
MUTUAL FUNDS - AN ALTERNATIVE WAY OF INVESTING

Vladimir Gonovski

ECPD Belgrade, Serbia gonovski@gmail.com

Abstract: Worldwide mutual funds have a long history, but in Republic Macedonia are a relatively new financial instrument. The general public has insufficient information about mutual funds, they don't know about their opportunities, but on the contrary, a big number of citizens have uncertainty about investing in mutual funds.

Mutual funds are financial intermediaries that bind the money from many investors and then invest in securities with the help of professional managers who manage these funds.

The roots of the mutual funds originate from the XVII century, when the UK and the Netherlands begin with the establishment of such funds. It is thought that the first fund was established in 1774 year by the Dutch merchant Adriaan van Ketwich. He pools money from a number of subscribers to form an investment trust.

From then until the 90s of the twentieth century, it is noted gradual development of mutual funds worldwide. Normally in this process, developed countries led by the USA are countries where are mostly mutual funds, counting as the number of funds and the size of funds. For increase development lately big importance have development of law, regulation and supervision of mutual funds in all countries. Also, very important for the development of mutual funds are:

The level of savings - If the state has a large middle class that has enough savings, the possibility of developing mutual fund is bigger.

Policymakers - if a country's mutual funds are already present, policymakers in that country should recognize the influence of the whole economy, and to take measures that will enable the continuation and improvement of the impact of mutual funds.

Flexibility in mutual funds - if the legal framework does not enable innovative fund structures, mutual funds will not develop with appropriate dynamic.

Keywords: mutual funds, investment, investor.

INTRODUCTION

Mutual funds as a financial instrument are present long time, but the literature associated with them begins to develop with faster steps in the last 20-30 years. This is especially true for developing countries and underdeveloped countries because mutual funds in them appear in the same period. Many authors define mutual funds and will be listed several definitions of them.

A mutual fund is a company that pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt. The combined holdings of the mutual fund are known as its portfolio. Investors buy shares in mutual funds. Each share represents an investor's part ownership in the fund and the income it generates (Investor.gov, 2017).

A mutual fund is a type of investment fund. An investment fund is a collection of investments, such as stocks, bonds or other funds. Unlike most other types of investment funds, mutual funds are "open-ended," which means as more people invest the fund issues new units or shares (Canadian Securities Administrators, 2012).

Cvetanovski and Kožuharov (2016) say mutual fund is 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.

Mutual funds are investment companies that collect savings from many individual investors and invest those savings in a wide range of financial assets or securities. The funds' pooling of individual savings makes it possible for small investors to obtain fractional shares of many different securities and thereby enables them to gain the benefits of diversification and lower transaction costs. For households with limited wealth, mutual funds provide one of the only practical means to own a diversified portfolio of stocks and bonds. It is well established that owning such a portfolio provides significant advantages for building a retirement nest egg (Carlson John B. et al, 2004:1).

Mutual funds are a product of the globalization of financial markets and represent financial instrument that can be a source of capital, especially in emerging economies. With their help free money from many investors are collected and these funds are invested in securities.

PROS AND CONS IN MUTUAL FUNDS

When someone decides to invest his goal is to achieve returns from investment with minimal risk. But for successful investment individual must possess great knowledge, ongoing research, expertise that not every individual possesses. Because of that mutual funds offer a number of benefits for investors :

- Diversification - by investing fund in mutual funds individuals minimize risk that may arise from investment in individual stocks and bonds by giving shares in many different assets. Mutual funds invest in dozens of different investment securities, making it possible to achieve diversification by investing in just one fund.
- Professional management - mutual funds are managed by professional managers who have the necessary knowledge and experience in managing such funds. They have a research team to help them in managing, teams that perform a variety of analyses with purpose of successful venture funds. No need to expect that these managers will invest funds without errors, but the fund managers are in a better position to manage investments and get higher returns.
- Affordability – mutual funds have low minimums. Any small investor cannot afford to buy shares of major corporations. But investing in mutual funds does not require any major assets. For example, in the USA can make a minimum investment of \$1,000 and in India it is Rs500.
- Range of investment options - mutual fund suits the needs of individual investors. Depending on the wishes of the investor anyone can decide to invest in funds with larger, smaller or a combined risk. Investments may be in multiple asset classes, including share, bonds and money market funds. When you have changes in your life, it is easy to rearrange your portfolio to suit your altered lifestyle.
- Reinvestment of Income - Another benefit of investing in mutual funds is that they allow profit to be reinvested in the fund without any additional costs. In other types of investments we have additional costs for each new investment, but in mutual funds these costs are absent.
- Transparency - operation of funds is under the supervision of many state institutions, is evaluated by many rating agencies and many financial publications are writing about them, so that investors have a chance easily to make comparisons between funds and make the best choices for themselves.

