Mutual funds
in the Republic
of Macedonia

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ECPD

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List of Abbreviations

AUM	Assets under management
Bn	Billion
BF	Balancing Funds
CAPM	Capital Assets Pricing Model
E	Equity
EBITDA	Earnings before Interest, Depreciation, Amortization and Taxes
EFAMA	European Fund and Assets Association
e.g.	Exampli gratia (Latin), for example
ESMA	European Securities Markets Authority
et al.	Et alia (Latin), and others
etc.	Et cetera (Latin), and other things
EU	European Union, Europe
EUR	European Union Currency, EURO
GDP	Gross Domestic Product
GP	General Hypothesis
H	Hypothesis
ICI	Investment Company Institute (USA)
i.e.	Id est (Latin), that is
IF	Investment Funds
IRR	Internal Rate of Return
MF	Mutual Funds
MC	Mutual Funds Management Company
MBI	Macedonian Stock Exchange Index
MKD	Macedonian Denars
MPT	Modern Portfolio Theory by Markowitz
MSE	Macedonian Stock Exchange
mm	Million
N/A	Not Applicable
NAV	Net Assets Value
NBM	National Bank of the Republic of Macedonia
NI	Net Income
PF	Private Investment Funds
Rev	Revenue
RM	Republic of Macedonia
ROA	Return on Assets
ROE	Return on Equity
S&P	Standard and Poor's
SEC	Securities and Exchanges Commission
StDev	Standard Deviation
USA	United States of America
USD	United States Dollar

Definition of Terms

Alpha (α) – a risk indicator measures the MF's excess return relative to a market index, in which a positive α represents that fund manager produces a higher return than the benchmark, while a negative α means that the fund did not achieve sufficient return for the amount of the undertaken risk.

Account Fee – a fee that some funds separately impose on investors for the maintenance of their accounts. For example, accounts below a specified dollar amount may have to pay an account fee.

Assets under Management (AUM) – value of all securities within a MFs portfolio

Atractive Funds – include funds that are categorized as: index funds, cash funds that invest in highly liquid instruments, hedge funds, funds investing in gold, mechi funds and others;

Back-end Load – a sales charge (also known as a "deferred sales charge") investors pay when they redeem (or sell) mutual fund shares, generally used by the fund to compensate brokers.

Balansing Funds – aim at balancing their portfolios with equities and bonds inorder to provide stable returns and long-term growth. Most commonly, the portfolio of these funds is composed of bonds and equities in companies with a high credit rating (i.e. blue chip companies), thus decreasing the potential risk and fluctuation in equity prices. Additionally, these funds can be subdivided into: funds focused on assets; funds focused on return growth; dividend funds; globally active funds and other;

Benchmarking – is a useful method in evaluating fund performance via comparison with an appropriate benchmark index, defining expectations on returns with actual realization, and further more, defining if funds perform impressively or under-perform. In such cases, choosing the right benchmark is essential inorder to provide a realistic comparison[1]. Therefore, inorder to provide a more perspective evaluation, fund's are compared against adequate benchmark indices, other funds and the market in general. Through such comparison MF returns are verified given the context in which returns

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[1] For example, using a US index of performance for small-cap EU funds has no sense. Also, there is no use in comparing bond funds with equity funds, only.

are achieved, contrary to the stand-alone (isolated) evaluation of returns which have little meaning.

Beta (β), – measures risk as a sensitivity of fund's returns to the returns of a market index, with a base line coefficient of βequal to 1.0. Thus, a coefficient greater than 1.0 indicates that the fund's returns are more volatile than the benchmark index, while β between 0 and 1.0 implies that a fund is less volatile in comparison to the market performance[2]. Consequently, a fund with β =1.0 means that the fund tracks the index

Bond Funds – invest in corporate, state, municipal and international bonds in various sectors of the economy, with an aim to produc increased capital profit and high returns;

Capital gains distribution (realized) – as a return measurement of MF performance is achieved when profits are made due to increase in securities prices, upon which the fund manager sells the securities, thus creating a difference between the sale price and purchase price of the secutity. Typically, such capital gains are distributed to sharehoulders annually, and like dividends, same can be payed in cash or reinvested in additional fund units. When payout of capital gains occurs, the value of the fund drops exactly the amount of the distribution which accounts for the decrease in assets it holds.

Classes – different types of shares issued by a single fund, often referred to as *Class A* shares, *Class B* shares, and so on. Each class invests in the same "pool" (or investment portfolio) of securities and has the same investment objectives and policies. But each class has different shareholder services and/or distribution arrangements with different fees and expenses and therefore different performance results.

Closed-end Fund – a type of investment company that does not continuously offer its shares for sale but instead sells a fixed number of shares at one time (in the initial public offering) which then typically trade on a secondary market, such as the New York Stock Exchange or the Nasdaq Stock Market. Legally known as a "closed-end company."

Consistency – is one of the most important methods in evaluating a fund performance, since the same covers a longer-time performance in regards its stability concerning the outlined policies as outlined in their objectives and strategies (prospectus). Consistency is more relevant than high long-term aggregate returns, and gives a thorough comparison of MF with similar strategies.

Contingent Deferred Sales Load – a type of back-end load, the amount of which depends on the length of time the investor held his or her shares. For

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[2] For example, a fund with β = 1.2 shows that a fund is 20% more volatile than the index, since on average it will increase 20% when the market is up, and will fall 20% when the market is down. On the other hand, a fund with β = 0.8 indicates that a fund is less volatile than the market, meaning that it will give a 20% lower return when the market is rising and will decline only 20% when the market is falling.

example, a contingent deferred sales load might be (X) % if an investor holds his or her shares for one year, (X-1) % after two years, and so on until the load reaches zero and goes away completely.

Conversion – a feature some funds offer that allows investors to automatically change from one class to another (typically with lower annual expenses) after a set period of time.

Costs – are a portfolio based risk-adjusted measure aimed at the evaluation of different types of costs associated with MFs which are real and incur as the result of rendered services. The same are generally divided as: *shareholder fees* and *annual operating expenses*. Although not directly liked to MF performance as regards to returns and risk, costs are an important element in determining overall MF performance – often overshadowed by investor's thirst for returns and profits. Inorder to avoid ambiguity and manipulations in calculating costs, autorities on the MF industry have imposed strict provisions that obligate MFs to be highly transparent in providing investors with information on their costs which has become an essential criteria and a must consideration in the fund's prospectus and annual reports.

Costs as Shareholder Fees – usually include sales commissions and transaction costs associated with investor's purchase, redemption or exchange of shares.

Costs as Annual Operating Expenses – usually include ongoing fixed fees paid each year for management, distribution and other fund expenses.

Cross-border mutual funds – are mutual funds that are registered in one country and are sold 'cross-border' into one or more other countries. These funds tend to be domiciled in countries with the most favourable business environments for establishing, servicing, and distributing funds throughout the world, such as, legal or tax withholding advantages, quality of workforce, as well as, efficienct and legal expertise embedded in the regulatory approval process.

Distribution Fees – fees paid out of fund assets to cover expenses for marketing and selling fund shares, including advertising costs, compensation for brokers and others who sell fund shares, and payments for printing and mailing prospectuses to new investors and sales literature prospective investors. Sometimes referred to as "12b-1 fees."

