

Impact of Investor Sentiment, Exchange Rates, and Foreign Capital Flow on Jakarta Islamic Index Stock Returns

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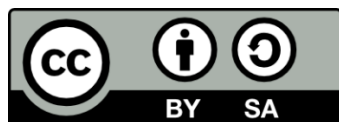
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Abstract

This study examines the impact of investor sentiment, changes in exchange rates, and foreign capital flow on the Jakarta Islamic Index's return. This study uses daily data between January 2, 2017, and December 30, 2021. After examining the characteristics of autocorrelation and stationarity, we apply the Difference-Generalized Methods of Moment (D-GMM) model. In short, we do not find the effect of investor sentiment on stock returns in both contemporaneous and lag periods. Meanwhile, significant changes in exchange rates have a negative effect on stock returns on contemporaneous and lags, but foreign portfolio flows on contemporaneous and significant lags positively affect stock returns. Thus, our results have implications for trading strategies, asset pricing, and portfolio management carried out by foreign investors on Islamic stocks in Indonesia.

Keywords: Difference-Generalized Methods of Moment (D-GMM); Jakarta Islamic Index; exchange rates; investor sentiment; foreign capital flow

INTRODUCTION

The stock market is sensitive to economic developments and financial stability, including changes in investor sentiment, changes in exchange rates and foreign capital flows in influencing stock price movements. Irrational asset pricing and abnormal growth in the stock market will one day lead to a crisis that will lead to the bursting of an economic bubble (Ansari, 2020). To restore financial markets, many developed and developing countries will adopt monetary easing by lowering interest rates which will lead to changes in exchange rates (Lim & Mohapatra, 2016; Miyakoshi et al., 2017). Exchange rates play an important role in transmitting shocks of increased foreign capital inflows to developing countries. The inflow of foreign capital creates financial market stability and increases stock prices. However, stock market shocks occur if they suddenly attract investment in the stock market (Han et al., 2015; Naufa et al., 2019).

Since Keynes (1937) introduced the notion of irrationality to the stock market, a growing body of research has begun to examine how investor sentiment impacts on the shaping of equity market values (see, for example, De Long et al. 1990; Brown and Cliff 2004; Baker and Wurgler, 2006; Li et al. 2019; Liang et al., 2020; Xu et al., 2021). However, identifying and measuring investor sentiment and its impact on stock returns remains an area of interest for developing countries, and Islamic stocks in particular. Representing investor confidence, investor sentiment can influence financial decisions (Parveen et al., 2020), investor position (Frazzini & Lamont, 2008), risk preferences (Qadan et al., 2019), risk premium (Qadan & Aharon, 2019). sources of risk (Cagli et al., 2020). Regarding the tradeoff of risk and return, it varies in the short and long-term depending on changes in global sentiment (Guo et al., 2013; Wu & Lee, 2015). Therefore, the more optimistic investor sentiment will make the price far from its intrinsic value.

In general, financial markets cannot be separated from fluctuations in exchange rates. Empirical evidence from previous research supports exchange rate movements having an impact on company performance that leads to increases and decreases in stock prices (Bahmani-Oskooee and Saha, 2018; Tiryaki et al., 2019; Ahmed, 2020) Two theoretical approaches explain the interconnection of exchange rate changes to the market. stock shares. First, the flow-oriented approach popularized by Dornbusch and Fisher (1980), where the depreciation of the exchange rate makes export prices cheaper. Firms can export more and earn more profits, which will increase the share price (Ding, 2021). On the other hand, the depreciation of the exchange rate increases import costs for the company, which can increase production costs and therefore decrease sales and profits which leads to a decrease in the company's stock price (Bahmani-Oskooee & Saha, 2016). While the second is the portfolio-balance approach developed by Frankel (1983) and Branson and Henderson (1985). Changes in exchange rates affect stock prices through market mechanisms related to demand and supply by foreign investors for portfolio rebalancing that affects stock prices due to capital inflows and outflows (Lin, 2012; Tsaganos & Siriopoulos; 2013; Boako et al., 2015).

The factor of foreign investors plays an important role in increasing and decreasing stock prices. In general, the inflow of foreign capital pushes stock prices up and away from their fundamental values, thus creating an asset price bubble, while stock sales transactions suddenly cause stock prices to drop drastically. Thus, triggering other investor panic and financial collapse

(Kim and Wei, 2002; Jeon and Moffett, 2010), More explicitly, foreign portfolio flows seem relevant to the trade feedback hypothesis which is related to risk balancing, and momentum strategies, information transmission, price formation assets, and international portfolio diversification (French and Vishwakarma, 2013; Ahmad, 2016). The impact of foreign capital inflows (outflows) leads to an increase (decrease) in different stock returns in short- and long-term conditions because foreign investors use positive and negative feedback trading strategies (Marfatia, 2021).

