CHAPTER 1

INTRODUCTION

1.1. Background of the Study

In Islam, investment is an activity that is highly recommended to organize people's wealth, because by investing, personal wealth will become more productive and also bring benefits to others. Al-Quran explicitly forbids the accumulation of activity on personal wealth. In order to implement the investment appeal, there must be many options that people can use to invest their wealth. One of the option that people can choose to invest their wealth is using capital market institution. Capital market became one of the important influence to the world economics. Many companies and industries use capital market institution to organize their financial assets. In fact, there will be no modern economic without any role of capital market. In the broadest sense, capital market can be defined as organizing financial system, including commercial bank and all of the intermediaries in finance, and also short-term and long-term securities. In specific term, capital market can be defined as an organized markets that trade stocks and bonds with the services of a broker, the commissioner and the underwriter. Unfortunately, during the time, capital market became the most economic place to run a transaction that is prohibited by Islamic law such as interest *(riba')*, gambling *(maysir)*, *gharar*, fraud, and

others. Attempts to perform the Islamization of capital turnover in the sector which are vital to modern economies is increasingly intense.

Islamic investment nowadays becoming one of the investation product that many people choose to do their investation. Moslems are now has an option to use Islamic investment to invest their money without afraid of breaking the Islam rules of trade. Islamic Investment is investment activity that is consistent with the principles of Islamic law (Sharia) and its practical application through the development of Islamic economics. Islamic investment developments in the world is very rapid. Many countries consider that Islamic investment can be a good opportunity for investment because they can still do the investment without violating the Islamic law.

Indonesia as one of the country that populated by Moslem is started to develop the Islamic capital market. Although its development is still new compared to the Islamic banking, Indonesia's Islamic Capital Market is expected experience rapid growth along with significant growth in Indonesia Capital Market Industry. As far known, Islamic capital market in Indonesia is associated to the Jakarta Islamic Index (JII), which only composed of 30 Islamic securities listed in Indonesia Stock Exchange (IDX), whereas Islamic Securities existed in the Indonesia Islamic Market are not only consists of 30 shares that become the constituents of JII but also consists of various type of securities. This was become more apparent after Bapepam-LK issued Islamic Securities List (DES) in November 2007. Since then, Bapepam-LK made DES as the only

reference for Islamic Securities in Indonesian capital market. The Dow jones Islamic Market World Index (DJIMID) were introduced in 1999 as the first benchmarks to represent Islamic compliant portfolios. The indexes are maintained based on a stringent and publish methodology. An independent Sharia Supervisory Board counsels Dow Jones Indexes on matters related to the compliance of index eligible companies. Excluded from the indexes are producers of alcohol and pork-related products, providers of conventional financial services (banking, insurance, etc.) and providers of entertainment services (hotels, casinos/gambling, cinema, pornography, music, etc.). Tobacco manufacturers and defense and weapons companies, although not stricly forbidden for investment under Islamic Law, are excluded from the indexes as well. In addition to the industry screens, stocks are also subjected to a series of financial ratio screens to remove companies based on debt and interest income levels. The Dow Jones Islamic Market family going back to 2003 is already covering approximately 48682 indexes, 4414 companies and 46 data items. Since that, Dow Jones Islamic Market World Index is known as the biggest Islamic stock market index in the world.

The impact of globalization has caused the transfers of funds and investment activities to be no longer limited in one country only. those activities are now expanded to all over the world. A growing body research has explored information transmission between and accross countries. Information transmission can be described as a correlation between one market to another

market. According to Koutmos (1996), information transmission or correlation among markets can be investigated in terms of first moment and second moment interdependence. Transmission of information at first moment interdependences can be defined as relationship at return level whereas transmission of information at second moment interdependence looks at transmission of information at volatility level. This study tries to expand the literature on transmission of information at return and volatility level by examining international market interdependence between the Islamic stock of Jakarta Islamic Index (JII) and Dow Jones Islamic Market World Index (DJIMID).

1.2. Problem Definition

The main objective of this study is to examine the transmission of information (first and second moment interdependencies) between the Islamic stock index in JII and DJIMID. So, the problem definition of this research is, "Information Transmission Between Islamic Stock Index in Jakarta Islamic Index (JII) and Dow Jones Islamic Market World Index (DJIMID)."

1.3. Scope of the Study

a. This research is focused on Islamic indices that listed on Jakarta Islamic Index (JII) and Dow Jones Islamic Market World Index (DJIMID).

b. The research is based on daily closing price of the Jakarta Islamic Index (JII) and Dow Jones Islamic Market World Index (DJIMID).

c. This research examines return and volatility of the Jakarta Islamic Index (JII) and Dow Jones Islamic Market World Index (DJIMID). The research period is from November 30th, 2007 until May 16th, 2012. The dates covered in this study are the only dates in which both markets are traded. The daily returns for both markets are calculated using continuously compounded return.

d. The research will use the bivariate VAR GJR-GARCH model. This model is considered because it allows simultaneous estimation of mean and variance equation of stock indices in different countries.

1.4. Objective of the Research

The objective of this research is to examine transmission of information at return and volatility level between the Jakarta Islamic Index (JII) and Dow Jones Islamic Market World Index (DJIMID).

1.5. Benefits of the Research

a. For author: beside serve the personal interest of the author, this research will also give a new knowledge and experience to the author especially about capital market information transmission.

b. For Investor: this research will help investor to know more about information transmission of Islamic Investment so that they can make a decision whether they will invest their money or not.

c. For another researcher: this research can be used as one research for the same field of research but conducted to different sample or different research period.

1.6. Writing Structure

Chapter I: Introduction

In this chapter, author pictures the background of the research; which consists of problem definition and then, scope of the study, objectives of the research, benefits of the research, and the writing structure.

Chapter II: Theoretical Background

This chapter pictures the theoretical background or the theories basis which relevant and needed in conducting this research, also the hypothesis.

Chapter III: Research Methodology

This chapter describes the design of the research and grouped into three parts as the population and sampling, data gathering, and the empirical model.

Chapter IV: Data Analysis

This chapter describes the analysis of the gathered data and also the interpretation of data resulted from data processing.

Chapter V: Conclusion and Recommendation

This chapter pictures the conclusion of the research; its implications, limitations, and also further research which provides critical points for improvement in the future research or study.