Divesification—means the reduction of investment risk through investing in various assets (financial instruments). Diversification and hedging are the essential techniques in risk reduction.;

Diversified Funds – are an important type of IF which invest in portfolios composed of equities in various sectors of the economy. Their goal is to maximize the capital returns through investment based on a wide-variety of strategies, from most conservative to most agressive. The funds in this category are funds with an agressive gowth with an aim to increase returns on a short-term basis, through investments in: shares in different companies (less known and with a high ratio between price and returns); derivative in-

struments; investments in emerging markets (BRIC and others); in european equities in various sectors, and othes.

Dividends – are returns in the form of regular income payments recieved from investment in both equities and bonds. Many bonds pay dividends as interest payments and many companies pay cash dividends on a quarterly, or semi-annual basis. These payments go into the portfolio of the fund on the grounds of their investment in shares and bonds. MFs distribute such dividends to their shareholders according to pre-determined schedule, which can be on a monthly, quarterly, semi-annual or annual basis. MF shareholders have a choice whether to recieve these payments in cash or to recieve additional shares-units of the fund. When the MF pays out dividends its NAV per share-unit drops by the amount equal to the divident payout, as the size of the fund's assets are reduced. The actual day on which the fund makes payout of dividends is called the fund's ex-divident rate.

Domestic Savings – are calculated as GDP less final consumption expenditure (total consumption).

EFAMA (European Investment Funds Industry) – is the EU counterpart of ICI in providing key information and reliable statistics through a range of regular publications: Annual Fact Book – trends in European Investment Funds, Annual Asset Management Report, Monthly Fact Sheet on the Investment Industry, Quarterly Statistical Release on the European Investment Funds Industry, Quarterly International Statistical Release on Worldwide Investment Fund Assets and Flows.

Efficient Market Hypothesis (EMH) –

Exchange Fee – a fee that some funds impose on shareholders if they exchange (transfer) to another fund within the same fund group.

Exchange-Traded Funds – a type of an investment company (either an open-end company or UIT) whose objective is to achieve the same return as a particular market index. ETFs differ from traditional open-end companies and UITs, because, pursuant to SEC exceptive orders, shares issued by ETFs trade on a secondary market and are only redeemable from the fund itself in very large blocks (blocks of 50,000 shares for example).

Expense Ratio – the fund's total annual operating expenses (including management fees, distribution (12b-1) fees, and other expenses) expressed as a percentage of average net assets.

Fees – fees paid by the fund out of fund assets to cover the costs of marketing and selling fund shares and sometimes to cover the costs of providing shareholder services. "Shareholder Service Fees" are fees paid to persons to respond to investor inquiries and provide investors with information about their investments.

Front-end Load (direct costs) – an upfront sales charge investors pay when they purchase fund shares, generally used by the fund to compensate brokers. A front-end load reduces the amount available to purchase fund shares.

Growth investing – is a strategy preferred by MF managers and advisers who choose equities of companies with expected rapid growth potential, resulting in fast increase in earnings. Such expectations are based on anticipated company earnings on the side of analysts' reports which can move in an upward direction. Variances to the growth strategy exist in several forms, out of which most common are *growth investing at a reasonable price* (GAPR) and momentum trading. The GARP strategy is considered to be more conservative due to its affinity for stocks that are more reasonably priced and with a potential for generating above average growth. It is often practiced in cases when share prices have declined due to disappointing earnings and are cheaper compared to assets in their peers, so that their current price is only temporary down – underpriced, and thus, instead on focusing on instant profit, they focus on growth over a longer term. Another distinctive alternative in growth investing is *momentum trading*, or *timing the market strategy* which is generally classified as the most risk taking strategy in which measures of value are ignored to a large extent. Managers practicing such a strategy usually pick stocks with expected rapid rise, popularly known as "strong buy" stocks under recommendations from majority of analysts that cover a particular companies with expected significant earning rates of growth exceeding– surprising the overall market. Another major characteristic of this strategy is their custom in holding securities that are considered expensive, buying the same before a major increase is expected, and selling equities just before a price decline occurs.

ICI (Investment Company Institute) – is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs) and unit investment trusts (UITs). The ICI issues the most comprehensive monthly, quarterly and annual data for open-end (MF) ever since 1984. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. In addition to the annual Investment Company Fact Book, ICI released research and policy publications, examining the industry and its shareholders.

IIFA (International Investment Funds Association) – publishes reports on investment funds on an international level by compiling data from various national investment fund associations , such as ICI, EFAMA, and others.

Index Fund—describes a type of mutual fund or Unit Investment Trust (UIT) whose investment objective typically is to achieve the same return as a particular market index, such as the S&P 500 Composite Stock Price Index, the Russell 2000 Index, or the Wilshire 5000 Total Market Index.

Inherent risks – is a portfolio based risk category used in performance evaluation generally associated with specific types of MFs which vary dependent on the specifics of the fund itself. The same can take several forms, out of which most popular are *currency* and *interest rate risks*[3].

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[3] On both inherent risk types refer to definitions in this section.

Inherent Currency Risk – is a relatively increasing phenomenon due to the ever growing globalization resulting in a growing number of foreign and global MFs. Although these funds provide investors with the opportunity to access new markets much easier than buying directly securities on foreign markets, nonetheless, they create a unique risk associated with investing in global and foreign funds, since these investments (stock prices) are denominated in a particular foreign currency. Furthermore, radically negative effect may occur in cases when too much money is invested in stocks in a particular country, resulting in *risk concentration*. Ultimate changes in currency values along with eventual political instability (*political risk*) will increase the volatility of a global (international) MFs.

Inherent Interest Rate Risk – is also considered as an inherent risk of major importance, closely associated with investments in bond funds. Although generally considered as "safe" investments causing many investors to shift their investments to bond MFs – especially when approaching their retirement age and in search for a steady income – bond funds vary significantly in regards to their inherent risk. On the extreme, certain bonds may be even more speculative than securities, due to a number of factors, such as: *interest rates, frequency trading, bond quality, maturity* and others. The price of bond funds is negatively correlated to interest rate meaning that when interest rates rise bond prices fall and vice versus, which generates the dynamics of their trading. Fund managers often trade bonds as frequently as they trade with equities despite the maturity factor of bonds, since bond MFs are not required to hold the bond until it's maturity in order to receive a *face value*. This is especially evident when bond prices rise in which case fund managers sell them to realize a gain, as well as, when bond price drops in value, in which case fund managers also sell in order to minimize the loss. Furthermore, bond quality is also of key interest when considering investing in bond funds. In order to rank the underlying risk of bonds, credit rating companies (Fitch, Moody's, and S&P) assign ratings which defines the risk that the issuer will default on a bond, considering that fairest bonds are those that have a high credit worthiness rating and short-term maturation. Although there are a number of "investment grade" high quality bonds which provide the lowest yield and include many types of government issued bonds, there are also on the contrary, a vast number of high-yield or junk bond funds which trade with low – quality debt instruments issued by many companies as well as countries (esp. emerging economies). These types of bonds have been the case for a number of "bubble bursts" on the stock exchanges, since they are known to attract a vast volume of investments due to their high yields and large price fluctuations.

Investment – describes the purchase of assets or other forms of property with an aim to generate additional returns through the appreciation value of the asset in a certain future time, so that the same can be sold at a higher price. The same doesn't apply to banking (savings) deposits;

Investment Adviser – generally, a person or entity who receives compensation for giving individually tailored advice to a specific person on investing in stocks, bonds, or mutual funds. Some investment advisers also manage portfolios of securities, including mutual funds.

Investment Fund – a company (corporation, business trust, partnership, or limited liability company) that issues securities and is primarily engaged in the business of investing in securities. The three basic types of investment companies are mutual funds, closed-end funds, and unit investment trusts.

