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### Abstract

This study investigates the relationship between Shariah non-compliant risk and stock returns in Malaysia between 2018 and 2020. The findings demonstrate a significant positive relationship between Shariah non-compliant risk and stock returns. The study revealed that in the long run, investors prioritize higher returns over the Shariah compliance of a firm despite the higher risk associated with non-compliant stocks. This finding aligns with the conventional theory of finance, which suggests that higher risk leads to higher returns. On a positive note, the lower returns associated with Shariah-compliant stocks provide some indication that Shariah-compliant stocks are exposed to lower risk and are a more stable investment. The findings of this study offer valuable insights for investors seeking to invest in Shariah-compliant financial products and businesses. This research contributes to the literature on the relationship between Shariah non-compliant risk and stock returns in Malaysia and offers useful implications for policymakers and investors alike.

**Keywords:** Shariah Risk, Stock Return, Equity Market, Risk and Return, Malaysia

### Introduction

The Islamic capital market constitutes a critical constituent of the overall capital market in the Malaysian dual financial system. Given its importance within the Islamic capital market, Islamic equities serve a vital purpose in enhancing the trust of Muslim investors and assisting them in locating Shariah-compliant investment opportunities. Comprehending the underlying causes of fluctuations in Islamic stock equity returns in Malaysia assumes utmost importance. Prolonged volatility in stock returns is not only affecting the overall performance of companies or organizations but can also have adverse implications for the nation as a whole. Thus, this study seeks to investigate the determinants that influence fluctuations in Islamic stock returns in Malaysia from 2018 to 2020.

One of the most crucial components associated with the Islamic capital market is Shariah risk. Shariah risk refers to the risk that an investment or financial instrument that is

currently deemed Shariah-compliant could become non-compliant in the future. This risk is specific to Islamic finance because investments and financial instruments in this system must adhere to Islamic law, or Shariah, which prohibits certain activities and financial practices. Shariah risk is similar to the regulatory risk in that it is related to changes in the legal or regulatory environment, but it is unique to Islamic finance because of the reliance on Shariah compliance. For example, an investment that is currently permissible under Shariah law could become non-compliant if the interpretation of Islamic law changes, or if new regulations are introduced that prohibit certain types of investments or financial practices. Investors and financial institutions that participate in Islamic finance must be aware of Shariah risk and take steps to mitigate it, such as working with Shariah advisors and regularly reviewing their investments and financial products to ensure compliance with Islamic law. In short, Shariah risk can be defined as the risk of financial loss that is caused by changing the status of stock or Islamic Financial Institutions from Shariah-compliant to Shariah non-compliant (Noor et al., 2018)

Shariah risk also applies to Islamic stock equities. Shariah-compliant equities are those that are issued by companies that meet certain Shariah principles and criteria, such as not engaging in prohibited activities like gambling, alcohol, and tobacco. However, there is a risk that a company that is currently Shariah-compliant could become non-compliant in the future, either due to changes in the company's business activities or changes in the interpretation of Shariah principles. This could lead to the company's stock being deemed non-compliant and consequently being excluded from Shariah-compliant portfolios. To mitigate Shariah risk in Islamic equities, investors and financial institutions must regularly screen and review the companies in their portfolios to ensure ongoing compliance with Shariah principles. They may also work with Shariah advisors and use screening tools to identify companies that are more likely to maintain Shariah compliance over the long term. In Malaysia, the Securities Commission releases a list of Shariah-compliant securities twice a year that provides investors with a guide to selecting stocks under Shariah principles and thus minimizing the Shariah risk.

Previous research has shown that the Shariah status of a stock positively influences its price, with Shariah-compliant stocks expected to rise in value, while Shariah non-compliant stocks may experience a price reduction (Yazi et al., 2015). This is because investors view Shariah-compliant stocks as highly valued, and the status of Shariah-compliant adds value to the stock, influencing investors to buy more and driving up stock prices. On the other hand, investors tend to avoid Shariah non-compliant stocks, leading to declining returns (Dusuki, 2011; Wong, 2013; Sadeghi, 2008). The relationship between the stock return and the Shariah risk can be demonstrated by the calculation using the cumulative average abnormal return (CAAR) and the average abnormal return (AAR). After the Shariah status changes, it is observed that the CAAR and AAR of the Shariah non-compliant stock (1.47%) are much lower compared to the Shariah-compliant ones (10.67%) (McGowan and Muhammad, 2010). However, these prior studies investigate the short-term influence of Shariah risk on Islamic stock. Whether the impact of Shariah risk is significant in the longer time horizon is still a puzzle.

