**Risks and Returns and Economic Processes**

**In Developing Islamic Countries**

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**Abstract:** Islamic equity funds (IEFs) differ fundamentally from conventional equity funds since Muslims are prohibited to invest in certain companies/sectors and pay or receive interest. This paper analyzes the risk and return characteristics of a sample of 145 IEFs over the period 2000 to 2009. Our results show that IEFs are under performers compared to Islamic as well as to conventional equity benchmarks. This under performance seems to have increased during the recent financial crisis. We also find that IEF managers are bad market timers. They try to time the market, but in doing so, reduce the return rather than increasing it. An important implication of our results is that Muslim investors might improve their performance by investing in index tracking funds or ETFs rather than to invest in individual IEFs.

**Keywords:** Islamic equity funds, Risk-return characteristics, Alternative investments, Ethical investing, Islamic finance, Social Responsible Investing