

Promoting Responsible Investing in OIC Countries

Presented at
the OIC Member States' Stock Exchanges Forum 8th Meeting
Istanbul, Turkey.
November 11, 2014

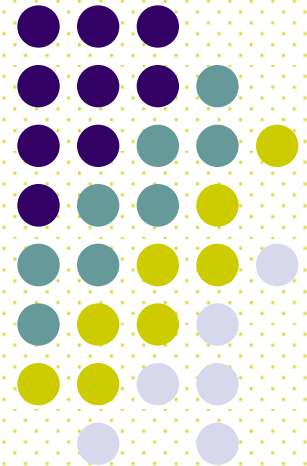
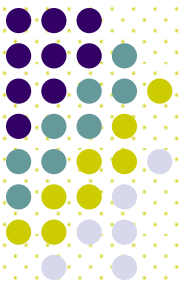
Jahangir Sultan
Bentley University

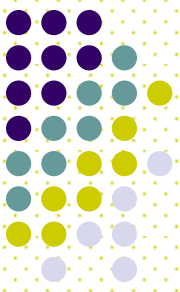
and

Currency Arbitrage Management Group, LLC

Marblehead, Massachusetts

*Confidential constituents list for all indices have been provided through a grant from the S&P Dow
Jones Indices.*

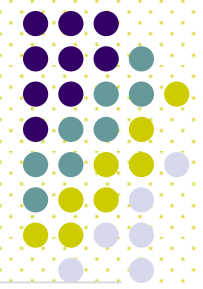




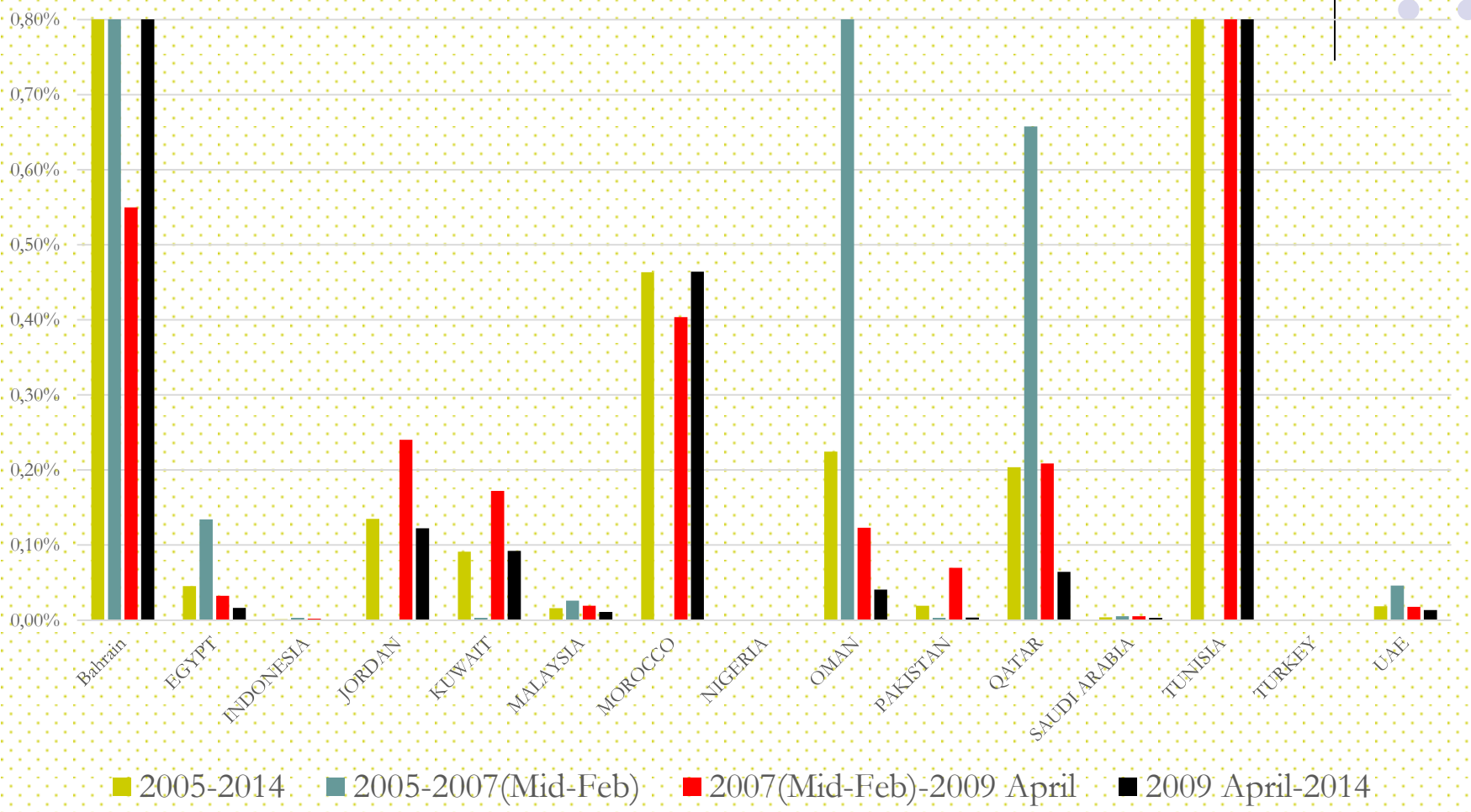
Promoting OIC markets

- Attract foreign investment in OIC countries through increased product development
- Indirect investing through DRs and ETFs representing OIC capital markets
- Direct investing in OIC member countries

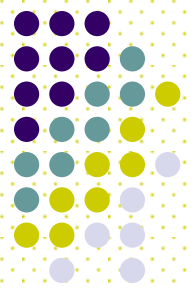
Breadth, depth, and liquidity in OIC capital markets – Illiquidity ($Amihud = (|R_t| / \$VOL)$)