Accordingly, motivated by the significance of shariah risk in the Islamic capital market and the importance of analyzing volatility in stock returns, this study aims to investigate the impact of Shariah non-compliant risk on stock return in Malaysia. Moreover, we also investigate whether other factors such as the Islamic market index and GDP per capita also play a role in influencing stock return. The study seeks to make important contributions to

the field, including providing insight to the regulator to develop appropriate policy, filling gaps in prior literature, and clarifying the relationship between the variables.

We utilize a sample of 20 companies listed in Bursa Malaysia that have experienced changes in their Shariah-compliant status over the course of three years, from 2018 to 2020, covering six times of Shariah announcement. Data on stock prices are collected weekly to calculate stock returns. The study will also analyze the Islamic market index, GDP per capita, return on asset (ROA), and total assets as controlling variables to better understand the relationship between these factors and stock return. Based on prior research, the study hypothesizes that Shariah risk has a significant impact on stock prices in Malaysia. We found that Shariah risk significantly impacts stock prices, and the revision of Shariah screening requirements has raised concerns about Shariah risk. The findings contribute to the research in Islamic finance by offering insights into the shariah risk issues. By shedding light on the influence of Shariah non-compliant risk and other factors on stock return in Malaysia, this study also contributes to the development of appropriate policy and investment decisions in the country.

The paper continues as follows: the next section discusses the background of the study, followed by a literature review and hypothesis. The research design presents the methodology of the study including data collection and analysis procedures. Subsequently followed by the discussion of findings. Finally, the last section concludes.

### **Background of the Study**

In June 1997, the Shariah Advisory Council (SAC) of the Securities Commission of Malaysia (SC) established the first list of Shariah-compliant securities, which provided investors with a guide to selecting stocks in accordance with Shariah principles. The availability of such a list not only facilitated investment decisions for Muslim and non-Muslim investors alike but also instilled confidence in the Bursa Malaysia stock exchange (Bursa Malaysia, 2022). The screening process for identifying Shariah-compliant stocks is released twice annually, in May and November, and comprises a quantitative and a qualitative assessment. The quantitative assessment involves examining the financial ratios of the company to ensure that its revenue is derived from acceptable sources and that it adheres to prescribed benchmarks for its financial ratios and business activities. The qualitative assessment evaluates the core business to ensure that it contributes positively to the national interest and has a favorable public perception, based on the views of the SAC of the SC of Malaysia. A company must pass both the quantitative and qualitative assessments to be categorized as shariah-compliant.

Consequently, on 18 June 2012, the SAC of the SC of Malaysia announced a revised Shariah screening methodology. The SC released the updated list of Shariah-compliant securities approved by the SAC on November 2013 (Securities Commission Malaysia, 2013). According to the report, a significant change in the Shariah status of companies was observed after the revision of the Shariah requirements and its corresponding announcement. The revision led to the removal of 158 stocks from the list of Shariah-compliant securities, resulting in a reduction of the Shariah-compliant stocks in Bursa Malaysia to only 72% (Yazi et al. 2015). The majority of the delisted companies failed to meet the financial ratios for debt-to-total assets and cash and cash-equivalent-to-total assets, which must be below 33%.

The identification of Shariah-compliant and non-Shariah-compliant stocks holds significant importance as it can serve as a guiding principle for companies seeking to be listed as Shariah-compliant stocks. This information also serves as a valuable reference for investors or fund managers who prefer to invest in Shariah-compliant stocks. This is especially

significant for Muslim investors who can enjoy the freedom to purchase any stock with the assurance of compliance with Shariah principles. Investors who prioritize investing in compliance with Shariah principles are likely to sell non-Shariah-compliant stocks and opt for Shariah-compliant ones. This increased demand for Shariah-compliant stocks has a direct effect on their stock returns. Other factors that influence stock prices include economic growth, Islamic market index, return on assets (ROA), and total assets.