Investment styles – as a portfolio based MF performance evaluation criteria determines the amount of risk an investor undertakes and prefers when purchasing a particular MF. It defines an investment managers choice of securities based on their analytical approach, and the frequency of change in strategies the same practices. There are two general investment styles: (i) growth investing, and (ii) value investing (for definition on both refer to this section).

Lipper Hindsight Database – is a global leader in supplying mutual fund information, analytical tools, and commentary. Lipper's benchmarking and classifications are widely recognized as the industry standard by asset managers, fund companies and financial intermediaries. Lipper's publishes weekly, monthly, and quarterly performance and outlook updates, cogent topic studies, timely studies of asset flows, and a regular series of interactive web-based client briefings. Lipper's provides research on more than 213,000 collective investments domiciled in 61 countries.

Management Fee – fee paid out of fund assets to the fund's investment adviser for investment portfolio management, any other management fees payable to the fund's investment adviser or its affiliates, and any administrative fee payable to the investment adviser that are not included in the "Other Expenses" category. A fund's management fees appear as a category under "Annual Fund Operating Expenses" in the Fee Table.

Market Capitalization – size of a business or corporation equal to the share price times the number of outstanding shares.

Market Index—a measurement of the performance of a specific "basket" of stocks considered to represent a particular market or sector of the U. S. stock market or the economy. For example, the Dow Jones Industrial Average (DJIA) is an index of 30 "blue chip" U. S. stocks of industrial companies (excluding transportation and utility companies).

Modern Portfolio Theory (MPT) – fundamentally known as the mean-variance portfolio theory, was developed by Markowitz who formulated the portfolio probelem as a choice of mean and variance of a portfolio of assets (balance between risk and return– the curve of indifference). MPT relies on the concept of investment diversification in achieving greater effectiveness compared to investments in one particular asset.

Money Market Mutual Fund – is a type of mutual funds that invests in short-term securities, such as Treasury Bills and other high quality, liquid invest-

ment types. The money market fund objective is to earn interest for share-holders while maintaining a net asset value (NAV).

Morningstar Rating (or "star rating) – Morningstar's rating looks at risk-adjusted historical returns from one to five stars, based on a concept of risk–and cost-adjusted return to the average investor. Unlike the S&P which takes into account the outlook for the individual underlying holdings of a fund, the Morningstar focuses on comparison groups to better measure fund manager skill, and is intended for use as the first step in the fund evaluation process, rewarding consistent performance and reducing the possibility of strong short-term performance masking the inherent risk of a fund. The Morningstar Rating is based on "expected utility theory," which recognizes that investors are a) more concerned about a possible poor outcome than an unexpectedly good outcome and b) willing to give up some portion of their expected return in exchange for greater certainty of return. The rating accounts for all variations in a fund's monthly performance, with more emphasis on downward variations. It Morningstar Risk-Adjusted Return measure, also accounts for the effects of all sales charges, loads, or redemption fees. Funds are ranked by their Morningstar Risk-Adjusted Return scores and stars are assigned using the following scale: Funds are rated for up to three periods—the trailing three-, five-, and 10-years. For a fund that does not change categories during the evaluation period, the overall rating is calculated using the following weights: When a fund changes investment categories, its historical information is given less weight, depending on the magnitude of the change; While the 10-year formula seems to give the most weight to the 10-year period, the most recent three-year period actually counts the most because it is included in all three rating periods; ratings are not assigned to funds in the Bear Market and Currency categories because the funds in these categories take very different approaches to generating returns.

Mutual Fund – the common name for an open-end investment company. Like other types of investment companies, mutual funds pool money from many investors and invest the money in stocks, bonds, short-term money-market instruments, or other securities. Mutual funds issue redeemable shares that investors purchase directly from the fund (or through a broker for the fund) instead of purchasing from investors on a secondary market.

NAV (Net Asset Value) – the value of the fund's assets minus its liabilities. SEC rules in most countries require funds to calculate the NAV at least once daily.

NAV per share – is calculated by subtracting the fund's liabilities from its assets (NAV) and then dividing the result by the number of shares outstanding. NAV (increase in share price) or unrealized capital gain happens when fund manager holds onto the securities that have risen in prices so that the share price (NAV) of the fund increases. On the contrary, unrealized losses are also reflected in the NAV when the price of securities in the portfolio drops. These gains-profits are often known as „paper profits" as long as the investor owns units in the fund. However, investors can lock in profits generated from an

increase in NAV value due to unrealized gains by selling their units in the fund at higher prices than the price at which units were purchased.

No-load Fund – a fund that does not charge any type of sales loads. But not every type of shareholder fee is a "sales load," and a no-load fund may charge fees that are not sales loads. No-load funds also charge operating expenses.

Open-end Fund – the legal name for a mutual fund. An open-end company is a type of investment company.

Operating Expenses – the costs a fund incurs in connection with running the fund, including management fees, distribution (12b-1) fees, and other expenses.

Portfolio – an individual's or entity's combined holdings of stocks, bonds, or other securities and assets.

Profile – summarizes key information about a mutual fund's costs, investment objectives, risks, and performance. Although every mutual fund has a prospectus, not every mutual fund has a profile.

Prospectus – describes the mutual fund to prospective investors. Every mutual fund has a prospectus. The prospectus contains information about the mutual fund's costs, investment objectives, risks, and performance. The same is publicly available.

Purchase Fee – a shareholder fee that some funds charge when investors purchase mutual fund shares. Not the same as (and may be in addition to) a front-end load.

R squared – is a portfolio base measure which indicates the oscillation of the fund's returns in respect to its index, in respect to the degree to which the fund's price movements are correlated to the benchmark index on a scale of 1 to 100[4]. R-squared is often used to confirm the usefulness of β because of their direct correlation, since a high R-squared indicates that beta is being compared with an appropriate index.

Ranking – as a follow-up step of monitoring is of particular importance in evaluating fund performance based on historical records. The same provides comparison of funds on a peer basis, within a complex sub-categorization dependent on the approach – method of the rating agency or institution. Regular monitoring and ranking is provided by specialized organizations, amongst which the most renown are S&P, Morningstar and Lipper's[5]. In essence the advantage of "star" ratings is in their ability to effectively identify good performing funds comparing them with adequate peers based on their consistency in respect to objectives, investment styles – strategies, risk undertakings, expenses, and finally, returns.

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[4] An R-squared=100 shows that a fund exactly tracks the movements of its benchmark index.

[5] For definitions on various rating agencies refer to this section.

Redemption Fee – a shareholder fee that some funds charge when investors redeem (or sell) mutual fund shares. Redemption fees (which must be paid to the fund) are not the same as (and may be in addition to) a back-end load (which is typically paid to a broker). The SEC generally limits redemption fees.

Return (total) – is a performance measure the includes of the most important elements that evaluate fund's performance over a given period – usually several years. The same is calculated by summing up the (i) distribution of investment increase from dividend or interest payment, (ii) distributed realized capital gains, and (iii) unrealized capital gains or losses, all of which are factored into the change in fund's NAV. When evaluating total return of funds the various elements in the formula may carry different levels of importance dependent on the type of MF which is analyzed[6]. Further extensions on the return formula provide additional elements dependent on the purpose of return analysis. Most common alterations on the return calculation formula are: (a) annualized total return – which reflects the total fund return over several years in a form of annualized return figure, measuring the average increase per year over a specific period on the grounds of compounded returns made on reinvested dividends and capital gains—mostly used to compare fund's performance with similar funds for the same period, (b) load adjusted total returns– in which NAV includes expenses for fund operations such a mangement fees and director fees factored in the NAV every day and need not to be deducted from the total return.

