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When Trump Tariffs Shake the World: Are Indonesian Sharia Stocks Shockproof?

Fuad Hasyim
Universitas Airlangga, Indonesia and UIN Raden Mas Said, Indonesia
Email: fuad.hasyim-2023@feb.unair.ac.id

Maksum
UIN Sunan Kalijaga, Indonesia and Universitas Annuqayah, Indonesia
Email: maksummuktie@ua.ac.id

Nurhidayat
UIN Kiai Haji Achmad Siddiq, Indonesia
Email: nurhidayat01@uinkhas.ac.id

Corresponding Author: First Author's Name

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Abstract

This study investigates the resilience of the Indonesia Sharia Stock Index (ISSI) to policy-induced ambiguity shocks, with a specific focus on Trump tariff policies framed within the VUCA paradigm. Employing a GARCH-X(1,1) model on daily data spanning from 3 June 2024 to 27 June 2025, the findings reveal that ISSI exhibits greater sensitivity to global uncertainty, significantly influenced by the VXEEM index than the conventional Jakarta Composite Index (IHSG). However, the dummy variable representing Trump's tariffs shows no statistically significant impact on the volatility of either market. These results suggest that the ethical screening mechanisms underlying Sharia-compliant stocks may offer limited protection against non-systemic, policy-driven shocks. The study offers conceptual and methodological contributions to the discourse on Islamic finance volatility modeling in an increasingly ambiguous global policy environment.

Studi ini mengkaji ketahanan Indeks Saham Syariah Indonesia (ISSI) terhadap guncangan ambiguitas yang dipicu oleh kebijakan, dengan fokus khusus pada kebijakan tarif Trump yang dianalisis dalam kerangka paradigma VUCA (Volatility,

Uncertainty, Complexity, Ambiguity). Dengan menggunakan model GARCH-X(1,1) pada data harian yang mencakup periode 3 Juni 2024 hingga 27 Juni 2025, temuan menunjukkan bahwa ISSI memiliki sensitivitas yang lebih tinggi terhadap ketidakpastian global, yang secara signifikan dipengaruhi oleh indeks VXEEM dibandingkan dengan Indeks Harga Saham Gabungan (IHSG). Namun, variabel dummy yang merepresentasikan kebijakan tarif Trump tidak menunjukkan pengaruh yang signifikan secara statistik terhadap volatilitas kedua pasar tersebut. Hasil ini mengindikasikan bahwa mekanisme penyaringan etis yang mendasari saham-saham berbasis syariah mungkin hanya memberikan perlindungan terbatas terhadap guncangan kebijakan yang bersifat non-sistemik. Studi ini memberikan kontribusi konseptual dan metodologis terhadap wacana pemodelan volatilitas keuangan Islam dalam lanskap kebijakan global yang semakin ambigu.

Keywords: Islamic Stocks; GARCH; VUCA; Trump Tariffs; Volatility

Introduction

When the world was shaken by the protectionist trade policies of President Trump, global financial markets experienced an unprecedented wave of uncertainty (Almazán-Gómez et al., 2025). The imposition of tariffs on major trading partners, not only China but also Mexico, Canada, and the European Union, triggered geopolitical tensions and substantial ambiguity surrounding global trade policy direction. This phenomenon is embedded within the framework of VUCA (Volatility, Uncertainty, Complexity, and Ambiguity). Among these elements, ambiguity occupies a distinctive position, as it reflects policy unpredictability that disrupts market expectations beyond economic fundamentals.

Market reactions to such tariffs have been nonlinear, often driven by abrupt changes in investor sentiment rather than economic fundamentals (Cioroianu et al., 2024; Z. Li et al., 2021; Wang et al., 2025). These ambiguity shocks can ignite extreme volatility, particularly in emerging markets like Indonesia, which remain highly sensitive to global capital flows and external sentiment. This context raises a critical question: are markets structured around ethical and religious values, such as Islamic equity markets, better equipped to absorb such policy-induced turbulence compared to conventional markets?