In Malaysia, there are two primary Shariah supervisory boards, namely the Shariah Committee and the Shariah Advisory Council (SAC). The Shariah Committee is responsible for monitoring organizational or company-level issues related to Shariah compliance for financial institutions offering Islamic financial products, whereas the SAC oversees all matters related to Shariah at the national level. Presently, it is evident that Shariah plays a significant role in shaping Malaysia's financial landscape and system. The major reason is that Islam is one of the fastest-growing religions worldwide, and the number of Muslims is projected to rise rapidly from 1.8 billion in 2015 to 3 billion in 2060, covering about 31.1% or three out of ten of the world's population (Lipka and Hackett, 2017), thereby leading to an increased demand for Islamic-based products, especially in the Malaysian context.

This trend has led to the empowerment of the SAC's role, the emergence of many Islamic financial products, and the growth of Islamic capital and money markets in Malaysia. However, a significant challenge arises when Shariah non-compliant risks arise in financial products. The Shariah status of products, such as stocks, is essential in Malaysia, as status changes, from Shariah-compliant to non-compliant, or vice versa, can have significant impacts on stakeholders, particularly investors. Muslim investors who desire to invest in Islamic stocks might develop a negative perception of this condition, leading to a loss of confidence in the product. Thus, this led to the withdrawal of investment by selling the stock considered Shariah non-compliant and opting for other products. Consequently, this can affect the stock return in Malaysia in the long run, causing stock return fluctuations.

This scenario is better demonstrated and explained by analyzing the impacts of the Shariah screening requirements revisions and announcements made in 2013 (Yazi et al., 2015). Therefore, the objective of this research is to examine the return of stocks weekly, investigate the relationship between Shariah non-compliant risk and stock return in Malaysia, and analyze the changes in the Shariah-compliant status of companies in Malaysia from 2018 to 2020. Moreover, the details of Shariah-compliant and non-compliant stocks are crucial as they can serve as guidelines for other companies that wish to be listed as Shariah-compliant stocks and as a reference for investors or fund managers who prefer to invest in Shariah-compliant stocks, especially for Muslims who seek a list of Shariah-compliant stocks to exercise their freedom to purchase a wide range of stocks.

## **Literature Review and Hypothesis**

### ***The Impact of Shariah Screening Revisions and Announcements***

Several studies have been conducted on the impact of Shariah compliance on stock prices in Malaysia. Jamil et al (2020) research analyzed the impact of Shariah-compliant announcements on the stock prices of listed companies over seven years using a previous screening methodology and two years using the revised methodology. The study found that new stocks added to the Shariah-compliant list had a positive impact on stock prices, while unlisted stocks had a negative impact. However, the research did not consider other factors that may affect stock returns.



Zainudin and Miskam (2014) investigated the impact of revised screening methodology on the Shariah-compliant status of public companies listed on Bursa Malaysia. The study found that certain factors influenced the status of Shariah-compliant securities to re-classify as non-compliant securities. The research concludes that the revised methodology is better at measuring the status of Shariah-compliant securities, but further details regarding the screening process are necessary. Yazid et al (2015) research investigated the impact of Shariah compliance announcements on stock price changes in Malaysia. The study found that dramatic changes in the Shariah status of stocks had an impact on the market, with Shariah-compliant stocks deemed more valuable compared to non-compliant ones. Dusuki (2011) and Wong (2013) study found that the status of a stock being Shariah-compliant positively influences its price, as investors consider Shariah-compliant stocks more valuable.

Overall, these studies suggest that the status of Shariah compliance has a significant impact on stock prices in Malaysia. Changes in a stock's Shariah status can result in significant changes in its share price, with investors considering Shariah-compliant stocks more valuable. The revised screening methodology has improved the measurement of Shariah compliance status, but further research is necessary to understand the screening process's details. The current study aims to fill the gap in prior research by examining the impact of Shariah non-compliant risk on stock returns from 2018 to 2020, considering controlling variables such as the Islamic market index, GDP per capita, ROA, and total assets. Hence, based on the above review of literature, we can formulate the following main hypothesis

H: The Shariah non-compliant risk has a significant negative impact on stock return.