Through the stock market decisions about buying and selling shares are made quickly based on financial information and indicators (Peiró, 2016). We define global investor sentiment about how foreign investors view the stock market in general. The more positive global investor sentiment towards the stock market will increase the buying and trading volume of foreign investors in the Indonesian stock market. Some evidence suggests that emerging market stock markets are vulnerable to sentiment shocks that lead to mispricing of stock prices (Anand et al., 2021; Pok et al., 2022). Second, Indonesia adheres to the flexibility of the exchange rate system, the more sensitive the exchange rate to changes in macroeconomic policies leads to the strategy of foreign investors in conducting transactions in the stock market due to exchange rate volatility (Rahman, 2021). While on the other hand, it is still a debate whether foreign capital flows have an effect in the long or short term on Indonesian stock market returns or not (Arroisi & Koesrindartoto, 2019). This is supported by Chadwick's research (2019), where Indonesia and other developing countries (India, Turkey, Brazil, South Africa) are vulnerable to shocks to foreign capital flows when global uncertainty increases.

Indonesia is a potential diversification for investment in the Islamic stock market. At the end of 2021, the capitalization of Sharia shares grew by 19.10% from the previous Rp. 3,344.93 trillion to Rp. 3,983.65 trillion (OJK, 2021). The special characteristics of Islamic equity impose a limit on the debt ratio not exceeding 45% of total assets and other prohibited income not exceeding 10%. These restrictions are disputed, previous studies have found stock price movements and the risk or volatility of sharia-compliant stocks are mostly driven by non-company factors (Ansari et al., 2020; Di et al., 2021; Danila et al., 2021; Chowdhury., 2022 Kartal et al., (2022). In this study, we examine how the influence of global investor sentiment, exchange rate changes and foreign capital flows affect stock returns in the Jakarta Islamic Index. Our study is relevant for developing countries both at the academic and market, which has not been explored before in the context of the Indonesian stock market. Since our research data is longitudinal, the assumptions of heterogeneity and endogeneity must be met. Therefore, we use the generalized method of moment first difference (Arellano & Bover, 1995; Blundell and Bond, 1998).

LITERATURE REVIEW

INVESTOR SENTIMENT AND STOCK RETURN

First of all, the notion of investor sentiment stems from behavioral finance in response to the failure of the traditional view to explain noise, market anomalies, arbitrage, and other

psychological characteristics of investors in the stock market (Ansari et al., 2020). Investor sentiment is defined as investor confidence, usually influenced by emotions, investment risk and future cash flows in financial markets. Sentiment generates investor optimism and pessimism reactions to certain stocks and portfolios due to current information, speculative behavior, noise in assessing a company that is not supported by facts (Baker & Wurgler, 2006; Aggarwal, 2019). Research Liston-Perez et al. (2018) provides empirical evidence that investor sentiment and noise significantly affect stock returns.

Empirically, investor sentiment overtime shifts towards stock returns which tend to be positive at the contemporary level and negative at the lag level, or vice versa (Zhang et al., 2019; Qadan & Aharon, 2019). Irrational investors and noise in the short term are correlated in generating stock mispricing (Ansari et al., 2020). Investors who are the earliest to use noise information will react more quickly to gain positive returns. At the same time, it increases positive sentiment which causes stock prices to rise above their intrinsic value (Miwa, 2016). However, in the long run, investors will readjust their portfolios by eliminating overvalued stocks that are far from fundamental. Research by Shah and Albaity (222) found that investor sentiment significantly negatively affects stock returns. Investors who react with optimism when sentiment is high will get low returns in the lagging period (Stambaugh & Yuan, 2017).

Hypothesis 1: Investor sentiment significantly affects stock returns

EXCHANGE RATES AND STOCK RETURNS

The main argument of the dynamics of positive and negative exchange rate changes on stock returns tends to be based on external and internal factors. The impact of changes in exchange rates affects the assets, liabilities, and cash flows of companies that play an important role in stock price movements (Parsva and Tang, 2017). Wong's research (2018) found that the exchange rate significantly affects stock prices. Multinational companies involved in international transactions share prices are strongly influenced by movements in real exchange rates. In addition, changes in exchange rates have a positive impact on real stock prices (Sui and Sun, 2016). On the other hand, the asymmetric effect of the exchange rate on stock prices has a different impact in the long and short term (Bahmani-Oskooee and Saha (2015).