Indonesia offers a unique setting to examine this issue due to the coexistence of two equity systems, the Jakarta Composite Index (IHSG) representing conventional markets, and the Indonesia Sharia Stock Index (ISSI) reflecting Islamic finance principles (Cipto et al., 2024; Lina et al., 2022; Subekti et al., 2022; Ulyah et al., 2024). Sharia-compliant stocks are filtered to exclude activities involving usury, excessive uncertainty (*gharar*), and non-halal sectors, theoretically enhancing their stability by avoiding speculative and high-risk financial exposure (Amanah et al., 2019; Haseeb et al., 2023; Raza et al., 2023). However, to what extent Islamic stocks are truly "shockproof" in the face of global ambiguity remains an open empirical question.

Prior studies have provided preliminary evidence supporting the defensive nature of Islamic equities during crises. Ali et al. (2022) showed that Islamic indices in emerging markets such as Pakistan and Indonesia offered better downside protection during the COVID-19 crisis. Similarly, Salari et al. (2025) reported that Sharia-compliant stocks responded more efficiently to macroeconomic shocks than conventional ones. Methodologically, GARCH and EGARCH models have been widely adopted to assess volatility responses to external shocks such as EPU (Economic Policy Uncertainty) and OVX (Oil Volatility Index). Aziz et al. (2020) found that Islamic equities across several countries, including Indonesia, displayed greater resilience to EPU shocks under bearish conditions. While Hasan et al. (2023) highlighted sector-specific hedging capabilities within Islamic indices, especially in consumer goods and finance, against GPR (Geopolitical Risk) and OVX.

Nevertheless, several layered gaps remain in the literature, which this study addresses to establish its state of the art and novelty. First, while most studies focus on macroeconomic shocks or systemic crises, few have explicitly examined ambiguity shocks stemming from erratic international trade policies such as Trump's tariffs.

Second, comparative research between conventional and Islamic markets within the same national context remains scarce and often overlooks the global policy dimension. Third, although GARCH-based models are common, few studies have extended them into event-based GARCH-X models that incorporate global sentiment indicators (VXEEM), exchange rate fluctuations (USD/IDR), trading volume, and policy-specific dummies. Fourth, geographically, the resilience of Islamic markets has been predominantly studied in MENA and GCC regions, while Southeast Asian markets, especially Indonesia remain underexplored.

In light of these gaps, this study addresses the central research question, "Are Islamic stocks in Indonesia truly shockproof when the world is shaken by Trump's tariffs?" To answer this, we compare the volatility dynamics of IHSG and ISSI in response to trade policy-induced ambiguity using an expanded GARCH(1,1) model (GARCH-X). This approach not only captures the temporal evolution of conditional volatility but also integrates global exogenous factors such as risk sentiment (VXEEM), exchange rates, trading activity, and discrete policy shocks (dummy variables).

This study contributes to the literature in three important ways. Conceptually, it reframes ambiguity within the VUCA framework as a key, yet understudied, driver of volatility in Islamic finance. Methodologically, it introduces a novel GARCH-X specification tailored for event-based volatility modeling. Practically, the findings offer valuable insights for investors, portfolio managers, and regulators seeking robust risk mitigation strategies in an era defined by policy uncertainty and geopolitical shifts. By evaluating whether Islamic financial principles foster structural market resilience, this research also contributes to the broader discourse on the role of value-based investing in navigating a turbulent global economy.