### ***Other Determinants of Stock Returns***

#### ***a. Islamic Market Index***

The Malaysian market has two broad categories of market indices: the KLSE Composite Index for conventional equities and the FTSE Bursa Malaysia Hijrah Shariah Index for Islamic equities. Previous studies have shown that the market index has a positive relationship and is significant to the stock return. This is supported by the investor awareness hypothesis model of market segmentation, which suggests that the presence of a company in an index leads to an increase in the number of investors who are aware of the company's existence since they view the index as stable. The variance in the investor's holdings has a significant impact on the expected returns of a stock's momentum. Furthermore, a stable market index boosts investors' confidence, leading to increased investments in the market index and consequently causing a rise in the stock return. The higher the confidence level of investors towards the stock market return, the higher the stability and performance of the stock market return, thus increasing the performance of the stock return.

#### ***b. Economic Growth***

Research has suggested that there is a relationship between stock returns and economic growth, with the stock market often used as a proxy for economic growth. GDP per capita is a measure of economic growth that assesses a country's prosperity based on economic growth per person. Per capita income is a measure of the total funds generated per individual in a country. Previous studies have demonstrated that GDP per capita has a positive influence on stock returns. Bertuah and Sakti (2019) found that GDP per capita was the most significant factor in determining stock returns, with a positive relationship established between GDP per capita and stock returns. Similarly, Laichena and Obwogi (2015) utilized regression analysis to

determine the association between GDP per capita and stock returns. The results indicated a significant positive relationship between GDP per capita and stock returns. The report suggests that stock returns are impacted by a country's economic output per person. Countries with higher per capita GDP tend to have fewer populations, resulting in a more even distribution of wealth and increased GDP which can lead to a rise in stock return.

#### c. Return on Assets (ROA)

Several studies have investigated the relationship between financial ratios and stock returns, particularly focusing on return on assets (ROA). The ROA ratio is used to measure a company's profitability by assessing its ability to generate earnings from its assets. A higher ROA ratio indicates a more efficient use of assets in generating profits, which may attract investors and consequently result in higher stock prices. Herawati and Putra (2018) investigated the impact of financial ratios, including ROA, on the stock prices of 11 companies in the food and beverage sector listed on the Indonesia Stock Exchange from 2012 to 2015. The results indicated a significant positive impact of ROA on stock prices, supporting the hypothesis that higher ROA leads to higher stock returns. Another study by Saleh (2015) focused on the Oil and Gas companies in Pakistan and found that ROA had a positive correlation with stock returns, further supporting the importance of ROA as a predictor of stock performance. Overall, these studies provide empirical evidence to support the positive association between ROA and stock returns, highlighting the relevance of ROA as a key financial indicator for investors in assessing stock performance.

#### d. Company Size

Numerous studies have found that company size has a positive and significant effect on stock returns (Nasrudin, 2022). Company size can be measured using various metrics such as total sales, total assets, the number of employees, market capitalization, and capital invested. A company's size is reflective of its ability to possess and diversify the number of services or products it can provide to its customers, which in turn can impact its competitiveness in the industry. In economic terms, company size plays a vital role in a business's competitiveness with other industry rivals, as it represents the company's position in the market. In general, larger company size is preferred, as it can signal the company's strength to the public and attract more attention from investors.

In sum, for the control variables, the Islamic market index, GDP per capita, return on assets (ROA), and total assets are expected to have a positive impact on stock return.

### **Research Design**

#### ***Data Description***

The sample for this study was drawn from companies listed in the Securities Commission (SC) report. Specifically, a subset of twenty companies was randomly selected from those that had undergone changes in their Shariah compliance status. The study made use of secondary data obtained from various sources, including the SC report, Bursa Malaysia, open access stock price database, annual reports, and the World Bank database. The data consisted of both dependent and independent variables, with the former being represented by changes in stock return and the latter by Shariah risk, Islamic market index, economic growth, return on assets (ROA), and total assets of the companies.

The data for stock return was collected weekly from an open-access stock price database. We define the Shariah non-compliant risk as an indicator variable where one

denoted non-compliance and zero otherwise. FBM Hijrah Shariah Index, obtained from Bursa Malaysia is the proxy for the Islamic market index. Data on economic growth are collected from the World Bank database, specifically using Gross Domestic Product (GDP) per capita indicators for Malaysia. Data on ROA and total assets are obtained from the annual report for each company. The data collection period for this study spanned from 2018 to 2020.