On the other hand, the stock market is inseparable from exchange rate fluctuations. There is a lot of empirical evidence that supports the transmission effect of changes in exchange rates on volatility and returns in the stock market (Glen, 2002). Research by Andreou et al., (2013); Ahmed, (2014); Bahmani-Oskooee and Saha, (2018) found that changes in exchange rates have a significant effect on stock returns. The stock market functions as a transmission mechanism for exchange rate movements, because stock prices are related to consumption spending and investment spending (Ioannidis and Kontonikas (2006). Research by Naresh et al. (2018) found that the depreciation of the US dollar against the local currency has a positive effect on stock returns. Leung et al. (2017) also found the spillover effect of positive exchange rate changes affecting stock return volatility.

Hypothesis 2: Exchange rates significantly affect stock returns

FOREIGN CAPITAL FLOW AND STOCK RETURN

Since the financial and monetary crises in 1998 and 2008, the effect of foreign capital inflows into emerging markets differing in the short and long term has become an interesting issue for research and debate. This is related to changes in global risk aversion and past returns, and future return preferences which serve to encourage foreign capital inflows to positively affect stock market returns (Lim and Mohapatra, 2016; Miyakoshi et al., 2017). In addition, the presence of foreign investors leads to stock market stability (Han et al., 2015) and liquidity (Naufa et al., 2019) because foreign investors trade with significant volumes compared to domestic investors. Research by Lim and Mohapatra (2016); Miyakoshi et al., (2017) found that in the short-term foreign investors apply a momentum strategy to get profits as quickly as possible, while Hau and Rey (2006) suggest that rebalancing foreign investments has a positive effect on stock returns in the long term.

Many previous studies have studied the effect of foreign inflows on stock market performance in obtaining investment returns (French and Li, 2017; Yan and Wang, 2018; Arroisi & Koesrindartoto, 2019; Ansari et al., 2020; Kartal et al., 2022). Overall, they find that foreign equity flows significantly influence stock market returns. Foreign investors react more strongly to information by buying rather than selling shares, which increases the volume of transactions, which will make the stock price more expensive (Dvořák, 2005; Albuquerque et al., 2009). Investors will invest in the long term in stocks of companies that perform well and have high liquidity, market capitalization, positive innovation for valuation measures. because positive optimism will be obtained (Hau & Rey, 2006; Ansari et al., 2020).

Hypothesis 3: Foreign capital flows significantly affect stock returns.

RESEARCH METHODS

DATA AND METHODOLOGY

This study examines the effect of investor sentiment, changes in exchange rates and foreign capital flows on stock returns in the Jakarta Islamic Index (JII) using daily data. In addition, we used purposive sampling to collect data from constituents in the Jakarta Islamic Index (JII). In our study the research sample criteria are as follows: First, we select a sample of companies that are consistently listed on the Jakarta Islamic Index (JII) from January 2017 to December 2021. Second, stocks that are actively traded by foreign investors. Thus, the final sample consists of 14 companies with a total of 16968 observations. Explanation of the definition of variables and data sources is presented in table 1.

Table 1: Description of Research Variables

Variable	Definition	Data Source
Return _{it}	Stock returns listed on the Jakarta Islamic Index (JII)	Thomson & Reuters
Sentiment _{it}	CBOE volatility index as a proxy for global investor sentiment	Thomson & Reuters
Exchange Rate _{it}	Change in Exchange Rate/IDR in percent	Thomson & Reuters

Variable	Definition	Data Source
Foreign Capital Flow _{it}	The ratio of total foreign capital inflows to total trading volume. The total foreign capital inflow is the difference between net purchases and transactional sales.	Thomson & Reuters
IHSG Return _{it}	Composite Stock Price Index Return.	Thomson & Reuters
US Bond Return _{it}	Return on United States bond with a tenor of 1 year.	Bank Indonesia
Indo Bond Return _{it}	Return on Indonesian bonds with a tenor of 1 year.	Thomson & Reuters

We use daily data from January 2017 to December 2021.