Research Method

This study aims to analyze and compare the volatility of the Indonesia sharia stock index (ISSI) and the conventional Jakarta composite indexs (IHSG) in Indonesia in response to global uncertainty and trade policy shocks associated with the Trump administration. The research utilizes daily data from June 3, 2024, to June 27, 2025, comprising a total of 278 observations, adjusted for active trading days (Monday to Friday). The primary data source is the Yahoo Finance, which includes the daily closing values of ISSI and IHSG, their respective trading volumes (logarithmic natural in billion Rupiah known as VOLISSI and VOLIHSG), the daily USD/IDR exchange rate (EXR), and the CBOE Emerging Markets ETF Volatility Index (VXEEM) as a proxy for global market volatility and risk sentiment. A dummy variable is introduced to capture the Trump tariff announcement shock on April 2, 2025, with values coded as 0 prior to the announcement and 1 thereafter. This shock is conceptually framed as an ambiguity shock under the VUCA paradigm.

The study employs the GARCH-X(1,1) model, which incorporates exogenous variables into the conditional variance equation (Bollerslev, 1986). This model is chosen for its ability to capture time-varying conditional volatility, persistence of

shocks, and heteroskedasticity, while accommodating the influence of both global and domestic factors. The conditional mean is estimated using an ARMA(1,1) specification to control for autocorrelation and moving average effects in daily return series. The estimation is conducted through Maximum Likelihood (ML) with a normal distribution, a standard approach in ARCH-GARCH modeling.

The model for the ISSI and IHSG indeks is specified as follows:

Model 1

Mean Equation

$$r_t^{ISSI} = \mu + \phi_1 r_{t-1}^{ISSI} + \theta_1 \varepsilon_{t-1} + \varepsilon_t \quad \text{... (1)}$$

Variance Equation

$$\sigma_t^2 = \alpha_0 + \alpha_1 \varepsilon_{t-1}^2 + \beta_1 \sigma_{t-1}^2 + \gamma_1 XVEEM_t + \gamma_2 EXR_t + \gamma_3 \ln (VolISSI)_t + \gamma_4 Dummy_t + \epsilon \quad \text{... (2)}$$

Model 2

Mean Equation

$$r_t^{IHSG} = \mu + \phi_1 r_{t-1}^{IHSG} + \theta_1 \varepsilon_{t-1} + \varepsilon_t \quad \text{... (3)}$$

Variance Equation

$$\sigma_t^2 = \alpha_0 + \alpha_1 \varepsilon_{t-1}^2 + \beta_1 \sigma_{t-1}^2 + \gamma_1 XVEEM_t + \gamma_2 EXR_t + \gamma_3 \ln (VolIHSG)_t + \gamma_4 Dummy_t + \epsilon \quad \text{... (4)}$$

The GARCH-X model has been widely applied in previous studies to assess the impact of economic policy uncertainty (EPU), trade policy uncertainty (TPU), and global market shocks on stock indices, particularly within emerging markets (Aziz et al., 2020; Ghosh et al., 2022; Hasan et al., 2023; Hoque & Zaidi, 2020; Tabash et al., 2025). Accordingly, this approach not only captures domestic volatility dynamics but also offers a robust analytical framework to evaluate whether Islamic stock indices exhibit structural resilience to external shocks relative to conventional indices, consistent with the ethical screening and risk-sharing tenets embedded in Islamic finance.

Results

The Augmented Dickey-Fuller (ADF) test results (table 1) indicate that several of the variables in this study exhibit non-stationarity at level but achieve stationarity after first differencing. Specifically, the ISSI, IHSG, and EXR variables show p-values greater than 0.05 at level, suggesting the presence of unit roots and a lack of stationarity. However, all three become stationary at the first difference level, as reflected by their significantly negative t-statistics and p-values of 0.0000. In contrast, the trading volumes for ISSI and IHSG, along with the VXEEM index, are found to be stationary at level, as indicated by their p-values being below the 5% significance

threshold. These results justify the use of log-differenced return series for ISSI and IHSG in the subsequent GARCH modeling, aligning with best practices in time series volatility analysis (Brooks, 2019; Nelson & Plosser, 1982; Porter & Gujarati, 2008). Employing stationarity tests such as ADF is critical in time series econometrics to avoid spurious regressions and ensure valid inferences in volatility modeling.