### Empirical Model

To determine whether Shariah non-compliant risk has a significant impact on changes in stock returns, we analyze using a multiple regression model of Ordinary Least Squares (OLS) to identify whether variables (Shariah risk, FBM Hijrah Shariah Index, GDP, ROA, and Size) have a significant difference with the change of stock return in selected companies. The model for the analysis can be written as

$$\begin{aligned} \text{Stock return}_{it} &= \alpha + \beta_1 \text{Shariah risk}_{it} + \beta_2 \text{Market}_t + \beta_3 \text{GDP}_t + \beta_4 \text{ROA}_{it} \\ &+ \beta_5 \text{Size}_{it} + \varepsilon_{it} \end{aligned} \quad (1)$$

Where;

Stock return = The profit gained from an investment of stock in a definite time. A positive return represents a profit while a negative return represents a loss (Dhand, 2022). The weekly stock return can be calculated by: *Weekly stock return = (current week's price - prior week's price / prior week's price) \* 100*.

Shariah risk = Indicator equal to 1 if the company is non-Shariah-compliant and 0 otherwise. This variable identifies the risk of a change in a company's Shariah compliance status after the publication of a new Shariah-compliant list, as a result of non-conformance with the screening criteria. In this regard, we have randomly selected twenty companies that were listed as Shariah-compliant in the SC report of May 2018 and designated these companies as 0. In the event that a company is reclassified from Shariah-compliant to non-Shariah-compliant in the forthcoming Shariah announcement, the data will be classified as 1.

Market = Proxied by the natural logarithm of FBM Hijrah Shariah Index. The FBM Hijrah Shariah Index constitutes a prominent benchmark for Islamic investors seeking to identify Shariah-compliant investment opportunities that satisfy the relevant screening criteria. This index is designed to serve as a foundation for a range of Shariah-compliant investment products and is sourced from data gathered by Bursa Malaysia (Bursa Malaysia, 2022).

GDP = Measured economic growth proxied by the natural logarithm of GDP per capita. GDP per capita is a main indicator of economic output and is usually used as a broad measure of average living standards or economic well-being (OECD, 2013).

ROA = Return on Asset (ROA) is a measure of the efficiency of a company when using its assets to generate profit. The ROA can be calculated by: *ROA = (Net Profit / Total Assets) x 100*

Size = Company size measured by the natural logarithm of total assets. Total assets refer to the sum of all the resources owned or controlled by a person, company, or organization. It is an important metric for investors, lenders, and



analysts to evaluate the financial health and performance of an organization. Companies also acquire assets to increase the cash flow by using those assets (Thakur, 2022).

### Findings and Discussions

Table 1 shows the descriptive statistics of the variables used in this research. The research sample is derived from twenty companies listed in Bursa Malaysia, with data collected weekly between January 2018 and December 2020. Table 1 presents descriptive statistics for the sample, which consists of 3140 observations. The dependent variable in this study is stock return, with a mean value of 0.4120 and a standard deviation of 11.2398. The main independent variable is Shariah risk, with a mean value of 0.4424 and a standard deviation of 0.4967. Additionally, the mean value for the Islamic market index is 9.5246 with a standard deviation of 0.0683, while GDP per capita has a mean value of 9.3117 and a standard deviation of 0.0430. Finally, the mean value for ROA is -4.7309, with a standard deviation of 14.3753. Total assets have the highest mean value of 16.9846, while ROA has the lowest mean value compared to the other variables.

Table 1  
*Descriptive statistics*

Variable	N	Mean	SD
Stock Return	3140	0.4120	11.2398
Shariah Risk	3140	0.4424	0.4967
Market	3140	9.5246	0.0683
GDP	3140	9.3117	0.0430
ROA	3140	-4.7309	14.3753
Size	3140	16.9846	3.5143

The descriptive statistics reveal that ROA has the highest standard deviation of 14.3753, indicating a high degree of variation in the set of values, and a significant spread from the mean (-4.7309). This suggests that ROA carries a high level of volatility risk, and the wider range of values increases the risk of volatility. Conversely, the lowest standard deviation is observed in GDP per capita, indicating a smaller variation in values and lower associated risk. In general, higher standard deviations are indicative of greater volatility risk, while lower standard deviations imply lower risk.