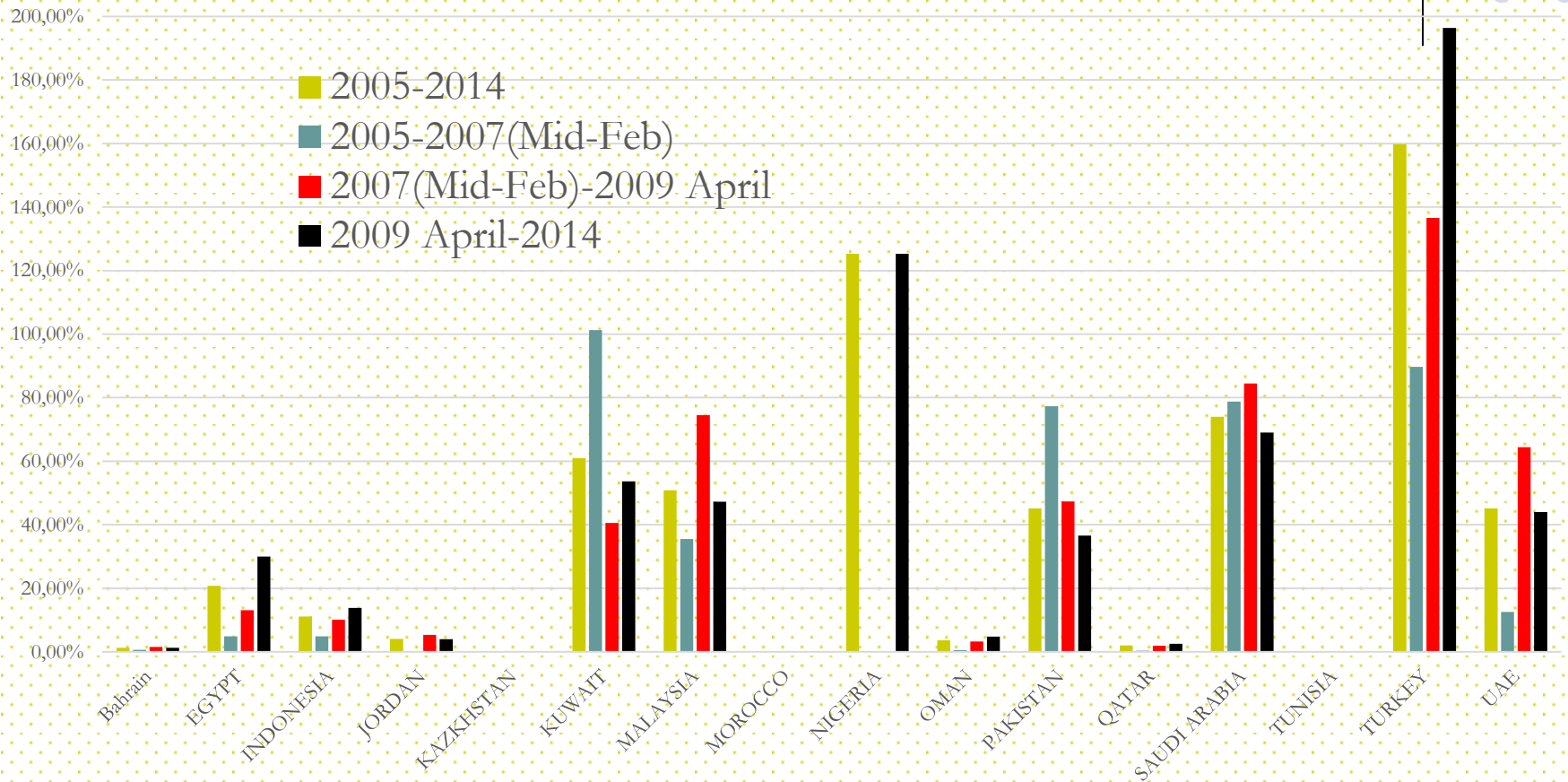
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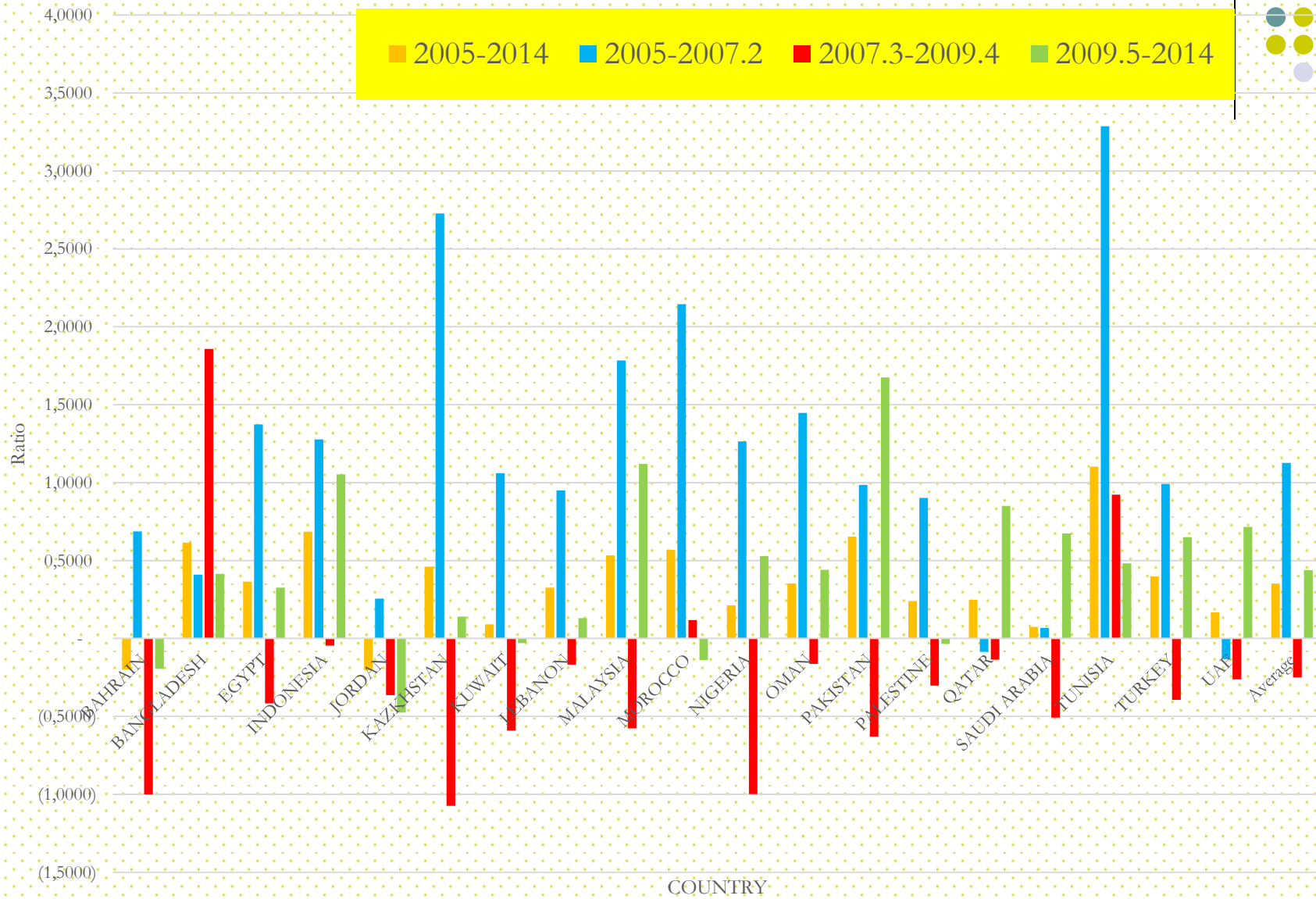
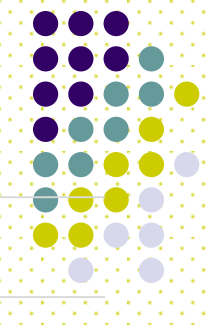
Breadth, depth, and liquidity in OIC capital markets – Volume (scaled)