Table 1. Unit Root Test

	Level		1st difference	
	t-Stat	**Prob.***	**t-Stat**	**Prob.***
ISSI	-1.88407	0.33960	-16.48652	0.00000
IHSG	-1.59509	0.48380	-16.16224	0.00000
VOLISSI	-3.48347	0.00910	-14.44963	0.00000
VOLIHSG	-4.67893	0.00010	-17.92878	0.00000
VXEEM	-5.68662	0.00000	-21.11410	0.00000
EXR	-1.25621	0.65040	-15.56296	0.00000

Source: Own's Work (2025)

The correlation matrix (table 2) reveals several notable interrelationships among the variables. The ISSI and IHSG indices exhibit a strong positive correlation (r = 0.87), suggesting a high degree of co-movement between Islamic and conventional stock markets in Indonesia, consistent with previous findings on the systemic linkage between ethical and conventional indices in emerging markets (Alamgir & Cheng, 2023). Trading volumes for both indices (VOLISSI and VOLIHSG) also show moderate to strong positive correlations with their respective indices, with VOLISSI more closely linked to ISSI (r = 0.63) than VOLIHSG is to IHSG (r = 0.29), supporting the notion that investor sentiment in Shariah-compliant equities can be more tightly coupled with market movement under value-based constraints (Setianingsih et al., 2024).

Meanwhile, the exchange rate (EXR) demonstrates a strong negative correlation with both ISSI (r = -0.70) and IHSG (r = -0.87), indicating that rupiah depreciation tends to coincide with declining stock index values, aligning with literature on exchange rate pass-through and risk-aversion behavior in foreign portfolio investment (Aziz et al., 2020). Interestingly, the VXEEM indeks, used here as a proxy for global volatility has weak correlations with both ISSI (r = -0.04) and IHSG (r = -0.05), suggesting limited direct spillover from global volatility into Indonesia's equity market in raw correlation terms. However, this does not preclude significant dynamic effects in conditional volatility models such as GARCH, which are known to detect spillover shocks not apparent in static analysis (Ghosh et al., 2022; Hasan et al., 2023). Overall, the matrix highlights both local sensitivities and partial insulation from global uncertainty, particularly in Islamic equities reinforcing their reputation as relatively resilient instruments in turbulent global environments.

Table 2. Correlation Matrix

	ISSI	IHSG	VOLISSI	VOLIHSG	VXEEM	EXR
ISSI	1.00000	0.87161	0.62542	0.48683	-0.04351	-0.69688
IHSG	0.87161	1.00000	0.54051	0.28901	-0.05303	-0.87285
VOLISSI	0.62542	0.54051	1.00000	0.79235	0.12997	-0.53522
VOLIHSG	0.48683	0.28901	0.79235	1.00000	0.04699	-0.25579
VXEEM	-0.04351	-0.05303	0.12997	0.04699	1.00000	-0.06979
EXR	-0.69688	-0.87285	-0.53522	-0.25579	-0.06979	1.00000

Source: Own's Work (2025)

The estimation results for the GARCH(1,1) model on ISSI (model 1 in table 3) reveal key dynamics in both the mean and variance equations. In the mean equation, the AR(1) coefficient is negative and marginally significant ($p = 0.0666$), suggesting a weak mean-reverting behavior in the returns of Islamic stocks, whereas the MA(1) term is significantly positive ($p = 0.0285$), implying that past shocks have a substantial and positive influence on current returns. In the variance equation, the GARCH term is not statistically significant, while the ARCH term (lagged squared residual) is only marginally significant, indicating that the model captures limited volatility clustering. However, exogenous shocks such as global market volatility (VXEEM) and the exchange rate (EXR) have a significant and positive effect on ISSI volatility ($p = 0.0115$ and $p = 0.0214$, respectively). This suggests that Islamic stocks in Indonesia are sensitive to global uncertainty and currency fluctuations, though the Trump tariff shock (DUMMY) and trading volume (VOLISSI) do not exhibit statistically meaningful impacts.