Table 2 presents basic descriptive statistics for all variables, such as mean, SD, min, max, skewness, and observations for all variables (daily data) used in this study. The average return in the Jakarta Islamic Index (JII) is 0.0034, and the standard deviation is 0.2891, while comparatively it shows a higher max return of 34.1357 with a minimum value of -0.8447. On the other hand, the max return for IHSG is 0.0001, American bonds are 0.0002, and Indonesian bonds are only -0.0003. Meanwhile, the minimum return for IHSG is -0.1677, American bonds are -0.5222, and Indonesian bonds are only -0.1076. Meanwhile, the maximum return on IHSG is 0.1019, American bonds are -0.5222, Indonesian bonds are only 0.2387. Based on these results, it shows that the return of the Jakarta Islamic Index (JII) is more profitable than other returns. This can be an investor's preference in investing. However, the skewness statistic for the IHSG return variable is negative, while for all other variables it is positive. The total observation of the study is 16968.

Empirical methodology

In empirical modeling, we first carried out our tests applying unit root and stationarity tests to the research data to ensure that the model was unbiased. This study used Difference-Generalized Methods of Moment (D-GMM). This model was proposed by Arellano and Bond (1991). GMM overcomes the problems of bias in dynamic panels, potential endogeneity, consistent estimates and efficiency in estimating parameters. In the GMM model the J-statistical orthogonality conditions must be met so that overidentification has an important role in increasing the efficiency of the estimator (Cragg, 1983). The model shows that y_{it} is dependent variable, $y_{i,t-1}$ is the dependent variable lag, x_{it} is the independent variable matrix, and ε_{it} is the standard error. In this study, it is formulated in the following equation.

$$y_{it} = \alpha y_{i,t-1} + \beta x_{it} + \varepsilon_{it}$$

Our study aims to examine the effect of investor sentiment, exchange rates and foreign capital flows on stock returns. We also add exogenous factors as instrument variables: IHSG return, Indonesian bond return, and United States bond return to each equation function. Therefore, the estimation model can be expressed with the following functions:

$$\begin{aligned}
return_{it} = & \alpha_0 return_{i,t-1} + \alpha_1 sentiment_{it} + \alpha_2 exchange\ rate_{it} \\
& + \alpha_3 foreign\ capital\ flow_{it} + \alpha_4 ihsg\ return_{it} + \alpha_5 us\ bond\ return_{it} \\
& + \alpha_6 indo\ bond\ return_{it} + \varepsilon_{it}
\end{aligned}$$

In each of the GMM estimation equations we perform in more detail two two-stage regressions. First, the lagged level variable is used for the instrument in estimating the first difference regression. The two first-difference lagged variables are used as instruments for level equation estimation (Windmeijer, 2005). Meanwhile, the use of the first difference GMM estimator needs to be auto hardened between variables by first and second order diagnostic tests in the AR (1) and AR (2) test residuals.

Table 2: Descriptive Statistics and Autocorrelation

	Mean	SD	Min	Max	Skewness	Observation	
Panel A: Summary of descriptive statistics							
Return	0,0034	0,2891	-0,8447	34,1357	104,4072	16968	
Sentiment	0,0041	0,0923	-0,2337	1,1560	3,0897	16969	
Exchange Rate	0,0001	0,0039	-0,0275	0,0457	1,5494	16970	
Foreign Capital Flow	-0,0218	0,2412	-0,8877	0,8954	0,0390	16971	
IHSG Return	0,0001	0,0115	-0,1677	0,1019	-2,4612	16972	
US Bond Return	0,0002	0,0525	-0,5222	0,4364	0,1748	16973	
Indo Bond Return	-0,0003	0,0238	-0,1076	0,2387	2,8371	16974	
Panel B: Correlation matrix							
	Return	Sentiment	Exchange Rate	Foreign Capital Flow	IHSG Return	US Bond Return	Indo Bond Return
Return	1						
Sentiment	-0,0559	1					
Exchange Rate	-0,0936	0,1008	1				
Foreign Capital Flow	0,1276	-0,0047	-0,0313	1			
IHSG Return	0,0264	-0,1020	-0,3508	0,0795	1		
US Bond Return	-0,1068	-0,0933	-0,0483	-0,0231	0,2034	1	
Indo Bond Return	0,0100	0,0083	0,0138	0,0222	0,0283	0,0139	1

Meanwhile, Panel B shows a simple correlation coefficient between the independent and dependent variables in investigating the effect of contemporary and lags. Negative and positive correlation coefficients between different variables in this study. Investor sentiment and changes in exchange rates have a negative correlation with stock returns, while foreign capital flows and stock returns have a positive correlation, thereby encouraging foreign inflows to the Jakarta Islamic Index (JII). The impact of changes that occur in contemporary and lags will have different effects on the return of the Jakarta Islamic Index (JII). we want to explore the effect in the long run it is necessary to control the stock and bond markets to get more valid results in making estimates.