Returns (Load adjusted) – include all loads, except fund's sales loads since same are dependent on the distribution channel, and do not include any redemption fees because same are a one-off charge. These loads are difficult to include when a fund is evaluated over a period of several years.

Risk evaluation – is a portfolio based investment strategy based on several statistical methods to assess risk. Even since Markowitz's MPT, the base for measuring risk has been the level of variation in returns of a fund or porfolio, which has been further developed and altered in a number of sub-catogories of comparison. Generally, the greater the fluctuation in returns the more difficult for an investor to liquidate and investment at a favorable price at any given time. Risk evaluation is of top interest to investors which are highly cautious regarding their investments and with a different preference on risk. Therefore, requesting for both analytical types of risk evaluation– narrative and graphic-over a prefered time horizon, are of unconditional importance to investors, which are typically considered in the MF prospectus. Over the years, many MF rating companies and academics have developed various risk indicators which evaluate risk from different perspectives, most of which are based on the past volatility as an indicator of the degree of fu-

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[6] For instance, Money Market MFs generate all returns from dividends without any capital gains and usually no share price changes, while Growth equity funds and High-yield junk bond funds generate returns due to unrealized capital gains and larger capital distribution, and normally without dividends distribution.

ture risk, such as: standard deviation; alpha, beta, R-squared, turnover rate, taxes, inherent risk[7].

ROA (Return on Assets) – is a factor that determines the profitability of a company or fund based on the ability of the compnay assets to generate revenues. The same is measured as the ratio between net revenues and total assets.;

ROE (Return on Capital) – measures the degree of generated revenue in regards to the invested capital (shareholders capital) and represents the efficiency of the company to generate profit on the invested capital (capital=difference between assets and liabilities);

Sales Charge (or "Load") – the amount that investors pay when they purchase (front-end load) or redeem (back-end load) shares in a mutual fund, similar to a commission. The SEC's rules do not limit the size of sales load a fund may charge, but FINRA's rules state that mutual fund sales loads cannot exceed 8.5% and must be even lower depending on other fees and charges assessed.

SEC (Securities and Exchange Commission) – regulatory and supervisory authorities in national economies regulating and supervising IF, MFs, stock exchanges etc.

Shareholder Service Fees – fees paid to persons to respond to investor inquiries and provide investors with information about their investments. See also "12b-1 fees."

Sharpe's ratio or index – measures the excess return (or risk premium)of a portfolio per unit of deviation in an investment asset or a trading strategy which is typically known as risk, representing a deviation risk measure. It determines how well the return of an asset compensated the undertaken risk on the side of the investor, on the basis of the comparison of the assets against a common benchmark (ex. S&P 500 total returns), thus, being directly computable from an observed benchmark. Unlike Treynor's ratio which encounters only systematic risk of a portfolio, the Sharpe's index observes both the systematic and idiosyncratic risks. The same, along with Treynor's index and Jensen's Alfa is often used to mark the performance and MF managers.

Specialized Funds – focus their assets in specific sectors of the industries dependent on the business cycles of the same. Generally, they invest in companies in one or several sectors of the economy (i.e. automotive industy, advanced technology companies, pharmaceutical companies, banking and others);

Standard deviation – as risk adjusted portfolio based standard measure of a fund's volatility which measures the degree to which fund's returns have varried from it's average return over a specific time framework. Funds with lower risk in general offer steadier returns over a long term, and are usually predictable even through both bull and bear markets. Although MF rating

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7 For definitions on the various risk measures refer to this section.

companies use different indicators for determining standard deviation[8], it is of general acceptance that funds with higher standard deviation are likely to continue deviating when the sector is facing difficult performances compared to funds with lower standard deviation.

Standard & Poor's (S&P) ranking – ranks funds using a STARS, STYLE DRIFT AND RISK RANK systems. "Stars" ranking based on risk-adjusted returns over 3, 5 and 10 years, through the implementation of the *Sharpe ratio* on the portion of a fund's return comparable to the 3-month Treasury bill, which is the proxy for a "risk-free" investment. The greater the deviation from the mean or average return, the greater the volatility, and hence the risk, of an investment. For a fund to be ranked higher than 3 STARS, its 3-year annualized total return must exceed that of the 3-month Treasury bill. For a fund to be ranked 5 STARS, its annualized 3-year total return must exceed that of its style benchmark, and it must outperform the 3-month T-bill over three years. STYLE DRIFT measures how closely a fund tracks its investment style -calculated based on a fund's deviation from its style benchmark index. While, RISK RANK (based on standard deviation, using 36 monthly observations for determining whether the variability in a fund's returns is "high," "moderately low," or "low" relative to similar funds within the same investment style.

Stocks traded, total value (% of GDP) – Total value of all traded shares in a stock market exchange as a percentage of GDP.

Stocks traded, turnover ratio (%) – Turnover ratio is the total value of shares traded during the period divided by the average market capitalization for the period. Average market capitalization is calculated as the average of the end-of-period values for the current period and the previous period.

Stock price volatility – Stock price volatility is the average of the 360-day volatility of the national stock market index.

Support Ratio (Age Dependency Ratio) – is a measure of the number of working-age people relative to those of retirement age.

Total Annual Fund Operating Expense – the total of a fund's annual fund operating expenses, expressed as a percentage of the fund's average net assets. You'll find the total in the fund's fee table in the prospectus.

Taxes – are of important consideration in portfolio based risk evaluation, since funds with higher turnover realize more capital gains and losses. Gains are often subject to capital gains taxes as the result of actively traded MFs which oblige shareholders to pay the same, even when funds perform poorly and generate lower profits. Higher taxes are paid as fund managers decide

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[8] For instance, Morningstar provides such statistics comparing MFs in the same category over a longer period, according to which a MF with a standard deviation of 30 is likely to tumble further than one with a standard deviation of 17. Since these fluctuations alone do not indicate whether a fund produces gains or losses which are of detrimental importance to investors, Morningstar also rates funds' returns/losses deviation on a peer and investment style comparison basis.

to sell off some of their most profitable securities, while in the most negative cases, shareholders may pay capital gain taxes that are more than the increase in returns. A great number of fund managers are often indifferent to these additional costs since they are focused on achieving higher annual returns.

Turnover rate – as a risk adjusted portfolio based measure representing the frequency at which a fund trades its securities and determines the level of active strategy implementation on the side of fund managers. Expressed in percentage, the turnover rate indicates the annual turnover of the bought and sold securities within a portfolio[9]. A higher turnover ratio (more than 100%) indicates more actively securities trading. Notably, higher turnover rates result in more transaction costs due to commissions and fees that may affect the overall MF performance in respect to its returns. These cost are of important consideration for investors since the turnover costs are not included in fund's expenses ratio, rather and are charged additionally. However, high turnover rates are not necessarily a negative feature, since at times, active trading can achieve short-term extraordinary profits when dealing with certain securities, especially those that are focused on emerging markets, small-cap stock and high-yield bonds. In contrast, high turnover rate can be of concern during bear markets when it erodes already low or negative returns.

UCITS (Undertakings for Collective Investment in Transferable Securities) – are investment (mutual) funds registered in the EU that have been established in accordance with UCITS Directive (adopted in 1985) which strongly focuses on investors protection and product regulation. Once registered in one EU country, a UCITS fund obtain an "European passport" and can be freely marketed across the EU. The National SECs are responsible for issuing all legal aspects of UCITS functioning.

