Malaysia which qualify to be sharia approved"*.

**Theme 13: Size of the Fund:** Introduction of size as a multiplicative term to dividend provides a significant improvement in the explanation of share prices (Karathanassis and Philiappas, 1988). The size of the firm, which is captured through total capital employed, is anticipated to effect the share prices positively as large firms are more diversified than smaller ones and consequently are less risky (Benishy, 1961 and Roselee and Fung, 2009). Similarly, for the unit trust funds when the fund is large that will increase the fund's portfolio diversification and then

decline the risk. This supported by Atiase (1985), who found that as the size of the firm grows and increase as a result the share price volatility declines. This has been view by informants as:

*“When the size of the fund is very big it gives the fund manager opportunity to go for more diversification, and can gain high return as the same time reduce the risk”* (Informant 2).

Furthermore, same view supported by informant four, who stated that: *“Diversification I gust is the key, if the fund is big, they are able to invest in many other type of funds, so that if particular fund is not performed well it will be offset by other funds. So, in overall it will balance the value of particular funds”* (Informant 2).

**Theme 14: Capital Appreciation:** According to SC in Malaysia, unit trust investment offers the unit-holders with two types of returns, capital appreciation and income distribution. Capital appreciation means, unit – holders can make profits when the redemption value or the total amount of net asset value of the Islamic equity funds is higher than the amount of initial investment (Othman, 2011). This may influence investors’ decision and increase the demand of investment in this fund. Informants as have viewed this:

*“I think when investor want to that said to invest in particular unit trust, the mine thing that are looking for a higher return , so if the return is higher definitely the investors will give the priority to that fund”* (informant 4).

*“If you see from investor point of view, investors invest in unit trust, and they do not invest in short-term. For equity fund, usually they go for medium to long term, depending on investment objective and they are looking for capital gain”*(Informant 6).

**Theme 15: Income Distribution:** is a profit that provides by the unit trust management company (fund manager) and distribute this profit among the unit-holders according to their investment amount in related funds and the fund’s declared policy (Othman, 2011). Molodovsky (1995) stated that dividends (income distributions in this case) are the hard core of stock value (Unit in this case), where, the value of any asset equals the present value of all cash flows of the asset. This has been viewed by informants as:

*“Cash flow is definitely one of the factors in deciding the NAV, in the future, where cash flow which represent the income distribution. Dividend signaling, so never decrease this dividend. If you decrease the dividend you might be giving wrong signal to the market, which may effect negatively on the NAV”* (Informant 2).

However, informant 1 has argued that we cannot link the effect of income on the value of the NAV, because difference funds have different objectives as stated that:

*“If the fund itself is income fund then of course the distribution will be the priority of the fund management of company. However, If the fund itself is a grow funds, then the distribution will not be a priority and so you cannot link for example the effect of income on the value of the NAV because different funds have different objectives”* (Informant 1).

**Theme 16: Risk:** which represented by volatility of the fund, where volatility is most commonly quoted in terms of standard deviation of returns (Allen *et al.*, 2009). There is more risk involved for asset (units in this case) whose price or return fluctuates more dramatically than the other (Allen *et al.*, 2009). Thus, the fund that has a higher volatility has high return and will be more demandable among the investors specially the aggressive-risk investors (risk-taker), which may effect the net asset value of that fund. Informants as have viewed this as:

*“I think it has some influence, depending on where and which sector they are investing. So, if that sector is volatile then defiantly will effect the NAV”* (Informant 4). This has been supported by informant 2 who stated, *“Sometimes, the riskiness of the project will also become important in determining the NAV”* (Informant 2).

## V. SUMMARY AND CONCLUSIONS

This study explores the themes (factors) that effect the variances and the fluctuations of the net asset value of Islamic equity unit trust fund in Malaysian unit trust industry. The study adopts a phenomenology approach via an in-depth interview tactic with six informants using the convenience sampling method. The findings of the study show that, the factors that influence the variances of net asset value of Islamic equity unit trust funds in Malaysian unit trust industry can be viewed from micro (internal) and macro (external) prospective. The Internal (microeconomic) factors namely fund manager experience, reputation and historical performance, *shariah* compliant aspect, size of the fund, capital appreciation, income distribution and risk. While the external factors (macroeconomic) are; economic growth, interest rate, inflation, money supply, foreign exchange rate, crude oil price, local stability, global stability and regulatory environment.

This paper contributes to the knowledge of Islamic unit trust industry in both theoretically and empirically. Theoretically, contribute towards enriching the existing literature by presenting specific cases of the micro and macro-economic determinants of the net asset value of Islamic equity unit trust industry in Malaysia. Empirically, this study benefits the investors, management of the companies and funds manager in taking successful investment decision through estimating the future direction of net asset value of Islamic equity unit trust by understanding the expected trend of the economic foundations (macroeconomic factors) as well as micro factors.

Finally, there is likely to be limitation bias in this study, where the main limitation for this study is the small number of people interviewed. Therefore, for further research the small sample could be avoided in the future by interviewing large



sample of people such as funds managers, unit trust investors, academic lectures and economic scholars to enhancement the findings of the study. In addition, this research can be reapplied on various type of unit trust fund not only equity funds, such as income funds, balance funds and money market funds.

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