Table 3: Stationary test

	Individual Effects		Individual Linear Trends	
	LLC	IPS	LLC	IPS
Return	109,947***	-98,6583***	-155,492***	111,426***
Sentiment	-106,556***	-103,536***	-150,389***	-65,2085***
Exchange Rate	-86,0093***	-74,2372***	-121,865***	-79,0018***
Foreign Capital Flow	-70,5758***	-61,1696***	-101,038***	-106,005***
IHSG Return	-118,710***	-103,072***	-167,869***	-110,880***
US Bond Return	-109,008***	-95,5559***	-154,992***	-102,766***
Indo Bond Return	-133,943***	-112,277***	-189,442***	-121,083***

Description: *** significant at 1%. LLC is Levin-Lin-Chu. IPS is I'm Pesaran_Shin

Based on Table 3, all variables used in this study are stationary with or without a trend using the LLC and IPS methods. Cointegration test was conducted to determine the long-term relationship between variables. The results of the individual effects parameters and individual linear trends are significant at 1%. We conclude that all variables do not move at levels that would give valid results in capital estimation. Therefore, we are not worried about the bias relationship between the variables used in testing the hypothesis in both the contemporary and lag periods using the generalized method of moment first difference.

RESULTS AND DISCUSSION

In Table 5 GMM shows the results of the regression and specification test. The results of the autocorrelation test are not significant in the second order AR (2) with a probability value of 0.732. While the J-statistical overidentification test is fulfilled with a probability of 0.0000. Therefore, the test results meet the specifics of the GMM model and the regression results can be interpreted. The increase in the value of the investor sentiment coefficient at -0.0044 and lags -0.0044 led to a decrease of one percentage point from stock returns, although statistically not significant. The exchange rate is statistically significant with a coefficient of -0.2811 in the contemporary period and -0.2804 in the lag period, a decrease of one point in the exchange rate causes a decrease in stock returns of -0.2811 and -0.2804. but the different results of foreign capital flows have a statistically significant positive coefficient affecting stock returns. In the contemporary period of 0.0433 and lags of 0.0433 which indicates an increase in foreign capital flows led to an increase of 0.0433 and 0.0433 one percentage point in stock returns.

Based on the estimation of the GMM panel in Table 4, it is found that the first hypothesis is not fulfilled where investor sentiment has no significant effect on stock returns. This result is the same as previous research (Chu et al., 2015; Akarsu, S., and Süer, 2022) this shows that the movement of Islamic stock returns is not driven by temporary investor sentiment or optimism but because of fundamental factors and long-term company performance. These results confirm investor sentiment in both the contemporary and lag periods, although the coefficient is negative, it does not have a significant impact on stock returns. This result is not surprising because foreign investors seek information about the prospects for future company performance not just

for a moment (Vlastakis and Markellos, 2012) to reduce uncertainty and noise (Aouadi et al., 2013) and increase returns (Ding and Hou, 2015). Apparently, foreign investors observe the company's operational performance to get higher returns in the long run. Stocks in the Jakarta Islamic Index have large capitalization and have low risk so they are not influenced by investor sentiment (Chu et al., 2015). This result is in accordance with the perception of foreign investors which use the strategy of buying stocks with profitable performance and selling stocks with low performance. In particular, foreign investors react to market performance rather than chasing instantaneous profits.

Table 4: The result of GMM First Difference

	Coefficient	Standard error	T – stat	Prob
Panel A: Regression results				
Return_{it-1}	-0.0058	0.0008	-6.8343	0.0000
Return_{it-2}	-0.0058	0.0008	-6.8344	0.0000
Sentiment_{it}	-0.0044	0.0023	-1.9486	0.0514
Sentiment_{it-1}	-0.0044	0.0023	-1.9446	0.0518
Exchange Rate_{it}	-0.2811	0.0634	-4.4329	0.0000
Exchange Rate_{it-1}	-0.2804	0.0634	-4.4221	0.0000
Foreign Capital Flow_{it}	0.0433	0.0011	38.2098	0.0000
Foreign Capital Flow_{it-1}	0.0433	0.0011	38.2421	0.0000
IHSG Return_{it}	1.0614	0.0223	47.5002	0.0000
IHSG Return_{t-1}	1.0618	0.0224	47.5104	0.0000
US Bond Return_{it}	0.0119	0.0043	2.7476	0.0060
US Bond Return_{t-1}	0.0126	0.0044	2.8754	0.0040
Indo Bond Return_{it}	0.0037	0.0083	0.4485	0.6538
Indo Bond Return_{t-1}	0.0037	0.0083	0.4497	0.6529
Panel B: Specification tests				
AR(1) stat.		-54,5338		
AR(1) prob.		0,0000		
AR(2) stat.		0,3013		
AR(2) prob.		0,732		
J statistics.		11284,76		
J statistics prob.		0,0000		