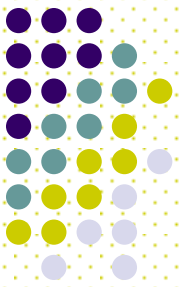
Volume (% of average group Volume)



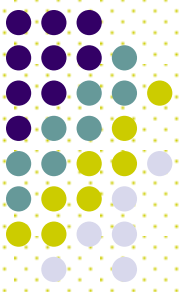
OIC member countries --- risk adjusted returns



Promoting responsible investing



- Big money moving to SRI; SRI universe is over \$4 trillion
- Pensions funds are now required to hold SC equities
- Why not demonstrate to the pension funds and other large institutional investors a new class of assets – SC compliant DRs and their ULs

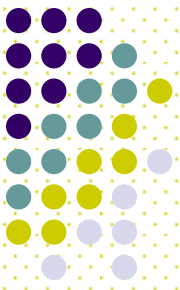


Reverse benefits of DR listing abroad

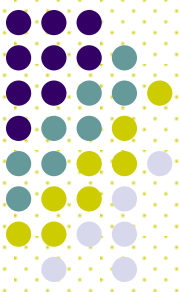
Most often cited reasons for listing DRs

- Improving liquidity and broadening the shareholder base
- Capitalizing on the product market reputation
- Fees
- Lower cost of capital
- External image/governance at home
- Price discovery

Effective international diversification with DRs or underlying shares?



- Diversification using DRs possible for foreign investors.
- However, a portfolio of underlying stocks may offer better diversification benefits.
 - Direct investment leads to lower correlation because of investment frictions including transaction costs; illiquidity; higher bid-ask spread; etc.

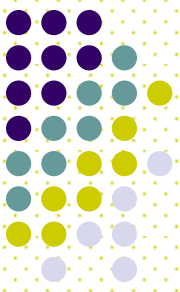


International portfolio diversification – Islamic DRs or their underlying stocks

Compare international portfolio diversification with DRs and their underlying foreign stocks

– which is better?

- Four regimes
 - 2003-2014
 - Pre-crash (2003-Feb 2007)
 - Crash (2007 (March) – 2009 (April))
 - Recovery (2009 (May) – 2014 October)

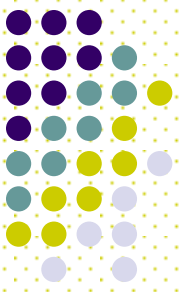


Performance* of Islamic DRs

<u>Regimes</u>	<u>DR portfolio rank</u>
• 2003-2014	1
• Pre-crisis	2
• Crisis	2
• Post-crisis	1

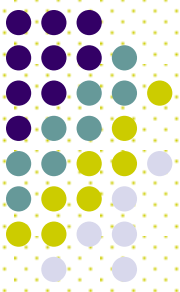
**Based on risk adjusted returns*

** Underlying portfolios perform similar*



Role of Borsa Istanbul

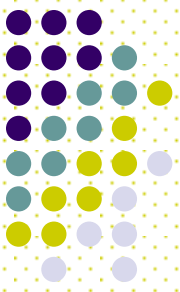
- Turkey is the leader among OIC countries regarding DRs/GDRs (70)
- Certainly, the success of these DRs hinges upon how the Borsa encourages the underlying firms to maintain active listing at home – avoid securities litigation
- Enforcement of securities laws; remove regulatory barriers; Improve disclosure and governance
- Encourage new IPOs among high quality firms



Benefits to OIC exchanges

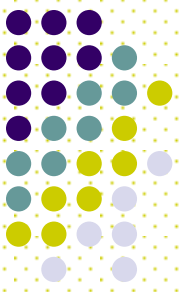
Improve efficiency by reducing market frictions:

- Conversion from DR to UL and UL to DRs
- Market based: investment restrictions on domestic and foreign investments; transaction costs; accounting and legal standards
- Trading based: liquidity



Role of exchanges

- Monitor capital flows – encourage long-term
- Monitor capital flights through UL--> conversion
- Hot money
- Monitor short selling of stocks linked to DRs
- Prevent accounting frauds to prevent securities lawsuits



Summary

- Possible to discriminate among various stock universes to identify disparate investment strategies
- Islamic investing allows both values and profit motivated investment strategies
- SC universe has unique appeal to those demanding SC compliance as well as profitability
- DRs provide international diversification