Unit Investment Trust (UIT) – a type of investment company that typically makes a one-time "public offering" of only a specific, fixed number of units. A UIT will terminate and dissolve on a date established when the UIT is created (although some may terminate more than fifty years after they are created). UITs do not actively trade their investment portfolios

Value investing – is a management strategy which searches for companies whose market value of equieties is cheap, with historically lower ratings ratio in comparison to their peers. Known also as „bargain hunters", these investment managers often discover companies that experience a sudden drop in

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[9] A turnover rate of 100% indicates that the fund manager changes the entire portfolio within an year, and a turnover ratio of 200% shows that securities are traded twice a year. On the other side, a low turnover ratio (< 30%) points out that a fund manager holds the securities for a longer period. MFs with a turnover rate of more than 100% (although certain funds may even have a rate of 300%) are usually considered to implement a momentum investment style-strategy, i.e. buying when stocks are on the rise and selling when the market is falling.

stock prices of a temporary nature, due to specific issues– often due to „bad news"– which have no impact on their fundamentals. These moments are treated as buying opportunities on the side of investors in search for value investments. Selecting the desired companies in which to invest, is usually performed on the grounds of two common measures which value investment managers practice: P/E – price to earnings ratio[10], and P/B – price to book value ratio[11]. In accordance to this type of strategy, managers set specific targets for these ratios that represent buying signals, and thus, sell the stocks when the ratios are reached and the stock price achieves it's „*true value*", or buy stocks that appear to be underpriced compared to its competitors or in a particular industry. The later approach has led to the developement of the so-called „*relative value*" fund managers which compare company stocks relative to it's peers, through an evaluation assets, earnings or sales between two similar companies.

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[10] P/E ratio is calculated by dividing the company's stock – assets by its share price earnings over the past 12 months. A high P/E ratio indicated that investors are willing to pay more expecting the company to increase its earnings, while a low P/E ratio indicates the opposite, and signals that company's shares are undervalued compared to it's peers, whith a tendency to rise. For adequate comparison its best to compare companies in the same sector.

[11] P/B ratio indicates how a company is valued relative to its assets, it is calculated by dividing the company's price by its book value per share. Book value presents the total value of company's assets minus it's liabilities excluding intangible assets, i.e. it represents the amount investors would receive upon company liquidation. A high P/B ratio may show that the price of stock exceeds the value of the company's net assets, and that its shares are over-priced, while a low P/B ratio may indicate that the stock is selling at a discount to its assets and that it might be a good buy.

Abstract

This research elaborates on the main characteristics and problems associated with the state of development of open-end (mutual) funds in the R. of Macedonia, and consequently, atempts to acknowledge the determinants for their more propulsive growth.

This is of particular relevance, since Investment Funds (IF) and Mutual Funds in particular, as one of the most important institutional investors on financial markets globally, are significant facilitators in mobilizing and allocating the surplus capital into the financial assets (securities) of the business sector. In this respect, they provide a more competitive and alternative form of financing vis-a– versus the existent types of financing through bank loans. On the other side, investors would benefit from the alternative in investing in long-term securities, vis-a-vis placing their savings in alternative investments, such as, banking deposits. Ultimately, a more effecient use of primary financial resouces, will significantly contribute towards faster overall economic growth of the country.

In the case of the R. of Macedonia, the development of the IF industry is a priority, considering that, existing Investment Funds in Macedonia failed to attract the adequate interest of domestic investors, despite the potential that is evident in other forms of investments, such as savings deposits which in 2012 amounted to nearly four billion euros.

The second important aspect of this research is the fact that in the R. of Macedonia there is a very scarce empirical research on this matter. In this regards, the findings of this study will be an attempt to shed newly acquired knowledge based on the techniques, methods and instruments which are implemented in this book.

In such a task, this paper, examines the importance of MF Industry development in the R. of Macedonia, on a theoretical and empirical level.

The theoretical part reviews important aspects MF as a contemporary phenomenon from their general aspects – history development,

theoretical background on their foundation, portfolio composition, management strategies and performance evaluation methods.

The empirical (research) part examines the overall state of MFs in the Republic of Macedonia comparing the same with selected neighboring ex-Yugoslav countries, in particular Serbia and Croatia, due to the fact that these countries are on a relatively same level of economic development in which MF were introduced more or less in the same period. Based on a selected research design and dataset, this research considers the three dimensions of MF Industry in the RM: (i) exogenous, i.e. overall economic development, institutional framework on investments, markets– in particular capital markets, and financial determinants, (ii) endogenous, i.e. entry– exit preconditions, management strategies and performance evaluation, as well as experience related determinants MF on the Macedonian capital market, (iii) descriptive and statistical results from the performed research, relevant for the analysis of strategic actions determinants, i.e. observable strategies that might lead to a more intensive development of the MF Industry in RM.

In summary, this book's research approach, which is of an exploratory nature, aims at contributing to the theoretical and implemental audience, through its conceptual framework, non-parallel to the existing research on the MF Industry in RM. Also, based on the magnitude of its descriptive and statistical findings, based on the chosen research design and hence, empirical results, this study offers a comprehensive ground for further research on the side of academia, and potential implementation on the side of practitioners.

1. Introduction

1.1. **Background of Research**

The twentieth century has marked the explosive growth of the Investment funds industry, and in particular of mutual funds (MF), which reached it's highlights on the U.S. financial markets. The such „boom" was mainly as the result of the inability of the banking sector to provide sufficient financing to the business sector, leading towards the expansion in the number of funds, as a preferential choice of investors on one side, and entities in search for capital on the other side. On such basis, IFs became one of the leading contributors towards the development of the financial markets in the U.S., and later, on global markets.

The growing institutionalization of financial savings followed by the growing importance of the role of pension and investment funds and insurance companies represents the most important change in the financial markets in recent times. By means of mobilizing the fragmented capital of individual as retail investors, institutional investors contribute to economic development and creation of social welfare, and at the same time realize their primary goal –profit maximization and risk diversification. On these grounds, Investment Funds have become of highest interest to not only institutional investors, but also, to the insured, shareholders, economy and society as a whole. This is particularly important in less developed countries where there is permanent „hunger" for capital.

The dynamic growth and popularity of IF, is based on their advantage as an investment alternative to smaller investors, due to their relatively higher returns in comparison to interests on savings deposits, relative safety based on the diversification of their portfolio, and much higher liquidity since their shares can be sold to the IF or on capital markets depending on the type of the fund.

Today, the performance of MFs, as institutional investors, is of great importance since they represent one of the sectors with the most

growth, and with a significant implication in the diversification of the global portfolio's, as well as to the overall efficiency of the international capital markets (Patro, 2000).

As for their contemporary financial magnitude and significance, in trading with securities on financial markets all over the world, the MF industry manages a total amount of assets close to 61. billion dollars[1], which comprises nearly 70% of the average GDP of the most developed countries [2].

Furthermore, on the most developed financial markets in the U.S., the managed assets by MF account for more than fifty percent of the global amount of assets managed by MF, which in 2012 reached almost 13.1[3] billion U.S. dollars, while on a global level, the same amounted to 26.8 trillion U.S. dollars[4]. In comparison, in the same year, the NAV of assets managed by IF in the R. of Macedonia[5] accounted for only 1.5 million U.S. dollars, while in the relevant countries of the region, the same reached 15.4 million U.S. dollars (Serbia[6]) and 2.179 billion U.S. dollars (Croatia[7]).

