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Comparative analysis between global sukuk and bond indices: value-at-risk approach (Article)

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Abstract

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Purpose: Sukuk is an innovative financial instrument with a flexible structure based on Islamic financial contracts, unlike a bond which is based on the structure of a loan imposed with interest. With the notion that sukuk differs considerably from the conventional bonds in terms of risks related to investment, this study aims to examine whether the sukuk market is different from conventional bond markets based on the value-at-risk (VaR) approach.
Design/methodology/approach: The VaR of a portfolio consists of sukuk and bond indices and is undertaken to determine whether there is any reduction in the VaR amount through the inclusion of the sukuk index in the portfolio. The analysis is undertaken based on the developed and emerging market bond and sukuk indices from January 2010 to December 2015. **Findings:** This paper examines whether the VaR of sukuk market differs from conventional bond markets by using fundamental techniques. It was observed that the VaR amount of sukuk indices is comparatively much lower than the VaR of bond indices in all the cases. Including the sukuk index with each bond index can reduce the VaR of the portfolio by around 30 to 50 per cent for all the developed and emerging market bond indices. **Research limitations/implications:** This research is limited to covering six years of data. Nonetheless, it is able to provide findings which are believed to be useful for the market players. **Practical implications:** This study unveils attractive opportunities in terms of diversification benefits of sukuk indices for international fixed-income portfolios. **Originality/value:** The VaR method is a useful risk management tool. This study uses this method to emphasise the significant reduction of risks and diversification benefits that sukuk investment could offer by including it in the investment portfolio. © 2020, Emerald Publishing Limited.

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