In contrast, the IHSG model (model 2 in table 4) presents a more robust mean equation, where both AR(1) and MA(1) terms are statistically significant ($p < 0.01$), indicating strong autoregressive and moving average effects. In the variance equation, the ARCH and GARCH terms are both insignificant, implying weak persistence of volatility over time. However, EXR and VOLIHSG are strongly significant ($p < 0.01$), indicating that exchange rate movements and trading volume significantly affect the volatility of conventional stock returns. The VXEEM index shows marginal significance ($p = 0.0896$), suggesting a partial influence from global volatility. The Trump tariff dummy is not significant in either model, indicating that the specific policy shock had no direct measurable impact on volatility during the observed period. Overall, while both markets are influenced by macro variables, the Islamic index shows higher sensitivity to global shocks (VXEEM), and the conventional index is more influenced by domestic trading activity and exchange rate fluctuations.

Table 3. GARCH Model 1

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	14.72395	13.86121	1.062242	0.2881
AR(1)	-0.632	0.344473	-1.834693	0.0666
MA(1)	0.690924	0.315432	2.190403	0.0285**

Variance Equation				
C	-640002	383102.6	-1.670575	0.0948*
RESID(-1)^2	0.179649	0.106371	1.688897	0.0912*
GARCH(-1)	0.171184	0.22766	0.751927	0.4521
VXEEM	3344.676	1322.758	2.528562	0.0115**
EXR	24.58461	10.68723	2.300372	0.0214**
VOLISSI	9056.841	10508.44	0.861863	0.3888
DUMMY	6860.027	7506.449	0.913885	0.3608

Source: Own's Work (2025)

Table 4. GARCH Model 2

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	4.198693	5.143961	0.816237	0.4144
AR(1)	-0.65993	0.176672	-3.73534	0.0002***
MA(1)	0.772779	0.144349	5.353561	0.0000***
Variance Equation				
C	-189954	49405.55	-3.84479	0.0001***
RESID(-1)^2	0.121609	0.091319	1.3317	0.1830
GARCH(-1)	-0.00189	0.160665	-0.01174	0.9906
VXEEM	246.593	145.2473	1.697745	0.0896*
EXR	4.056091	1.035171	3.918281	0.0001***
VOLIHSG	5302.535	1765.937	3.002674	0.0027***
DUMMY	-927.295	1411.822	-0.65681	0.5113

Source: Own's Work (2025)

Discussion

Main Finding

A closer examination of the GARCH model estimation results reveals distinct responses between Islamic (ISSI) and conventional (IHSG) stock indices to both global and domestic uncertainty. This study investigates whether Sharia-compliant equities exhibit greater resilience to trade policy shocks, particularly those associated with the Trump tariff announcements. The results suggest that Islamic equities are, in fact, more sensitive to global volatility drivers. This is especially evident in the statistically significant role played by the VXEEM index in influencing ISSI volatility, whereas its impact on IHSG appears relatively marginal.

This pronounced sensitivity of ISSI to global risk sentiment can be explained by structural and compositional differences between the two indices. ISSI is constructed through a Shariah screening process that excludes conventional banking, alcohol, gambling, and other non-permissible sectors (Amanah et al., 2019). Consequently, ISSI is primarily composed of mid-cap stocks concentrated in consumer and light manufacturing sectors, segments that are typically more vulnerable to external shocks (Alamgir & Cheng, 2023). Furthermore, many of these Shariah-compliant stocks tend to exhibit lower liquidity, making them more

susceptible to abrupt capital outflows triggered by rising global uncertainty, as reflected by spikes in VXEEM (Aziz et al., 2020).