In short, the descriptive statistics presented in Table 1 provide valuable insights into the distribution of data in this study, allowing for a better understanding of the associated risks and potential impacts on the dependent variable. The findings suggest that ROA carries the highest level of volatility risk among the independent variables, while GDP per capita has the lowest risk.

We conducted a Pearson correlation analysis to investigate the relationship between stock return, Shariah risk, and other control variables. Table 2 shows the Pearson correlation between the independent variables and dependent variables. The results of the analysis revealed that only Shariah non-compliant risk and GDP per capita were significantly correlated with the stock return, at a significance level of 5%. Conversely, the Islamic market index, ROA, and total assets were found to have no significant correlation with stock return.

Of the two significant variables, Shariah non-compliant risk exhibited a positive correlation with the stock return, indicating that as the former increases, so does the latter. On the other hand, GDP per capita displayed a negative correlation with the stock return, indicating that as GDP per capita increases, stock return decreases. The underlying reason for these correlations lies in the risk and volatility associated with the variables, which will be further explicated in the subsequent section.

Table 2

*Pearson Correlation Pearson*

	Stock Return	Shariah Risk	Market	GDP	ROA	Size
Stock Return	1.0000					
Shariah Risk	0.0440*	1.0000				
Market	0.0348	-0.3042*	1.0000			
GDP	-0.0477*	-0.2086*	-0.0779*	1.0000		
ROA	-0.0157	-0.0690*	0.0272	0.0691*	1.0000	
Size	0.0017	0.0589*	-0.0114	-0.0230	-0.0125	1.0000

\* Indicates significance at the level of 5%

Table 3 reports the result of the regression analysis between the dependent variables and the independent variable. As previously noted, the independent variable of interest in this study is the Shariah risk, and the aim is to investigate its relationship with stock returns. Table 3 presents the results of the regression analysis, revealing that the coefficient of the Shariah risk is positively significant at the 1% level ( $0.008 < 0.01$  with  $t = 2.65$ ). This finding suggests that the Shariah non-compliant risk has a significant impact on stock return, implying that higher risk leads to higher returns. In contrast to Hypothesis 1, which posits that Shariah non-compliant risk has a negative and significant impact on stock return, the study's results indicate that investors particularly in the long term are more attracted to Shariah non-compliant stocks due to their higher potential returns and performance compared to Shariah-compliant stocks.

Prior literature on this topic has focused on a short-term impact with a window period of 60 days. As a result, the literature has noted that investors are more sensitive to changes in Shariah status during this period and are more likely to invest in Shariah-compliant stocks. Based on our findings, we can postulate that after a few months, the focus shifts to stocks that offer higher returns. The non-Shariah compliant stocks generally possess higher risk as a result of having higher debts. Hence, this study supports the conventional theory of finance, which states that higher risk results in higher returns. From the Shariah perspective, this outcome is unfavourable since it indicates that investors are more inclined towards higher-risk stocks to attain higher potential returns regardless of the Shariah status of the firm. This will expose them to the risk of substantial losses. Nevertheless, from a positive view, the lower returns of Shariah-compliant stocks also suggest that Shariah-compliant stocks are exposed to lower risk, hence, are a more stable investment.

Table 3

*Regression result of Shariah Non-Compliance Risk on Stock Return and other determinations.*

Stock Return	Coefficient	t	P-Value
Shariah Risk	1.1572***	2.65	0.008
Market	7.9238**	2.54	0.011
GDP	-8.5259*	-1.77	0.078
ROA	-0.0088	-0.63	0.53
Size	-0.0053	-0.09	0.927
Constant	3.8677	0.07	0.946

Notes: \*\*\*, \*\*, and \* denote levels of significance at 1%, 5%, and 10% respectively.