From another statistical approach, based on a per capita investment in MF, American citizen invests 37,000 dollars in investment fund; Slovenian's citizen invests 968 Euros in investment fund, Croatian citizen invests 464 Euros in investment fund, while Serbian and Macedonian citizen invests less than 1 Euro in investment fund (Bifoline, 2012).

Without the development of the financial market— especially the capital market along with the greater presence of institutional investors and other financial intermediates, capital of domestic and foreign owners—as a prerequisit for financing the real sector, capital cannot be mobilized, without which no sustainable economic development of a country can be pertained. Problems arising from the shallow and underdeveloped financial market in the R. of Macedonia, further overloaded by the influence of the global financial crisis, neutralized a good start of newer institutional investors such as investment and pension funds. Additional difficulties arise from the overall

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[1] Data provided by IMF (2010).

[2] The OECD countries which are considered consist of: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Japan, Luxemburg, The Netherlands, Norway, Spain, Turkey, G. Britain and U.S.A.

[3] Investment Company Institute – ICI (2013). Annual Report for 2012.

[4] ibid.

[5] National Bank of The R. of Macedonia (2013). Annual Report for 2012.

[6] National Bank of The R. of Serbia (2013). Annual Report for 2012

[7] National Bank of the R. of Croatia (2013). Annual Report for 2012

state of economic development charactarized with a week real sector, high dependence on imports, weak and volatile local currency, large unemployment, increasing number of pensioners and other users of social benefits. Significant contributing factors are also, the lost confidence of the population in the financial system, based on past experience with banking deposits in the nineties, and the pyramidal savings schemes and scams. The lack of information about the benefits of investing to institutional investors, as well as the lack of "blue chips" securities and municipal bonds, have also played a significant role in this respect. Conclusively, these factors resulted in negative returns on the side of MF on the Macedonian financial market, despite the positive returns they recorded before the beginning of the global financial crisis. More importantly, these events largly influenced the slowed emergence of new institutional investors and MF in particular, although a significant interest of capital owners for investing in institutional investors is recently evident.

On these grounds, with only 1.8 million euros of managed assets in 2010, Macedonian MF have been far from their potential performance in comparison to other forms of investments.

Although, recently established in 2007, MF on the financial markets in Macedonia, have failed to attract the interest of domestic investors, which in turn, have redirected their investment potential in savings accounts with banks. Thus, in contrast to the almost insignificant investments in MF, the investments in savings deposits on the side of Macedonian investors have reached nearly 4 billion euros in savings deposits (2012).[8]

Having in mind the so far stipulated, it is almost illusionary to make any comparison between the performance of IFs in the R. of Macedonia with the same in advanced economies, nonetheless, certain usefull conclusions can be drawn from the MFs functioning in developed markets, for the purpose of determining possible solutions for the development of the MFs industry in the R. of Macedonia.

Furthermore, this book, intends to trigger the interest in the R. of Macedonia, of not only the academic audience, but also, the interest of practiotioners in the field of MF investments, with an aim to imrove their attractiveness to potential investors.

Thus, the objective of our study is to contribute towards the growth of MFs based on the findings in the performed research. In essence, a developed MFs industry will facilitate further the financial markets

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[8] National Bank of the Republic of Macedonia (2013). Annual Report for 2012.

functioning in the country of respect, as a pre-condition for overall economic development. Through the acquired adequate knowledge on the functioning of MFs in advanced economies an attempt will be made to suggest implementation of certain proposals that will produce successfull MFs performance on the Macedonian market, as a necessity to raise their significance on an „industry" level.

Therefore, in this research, based on adequate methods and techniques, a due evaluation will be undertaken in respect to the criteria and determinants for the to-date performance of MF in Macedonia, inorder to detect their weaknesses – anomalies, with an attempt to produce usefull parameters leading towards the construction of an efficient MFs industry, based on substantially developed management strategy and adequately designed (diversified) portfolio. Further more, complementary exogenous aspects will be also examined in order to provide evidence an constructive suggestions on their improvement, as well as aspects which will improve the overall business climate for the well functioning of MF.

In achieving these objectives, usefull data will be analyzed based on the general performance of MFs industry on the most developed financial markets (U.S.A. and E.U.), but also from the functioning of MF on markets that are with a relatively similar degree of development, such as as Serbia and Croatia.

1.2. **The research subject– field (problem)**

The essence and origin of the study lays in the field of financial investments and their articulation through financial markets, institutions and intermediaries, which have been the backbone of the rapid economic development of advanced economies. As of recently, financial investments have also provided explosive economic growth in other parts of the world, due to the globalization process, and in particular through the liberalization of financial flows and investments on the globally interconnected financial markets.

In modern circumstances, the most attractive intermediaries are IF which attract investment on a larger scale, enlisting them as the most significant institutional investors on a global level. Thus, it can be said that IF are financial intermediaries which aim at smaller and less educated investors, enabling them to become participants in the vast world of finances.

Although, there is an evident debate on determinants that provide economic growth to countries, producing a variety of models for such

development, there is a prevailing consent that developed financial markets contribute towards the competiteveness of the business, and to the overall economic competiteveness of countries, based on several functions (Bodie & Merton, 1999) (Rousseau & Sylla, 2003). These functions include facilitating the trading of risk, allocating capital, monitoring managers, mobilizing savings, and easing the trading of goods, services, and financial contracts.

In more depth, financial markets as a driving force in market economies, enable the efficient functioning and financing of the reproduction sector, through various mechanisams that stimulate the trade of goods, services, technology, information, money and capital. Thus, the financial markets, as an integral part of the over-all market, conduct an optimal allocation of assets and balance the supply of money and accumulation. The key determinants of financial markets are defined as locations, subjects, instruments, techniques and trends, that facilitate the exchange of the surplus and deficiency of money, and other forms of capital, by defining the price at which the exchange will be realized.

Within a developed market economy, the financial markets are driven by two types of financial institutions: depositary (commercial banks, saving banks, and others) which lend the acquired assets from the deposits, and non-deposit institutions (investment funds, pension funds, insurance companies and else), which allocate the such mobilized savings into various forms of investment instruments, such as securities (equities, bonds, derivatives).

These theoretical aspects, have been the rationale for the redirection of the economies of contitnental Europe, towards the anglo-saxon economic model under which businesses are dominantly financed through the emission of securities instruments. Thus, through the issuance of shares and corporate bonds, as traditional investments, companies generate the necessarry capital for financing their developmental projects. This form of financing is also practiced by governments, which through the issuance of bonds, have been able to finance their budgets, especially in times when sizable investments undertakings were necessarry for a more dynamic national economic growth. On the side of the investors, the essential interest in investments in certain types of capital (assets, securities and else) is aimed, on a long-term basis, to generate returns with minimum risk through an expected appreciation of the value of the investments, and upon the sale of the same, to acquire sufficient profit. This is an essential advantage of long-term investing in contrast to speculative trading

with securities on a short–term basis, which incorporate a much larger risk. The degree of risk is in a linear correlation with the expected returns, and varies from investing in low risk and low return investments – such as state bonds, up to riskier, but more profitable instruments – such as shares (equities).

1.3. **The Problem Statement**

Although, the interest of this study is closely linked to the traditional form of investments – comprised of equities, bonds, money and real estate – it is important to note the growth and size ability of alternative investments on the global financial markets, such as investments in physical goods (commodities) with a listed value (precious metals, and else), and investments in financial instruments in derivatives.