Beyond composition and liquidity, the heightened responsiveness of ISSI is also shaped by constraints in hedging capacity. Islamic capital markets impose religious restrictions that limit the use of conventional derivatives, resulting in fewer tools for investors to manage portfolio risk. In contrast, participants in the conventional market can turn to a wider range of instruments to mitigate volatility. As a result, global uncertainty is more directly transmitted to Islamic equities. Adding to this is the behavioral dimension, Shariah-compliant investors tend to be more conservative and risk-averse, potentially reacting more swiftly to negative shifts in global sentiment. Taken together, these structural, technical, and behavioral factors form a comprehensive rationale for the disproportionate effect of VXEEM on ISSI compared to IHSG.

This explanation aligns with another key finding that fluctuations in the USD/IDR exchange rate (EXR) significantly influence volatility in both indices. Although the conventional market demonstrates a stronger statistical association with exchange rate movements, the actual magnitude of impact appears more pronounced in the Islamic index. This further supports the argument that, despite its ethical screening and risk-averse orientation, the Islamic equity market remains considerably exposed to macroeconomic instability, particularly through channels such as currency depreciation and international capital flows.

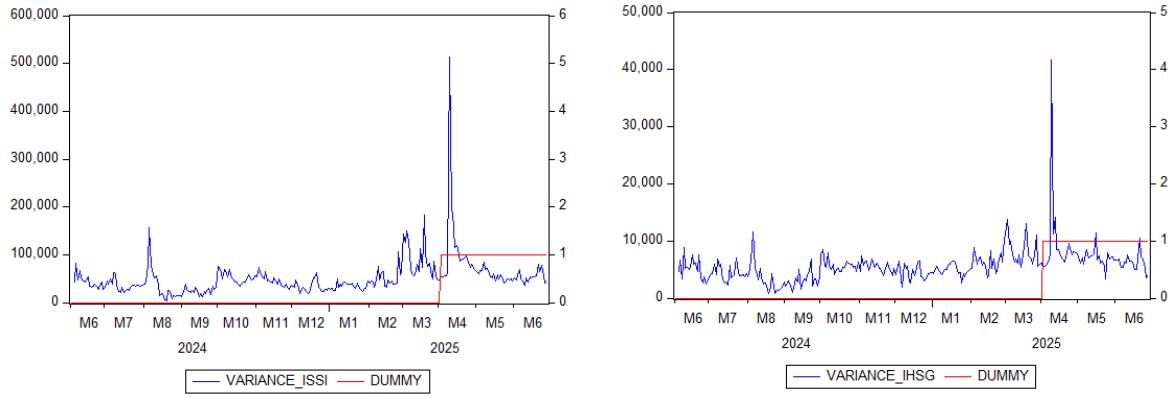
These insights diverge from previous studies that emphasize the superior defensive characteristics of Islamic equities during systemic crises. For example, during the COVID-19 pandemic, various studies found that Islamic equity indices in emerging markets offered better downside protection than their conventional counterparts. This resilience was attributed to the structural design of Islamic finance, particularly its prohibition of highly leveraged and speculative sectors, which naturally positioned Shariah-compliant equities as safer investment vehicles during broad-based macroeconomic disruptions (Alamgir & Cheng, 2023; Ali et al., 2022; Hasyim et al., 2024).

However, the context of ambiguity-driven and politically motivated shocks, such as the Trump tariff announcements, presents a different dynamic. These shocks are non-systemic in nature and tend to operate through less predictable and more selective transmission channels. Unlike systemic crises, which exert pressure across multiple sectors simultaneously, ambiguity-based policy shocks, particularly those indirectly affecting countries like Indonesia, generate effects that vary depending on the structural vulnerabilities of each indeks (Hasan et al., 2023). In such cases, the risk-filtering mechanisms inherent in Islamic finance appear insufficient to shield Shariah-compliant equities from elevated volatility.