The study also examined other control variables that could affect stock returns. The results, as shown in Table 3, reveal that the coefficient of the Market is positively significant at the 5% level ( $0.011 < 0.05$  with  $t = 2.54$ ), indicating that the Islamic market index has a significant impact on stock returns. Specifically, the FTSE Bursa Malaysia Hijrah Shariah Index, which trades only Islamic securities or products, moves in the same direction as the stock return. This result is consistent with the expected relationship, which posits that the Islamic market index has a positive and significant impact on stock return. Thus, a higher Islamic market index is viewed as profitable by investors, boosting their confidence and trust in the market. As a result, investors are more likely to invest in stocks, injecting more funds into the market to gain higher potential returns. This theory is in line with previous research that suggests that investors' propensity to invest in stocks is influenced by the level of trust in the market. A stable market encourages more investment, leading to an increase in stock return. In summary, a stable market index attracts more investors, which increases the stock return.

Concerning GDP per capita, the obtained p-value is significant at a 10% level of significance. However, compared to the confidence level of the other variables, this variable exhibits the lowest level of confidence, which is 90%. In contrast, the Shariah non-compliant risk and Islamic market index display confidence levels of 99% and 95%, respectively. The negative coefficient of GDP per capita is also significant at a 10% level ( $0.078 < 0.10$  with  $t = -1.77$ ), indicating that GDP per capita has an impact on stock return. The results suggest that GDP per capita moves in an inverse direction from the stock return, whereby higher GDP per capita results in lower stock returns. This finding is different from the prior expectation of a positive impact on the stock return. The result is contrary to prior literature that emphasizes a positive relationship between GDP per capita and stock returns. The discrepancy could be due to high investor expectations for GDP per capita increment, leading to disappointment when expectations are not met. This disappointment eventually causes a decrease in the stock price (Gunarto and Sembel, 2019).

We also present the results for our final controlling variables, ROA and Size. ROA measures a company's effectiveness in generating profits using its total assets after adjusting for associated costs, while total assets represent the size and performance of companies. The regression analysis results reveal that ROA and Size have negative coefficients but are not significant, where the p-value is greater than alpha ( $0.927 > 0.05$  with  $t = -0.63$  and  $0.946 >$

0.05 with  $t = -0.09$ ), respectively. The findings indicate that ROA and total assets do not contribute to stock returns. In sum, the findings demonstrate that our primary variable, Shariah risk, and other controlling variables, namely the Islamic market index and GDP per capita, are significant with stock returns. However, ROA and total assets are not significant with stock returns.

### **Conclusion**

The objective of the study is to investigate the impact of Shariah non-compliant risk on Islamic stock equity returns in Malaysia from 2018 to 2020. The study aims to provide insights into the determinants that influence fluctuations in Islamic stock returns and to make important contributions to the field. The study also seeks to analyze the Islamic market index, GDP per capita, return on asset (ROA), and total assets as controlling variables to better understand the relationship between these factors and stock return.

The findings provide empirical evidence that the risk of Shariah non-compliance, along with the Islamic market index and GDP per capita, can predict stock returns in the Malaysian stock market. The findings demonstrate that the risk of Shariah non-compliance is a critical factor in long-term stock returns. The study found that in the longer term, investors prioritize higher returns over the Shariah compliance of a firm, despite the risk associated with non-compliant stocks. The study supports the conventional theory of finance, which suggests that higher risk leads to higher returns. This indicates that investors are willing to take on higher risks for potentially higher returns, which could lead to substantial losses. However, from a positive outlook, the study suggests that the lower stock returns of Shariah-compliant stocks are an indication that these stocks are exposed to lower risk and are a more stable investment. The study contributes to shedding light on the influence of Shariah non-compliant risk and other factors on stock return in Malaysia, providing insights into the Shariah risk issues, and contributing to the development of appropriate policy and investment decisions in the country.

However, there are some limitations to this study that future research should address. First, the sample size is relatively small, consisting of only twenty companies from different industries. Therefore, future research should consider a larger sample size and cover a broader range of industries to enhance the generalizability of the results. Second, the study's observation period is limited to three years, and future research should consider a more extended observation period to better capture the dynamic nature of the stock market. To advance this field of research, future studies should also consider including additional independent variables, such as interest rates and inflation rates, which may influence stock returns. These variables can provide a more comprehensive understanding of the factors that drive stock returns. Furthermore, future studies should explore more advanced statistical techniques to enhance the accuracy of the findings.

In conclusion, this study provides valuable insights into the relationship between Shariah compliance and stock returns in the Malaysian stock market. Future research should address the study's limitations and consider incorporating additional variables to develop a more comprehensive understanding of the determinants of stock returns.

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