This table reports the generalized moment method regression (SYS-GMM). Panel A shows the coefficients and t-statistics in brackets. Panel B shows test specifications such as Arellano-Bond (AR) statistics, and J.Stat *, ** and *** show significant at 10%, 5%, and 1%, respectively.

The results of the study show that in the contemporary and lag periods, the coefficient of changes in the exchange rate has a significant negative effect on stock returns of the Jakarta Islamic index. The results of this study are different from (Sui and Sun, 2016; Naresh et al. (2018), but these results are in line with research (Delgado et al. 2018; Ahmed, 2020; Wong, 2021), These results support the argument of “portfolio- balance” proposed by Branson (1983) and Frankel (1983), which state that the exchange rate negatively affects stock prices through foreign capital

flows. More importantly, negative results in long-run equilibrium indicate that the depreciation of the dollar against the rupiah stimulates foreign exchange flows. international capital seeking investment opportunities and portfolio management in developing countries (Lin, 2012; and Tsai, 2012). Therefore, expectations of currency movements have a relatively significant impact on stock price movements. Thus, changes in the depreciation of the dollar against the rupiah lowers foreign currency returns, which causes investors to rebalance their portfolios by selling losing stocks and buying stocks that favorable performance thereby temporarily lowering stock prices (Salisu & Ndako, 2018)

More interestingly, the third hypothesis found a different effect with the previous hypothesis. The results of the study found that foreign capital inflows had a significant positive effect on stock returns in the contemporaneous and lag periods. The factors driving the flow of foreign capital are positive because Islamic stocks offer opportunities for portfolio diversification, lower risk, and the potential for company operational profits that have an impact on increasing stock returns in the long term (Garg and Dua, 2014). A number of previous empirical studies (Yan and Wang, 2018; Derbali & Lamouchi, 2020; and Kartal et al., 2022) also found that foreign capital flows significantly positively affect stock returns. Sharia stocks have a low level of financial leverage, not exceeding 45% of assets, thus driving the flow of foreign investment into the Jakarta Islamic index. Furthermore, companies that use low debt in their capital structure are more likely to use the income share for company expansion and operational improvements which consequently increase stock returns in the future (Alter & Elekdag, 2020). Therefore, foreign investors are optimistic about investing in companies with a lower level of financial leverage and lowering the shareholder's financial risk.

CONCLUSION

The results of this study indicate that investor sentiment does not significantly affect stock returns in both contemporaneous and lag periods. In short, stock returns on the Jakarta Islamic index are not driven by noise and investor sentiment, but stock prices are driven by rational investors and company fundamentals. Because the results are consistent with contemporary and lags investors use the company's past performance to predict future risks and returns for portfolio management. Meanwhile, negative exchange rate changes can be used by investors for portfolio rebalancing because they adjust their exposure to currency risk exposure to their portfolios by selling stocks with declining performance and buying stocks with increasing financial performance. On the other hand, foreign capital inflows have a significant positive effect on stock returns in the contemporary and lag periods. When Islamic stocks offer diversification, profitable future performance, lower debt levels and controlled risk, they have the potential to encourage the flow of foreign invested capital.

The findings of this study have several implications for policy makers and investors. For investors, the fact that the stock returns of large-cap and Islamic companies cannot be driven by sentiment, changes in exchange rates and foreign capital flows, means that investment strategies in the short and long term must include changes in sentiment, changes in exchange rates and foreign capital flows when measuring totals. investment risk. Meanwhile, policy

makers must be careful and take into account the impact of their decisions that can lead to financial instability and the outflow of foreign capital because foreign investors are looking for a market that is of higher quality and provides higher returns. However, our research has limitations in only examining large capitalization Islamic stocks. However, this study shows possible directions for future research with the impact of investor sentiment on small capitalization, medium capitalization and large capitalization Sharia stocks.

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