Visual inspection of the conditional variance (see Figure 1) further reinforces this interpretation. The most pronounced spikes in volatility for both IHSG and ISSI occurred in early April 2025, coinciding directly with the activation of the dummy variable representing the announcement of Trump's tariffs. This timing indicates that

market participants responded not only to prior speculation but also to the formal announcement itself. Contrary to expectations that policy clarity might reduce uncertainty, the surge in volatility in early April suggests that the announcement introduced new layers of ambiguity rather than resolving existing concerns. Interestingly, while volatility in IHSG declined gradually following the event, ISSI demonstrated a faster return to stability, despite initially experiencing a sharper reaction. This pattern suggests that although Islamic equities may exhibit heightened short-term sensitivity, they may also adapt more swiftly than their conventional counterparts.

Graph 1. Conditional Variance



In summary, this study finds that Islamic equities are not inherently immune to global policy ambiguity. While they may outperform during systemic crises, their resilience is conditional and not absolute, particularly when confronted with sector-specific or indirect external shocks. These nuanced findings underscore the importance of distinguishing between different sources of volatility when assessing the robustness and stability of Islamic financial instruments.

Limitations and Future Research Directions

This study has several limitations that warrant consideration. First, the use of the GARCH(1,1) model to simultaneously capture the volatility dynamics of Islamic and conventional equity markets may be suboptimal in identifying asymmetric responses to policy shocks such as Trump's tariff announcements. The finding that Islamic equities were not entirely shockproof contrasts with previous crises, such as the COVID-19 pandemic or geopolitical turmoil, during which Shariah-compliant stocks generally exhibited stronger resilience (Hasyim et al., 2024; Khursheed et al., 2024; Mzoughi et al., 2022; Nurdany et al., 2021; Setianingsih et al., 2024). This suggests the need to explore asymmetric conditional variance models like EGARCH or TGARCH, which have been proven to more effectively detect differentiated responses to positive and negative shocks (Nurdany et al., 2021)

Second, the study's temporal scope and single-event focus limit its generalizability. Market volatility is not only shaped by bilateral trade tensions but also by broader multilateral dynamics and macroeconomic factors not captured here.

For instance, Houidi & Ellouze (2022) demonstrate that Islamic markets may remain closely correlated with conventional markets under certain global regimes, thereby challenging the decoupling hypothesis. This calls for comparative studies across multiple volatility regimes and crisis typologies.

Lastly, future research should consider cross-country approaches with broader datasets and adopt predictive models such as GARCH-MIDAS or EGARCH-in-Mean. As shown by Ilyas et al. (2022), the structural dependencies between Islamic and conventional indices are dynamic and can only be thoroughly captured through multivariate and asymmetric modeling techniques. Expanding methodological frameworks in this way will not only enhance modeling accuracy but also contribute substantively to the literature on value-based investment resilience under global policy uncertainty.

Conclusion

Based on the GARCH model estimation results, this study concludes that Islamic equities in Indonesia (ISSI) are not entirely "shockproof" against global policy ambiguity, specifically Trump tariff shocks. While previous research indicated that Islamic stocks demonstrated superior defensive attributes during systemic crises like the COVID-19 pandemic or geopolitical tensions, this study found that ISSI volatility shows greater sensitivity to global uncertainty (VXEEM) than IHSG.

This divergence suggests that the ethical screening mechanisms inherent in Islamic finance may be less effective as a volatility shield against non-systemic and politically-driven shocks, such as trade policy ambiguity, which appear to operate through different transmission channels than broad macroeconomic disruptions. The findings underscore the importance of distinguishing between different types of volatility sources when assessing the resilience of Islamic financial instruments.

Practically, these results offer valuable insights for investors, portfolio managers, and regulators, highlighting the need for robust risk mitigation strategies in an era characterized by policy uncertainty and geopolitical shifts. The research contributes to the broader discourse on value-based investing by evaluating whether Islamic financial principles foster structural market resilience in a turbulent global economy. However, future research should consider more advanced asymmetric conditional variance models and broader datasets to capture the dynamic and nuanced responses of Islamic markets to various global shocks.

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