Having outlined the importance of financial investments to the business sector and to the overall growth of the economy, this research aims at stressing the need and importance of the growth of MF Industry in the R. of Macedonia as a cluster of financial intermediaries. Thus, providing a more competitive financial market, though which companies with a modest access to financial markets and with difficulties in acquiring the additional capital, as is the case with Macedonian companies, can obtain the needed capital at lower cost (corporate bonds), or at no cost (equities). This is especially significant, since today, the main source of financing of Macedonian companies is through banking loans with interest rates that are much higher than the same on developed financial markets.

As for the functional significance of MF as one of the most important institutional investors on financial markets, and also an alternative and competition to savings in banks, it is of worth to note their potential in attracting and investing the surplus of capital as an alternative mean for financing the business sector and stimulating the growth of the economy in general. This is especially important, since MF are less expensive and more easily accessible (through their allocation in securities instruments) in comparison to other forms of financing (banking loans and other forms).

This research, elaborates on the main characteristics and problems of open-end Investment Funds (Mutual Investment Funds) operating on the Macedonian market, since the same are underdeveloped, with proposals for their development, on the grounds of a providing relevant proposals for their development, encompassing a wide framework of criteria which are the essence of this research.

Furthermore, the study attempts to explore the aspects pertaining to the actual importance of the development of the Mutual Funds Industry in Macedonia, as a precondition for an overall economic development of the country. This is especially important, considering the fact that Investment funds are one of the most important institutional investors in all modern economies, playing integral role on the financial markets, thus providing the impetus for the growth of market economies. Consequently, in market economies, it is not possible to achieve an efficient and functional system of crediting the sectors of reproduction, without an organized and functional financial market, which represents a mechanism through which the exchange of goods, services, labor, technology, information, money and capital are facilitated.

The problem statement, which is formulated on the basis of the preliminary research on current state of MFs performance in the R. of Macedonia, presumes that MF have not sufficiently attracted the attention of domestic investors, despite the potential which exists in domestic savings (households and corporate) which are predominantly invested in banking deposits.

1.4. **Theoretical Framework**

The aim of this study is to provide a comprehensive analysis on the state of MF in the R. of Macedonia, comparing their performance with selected MF in the region, considering the functional and legislative similarities of the same. In this regard, the subject of study will be MF which are active since 2007 (when the first MF were opened) until 2012.

Within the theoretical framework of the research the following general aspects will be considered:

– to receive quality and relevant information on a theoretical and empirical basis that will contribute to better understanding, based on current parameters, in function of assessing the need for investment of free and available financial resources in MFs,
– to suggest a framework for further development and promotion of MFs, as alternative investment vehicles for available financial assets.

In order to seize insightful knowledge (answers) on these noted aspects, in this research the following specific actions will be undertaken:

i. collection of relevant data on the determinants affecting MFs growth (determinants for investing available financial resources in MFs vis-a-vis investing in other investment modes),
ii. definition of hypotheses,
iii. creating the content of the questionnaire
iv. designing the plans of the sample(s)
v. distribution of questionnaire in paper and electronic form to pre-viously pre-defined representative random sample,
vi. realization of empirical research,
vii. creating a database of survey questionnaires and data processing with appropriate techniques (software support),
viii. conducting a descriptive analysis and data conclusions based on the empirical findings, on the grounds of which, the determinants for further development of MFs in the R. of Macedonia will be con-structed within an overall framework, as a platform for future re-search.

Through an elaboration and exploration of the theoretical aspects, as structured previously, the final aim of this research is to reaffirm the essence of the research problem, stipulated in the fact that MF in the R. of Macedonia are not sufficiently attractive and developed and that determinants for their more propulsive growth should be addressed.

The theoretical literature researched will provide useful insight on a supply – demand basis of exogenous and endogenous determinants for MF development, in the same manner in which the empirical part of the study will be treated.

In this respect, and in logical sequence the examined literature will review issues that assess:

General aspects on MFs
– Historical, contemporary and outlook overview on MFs (emphasis on the state of MFs;
– Conceptual features (diversification and professional manage-ment),
– Institutional features (legal and regulatory as reflected in MFs es-tablishment and organization),

Determinants on MFs Development:
Exogenous (country characteristics):
● Overall socio-economic development in respect to investment po-tential:
  ○ Wealth (GDP/capita),

- ○ Investor sophistication (literacy rate, internet penetration, etc.)
- ○ Size of the population in determining the potential MFs market
- ● **Financial development** (markets and intermediaries) in respect to:
  - ○ Size, access, efficiency and liquidity, availability of sophisticated financial instruments, and stability – volatility,
  - ○ Trading market characteristics (trading costs, level of production technology and IT)
  - ○ Financial intermediaries level of development
- ● **Investor protection and quality of legal institutions and law enforcement**:
  - ○ Legal origins of the system (commonlaw vs. Civil law),
  - ○ Minority shareholder protection (anti-director laws),
  - ○ Securities regulation (disclosure requirements)
  - ○ Liability standards and public enforcement
- ● **MFs industry structure**
  - ○ Size and age of the Industry
  - ○ Level of concentration (investment assets concentration in MF vis-à-vis banks, insurance companies, and pension funds)
  - ○ Institutional framework relating to MFs (investor protection, barriers to entry and exit, associated costs, etc.)
  - ○ Household demand (Pension policy and changing demographics)
  - ○ Tax policy and other incentives

Endogenous (MFs Characteristics):
  - ○ Typical fund size
  - ○ Fund family size
  - ○ Age
  - ○ Expenses and loads,
  - ○ Past performance (flows, persistence. etc.)
  - ○ Management structure,
  - ○ Marketing exposure (number of countries where fund is sold, etc.)

Based on the fore-stated theoretical and hypothetical determinants, however with a focus on the problem of this study, a comparative overview approach to literary criticizam and empirical testing will be conducted, with respect to the state of MFs in the R.of Macedonia vis-a-vis the state of MFs in peer countries. In it's final objective as discussed in the conslusionary part, based on the previous parts, this study attempts to provide insightful suggestions on future research aimed at further development of MFs in the country of respect.

1.5. **Need for Study**

This study is motivated by the overall scarce amount of literature on the MF industry in the R. of Macedonia, especially in light of the problems associated with their development, and even more so, the lack of adequate research in regards to determination of their portfolio structures-diversification, management strategies and overall performance.

Most of the existing literature in the RM, only touches general aspects on MF on the market, providing general data in regards to their number and types, NAV and a historical overview of their existence, ever since their beginnings in 2007 until 2013. However, an in-depth study, as regards to the previously considered aspects on determinants for MF development and performance, especially on an "industrial" level, are almost non-existent.

Therefore, this research aims at producing a single and comprehensive study, unlike any so far works, with an endavore to take a holastic view on the topic of MF Industry performance in the RM and it's determinants. In doing so, the authors saw a distinct potential in gaining access to (i) significant (i.e.more comprehensive than prior studies) of particular MF's data, (ii) MFs experts (i.e. MF managers, and portfolio consultants) in order to design a research model that takes into consideration key determinants on MF performance in the RM, there by contributing to the field of research beyond only a pure financial evaluation of the MF Industry in the country of respect to this study.

1.6. **Purpose of Study**

As is the case with most researches, this particular research is conducted with an aim to provide empirical knowledge on the problem elaborated in this study, with a general objective to implement in practice the acquired results. Therefore, this study is aimed at both audiences: the academia, and practitioners in the MF Industry.

In such regard, the basic objective of this research is to provide a holistic description of the diversification phenomenon, as one of the elementary determinants which influences the development and growth of MF, and more so, as a contributor towards the overall economic development of countries. On these grounds, it is of essential importance to percieve the positioning and functioning of MF and the factors that govern their growth.

In respect to the methodological objectives of this study, it is of great significance to define the methods, techniques, processes and instruments through which the diversification of MF will be investigated, as an elementary function of their development.

The same is even more important, since in the R. of Macedonia, there is an almost insignificant opus of research on this matter. On the other hand, this research provides an opportunity no only to assess the existing scarce knowledge, but rather, to acquiry a new scholarly insight on the techniques, methods and instruments through which this phenomenon will be examined.

As for the practical objective of this research, the same lays in the practical implementation of the attained results. Namely, the outcomes of the study will portray the state of MF industy in Macedonia, which will produce usable knowledge on how to improve the development of the MF Industry in the country. Within the framework of the final objective, an independent functional model of portfolio diversification and strategies will be developed, to serve IF managers, and of benefit to potential investors in achieving hhigher returns on their investments in comparison to other forms of investments.

The specific objectives of the study is to:
– reasses the overall economic and financial preconditions for MF functioning and growth in the R. of Macedonia;
– reassess the institutional (legislative and regulatory) preconditions for the functioning and growth of MF in the R. of Macedonia;
– reasess the present position of MFs in the R. of Macedonia in comparison to peer countries, based on their size of assets, returns, costs and other performance characteristics;
– reassess the demand for MFs on the side of investors in the R.of Macedonia, based on their present and growth potential;
– reassess the demand for other forms of investments on the side of investors in the R. of Macedonia (savings deposits, insurance and pension contracts, and other);
– study the perception and behavior of Macedonian investors towards investing in MFs vs. investing in alternative forms of investments;
– develope a framework for their more propulsive growth of the MF Industry;discuss the need for MFs development as a contributing factor towards a more propulsive growth of the business sector (as an alternate source of financing).

The bellow Figure 1 summarizes the suggested approach in accordance of the audience's interests.
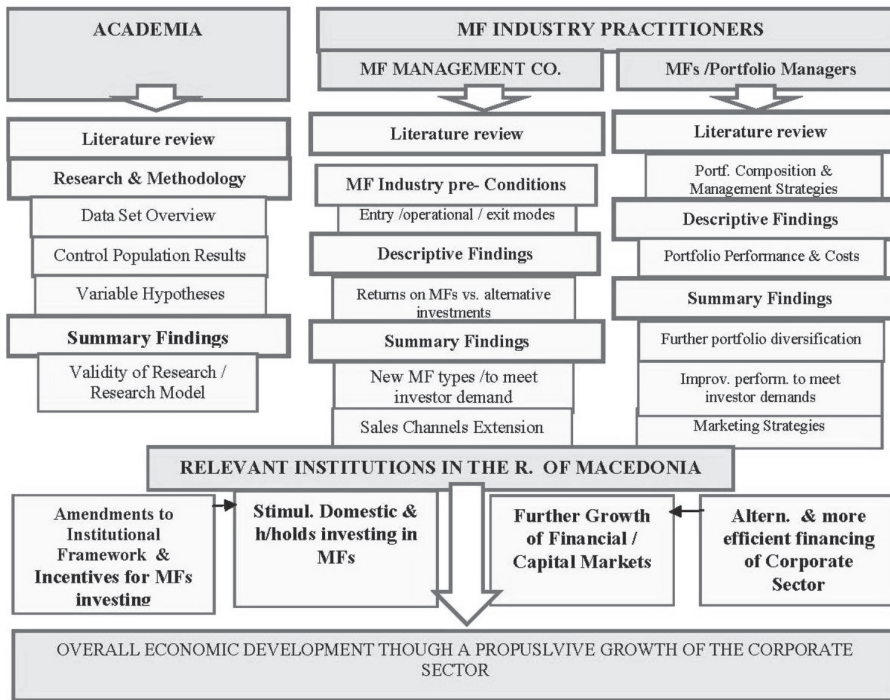
Figure 1. – Purpose of Study – Approach according to audience

1.7. **Scope and Limitations**

The scope of this research is to provide a broad and holistic overview for potential sources for the development of the MF Industry in the R.M. The chosen research design is built on the relevant pillars that determine the main drivers for the development of MF which are given equal attention, so that each set of determinants is considered to be distinctive and hence requires due and separate empirical analysis and approach.

The study is of an explanatory nature and attempts to provide an insight in current trends in the MF industry in the RM, offering adequate evaluation of MF performance. In such effort, a broad data set will be analyzed from a quantitative and qualitative point of view. In such respect, this research promotes an extensive graphical and descriptive presentation and discussion on the results. The tested variables will be analyzed in accordance to group and sub-group samples in the empirical section of this study. The results from the analysis will need to be in-line with the descriptive findings, on the grounds of which the trends and recommendations will be validated.

Flowingly, this study's limitations may be considered to be two fold. First, due to the holistic approach of the research design of this research, and hence, the complexity resulting from the gamma of provided variables which will be tested, the overall research model may lose a certain degree of transparency. Namely, the author considers the empirical part of this research to be a fertile ground for further research which eventually must be extended to further literature exploration in the field, and as a base for further testing. Furthermore, this study is not intended in providing exact and educated indication on the levels of MF performance and returns, which is of interest to potential investors in MF, in which case this research would need to be based on exact, time-sensitive evaluation on net returns, adjusted by market and other risk factors.

Instead, this research in exclusively concentrated with the illumination of actual observed levels of MF performance in the RM, and their comparison with MF performance neighboring-relevant markets, as an alternative investment option for potential investors, based on performance determinants from three major sources – market and financial, portfolio diversification and management strategies.

1.8. **Organisation of the Research**

The structure of the book is designed in five parts.

The first, introductory part, has already overviewed the significance of developed financial markets for the overall economic growth of countries, and the role of MF on financial markets in advanced economies, as well as their magnitude on a global level. As an introduction to the essence of this dissertation, a brief comparison was made with the MF performance on the Macedonian financial markets, stating their enormous lagging behind the MF on developed markets. In this introductory part, an outline of the main causes for writing this study as well as the problem and problem statement of the research, is duly treated. Conclusively in this part, the need, purpose and the scope and limitations of the thesis are determined.

The second part, considers the literature which treats the various aspects of MF in relevance to this study, systematized in three categories. The first part aims at providing general aspects and concepts behind MFs and their significance on global, regional and particular markets through a critical insight on a theoretical and empirical level. While the second part, in its two sub-parts provide a theoretical overview on the determinants for the development and growth of MFs on

a supply and demand side basis, approached from an exogenous to endogenous level. Consequently in the third part, an overview on the existent academic literature will be performed – although scarce – pertaining to MFs in the R. of Macedonia and peer countries, of relevance to this study.

The third part, elaborates on the model of the performed research itself, based on the selected design and methodology (methods, techniques and procedures), used on the specified research sample(s), along with the data considerations needed in the process of analysis and testing.

The fourth part, produces the empirical results-findings providing a summary of the research plan, procedures, tested hypotheses and supporting elements.

The final part, presents the conclusions and perspectives drawn based on findings, with considering remarks on the impact of the study, it's implication on a scholarly and practical level, as well as recommendations for further research and changes in academic concepts and theoretical approaches, and practical recommendations to be implemented in practice, leading towards a more dynamic growth of MF in the country of respect.