However, although they have numerous benefits mutual funds carry certain dangers for investors who should also be taken into consideration. It will be listed several of the major dangers that bring mutual funds:

- Fees and Expenses - management of mutual funds is carried out by professional managers and management entails costs. Cost management or salaries of the fund are paid regardless of whether and how much profit is generated. And some funds buy and trade shares so often that the transaction costs add up significantly. These fees are assessed to mutual fund investors regardless of the performance of the fund.
- Dilution: Although diversification reduces the amount of risk of investing in mutual funds, on the other hand is an obstacle to achieving greater gains. Given that the stakes in certain security that are profitable is only a small part of the fund's portfolio, the possibility of increased profit decreases. It is neither good nor bad side, so you can choose mutual funds whose portfolio follow an asset allocation model.
- Uncertainty - investors don't know what are buying specifically, so they are totally relying on the expertise of the manager.
- Inefficiency of Cash Reserves - mutual funds usually maintain large cash reserves because some members of the fund from time to time want to withdraw money. For this purpose the fund in order to have bigger liquidity and maintain its reputation rather than to invest the assets he holds a certain amount of cash, which instead brings profit stands in cash.
- Poor Performance: Returns on a mutual fund are by no means guaranteed. In fact, on average, around 75% of all mutual funds fail to beat the major market indexes, like the S&P 500, and a growing number of critics now question whether or not professional money managers have better stock-picking capabilities than the average investor (Investor Guide Staff, 2017).

Research of the pros and cons of mutual funds in Republic Macedonia are in their infancy. In regards to the legislative preconditions which have led to the slow growth of investment funds industry in the Republic of Macedonia, of validity are the findings of Pendovska i Koevski (2000) in Cvetanovski and Kožuharov (2016), which determine that the enforcement of the Law on investment funds is not sufficient, and that its implementation is not feasible without adequate mechanisms, control and supervision.

Although mutual funds in Republic of Macedonia are not yet sufficiently developed, does not mean that there is no need of them. Current underdevelopment of mutual funds is not the result of wrong economic policy, but

the Republic of Macedonia as a young state with all its economic, political and other problems can reach only these stage of development.

Because of several shocks in the past with the banking sector, resulted in the loss of deposits, among the citizens of Macedonia rule scepticism in terms of keeping money in banks. Despite confidence in the banks has increased in the last period and the banks registered a steady increase in the deposit base, however there are still many financial assets that citizens keep "below the pillow". Interest rates on savings in the country tend to decline, much like what happens in the European Union, but with a slower pace, and as a result, it is necessary to implement a number of actions which will popularized mutual funds. It would be normal that savings that are successfully managed from mutual funds to carry higher yields than keeping them in the bank, so here should be a chance for popularization of mutual funds. Collection of free savings of investors (regardless whether they are companies or citizens) on the one hand will enable their better profitability than if it would do any investor individually, on the other hand the beneficiaries of the funds will get easier way of getting to liquidity and investment funds, and doing it without taking loans from banks.

REGULATION OF MUTUAL FUNDS IN CERTAIN COUNTRIES IN THE WORLD AND IN MACEDONIA

A mutual fund sector will not expand strongly unless people are confident that mutual funds are worthy of their trust. Thus law and regulation must adequately protect investors, and a regulator must effectively and fairly enforce this legal and regulatory framework. A weak legal and regulatory framework or failure to enforce compliance with an adequate framework can negatively affect the mutual fund industry. (The World Bank, 2015)

When it comes to the regulation of mutual funds possible types of entities who can regulate the mutual fund sector usually in most of country of the world are :

- Central banks
- Securities Markets Authority
- Securities markets regulatory authorities
- “Mega regulators”
- Nonbank financial institutions regulatory authorities

In some countries, instead of these entities occur as a regulator, the right to regulate is given to Self-Regulatory Organizations and Trade Associations or Third-Party Regulation.

Regardless of the entity which regulates the operation of mutual funds, the rules under which these entities work should be updated appropriately to the new market conditions from time to time.

It will be mentioned some entity form couple countries that regulate mutual funds in them.

In USA like biggest county which have most mutual funds in world regulation is done by the U.S. Securities and Exchange Commission, which mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

In India regulation is done by the Securities and exchange board of India (SEBI) which the basic functions are to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto.

In Canada regulation is done by The Investment Funds Institute of Canada, and in the European Union is done by the European Commission.

Mutual funds as a form of investment in the Republic of Macedonia are in their infancy, and as a result it has not yet fully established rules. According to the law on investment funds in Macedonia, regulation of the establishment and operation of investment funds and companies, the management of investment funds, the issuance and sale of shares and stocks, redemption of shares, the promotion of investment funds, works for the investment funds performed by third parties and operation of the depository bank, responsible is a Commission for securities to perform work for the establishment and management of investment funds.

At the moment, according Commission for securities, the structure of the participants in the investment work in the Republic of Macedonia consists of:

- Five companies for management of funds: Ilirika FM AD Skopje, Inovo Status A.D. Skopje, KD Fondovi A.D Skopje, KB Publikum invest A.D.Skopje, WFP fond management A.D Skopje. – Thirteen open funds : Ilirika Southeast Europe open investment fund, Ilirika Global Emerging Markets open-end investment fund, Inovo Status Shares Open Investment Fund, KD Nova EU, KD BRIC, Open-end Investment Fund KB Publikum – Balanced, Open-end Investment Fund KB Publikum-Bonds, Open-end Investment Fund KB Publikum – Cash, KD Cash Deposit - open-end investment fund, Illyria Cash Fund - an open-end investment fund, KD Top Brands - open-end

investment fund, WFP CASH DEPOSIT - open-end investment fund, WFP PREMIUM INVEST - open-end investment fund, WFP 100% BOND - open-end investment fund.

- Ten private funds: Small Investment Fund, Fisher OMEGA Private Investment Fund, Fisher ALPHA, Fisher DELTA, Fisher GAMA, Fisher theta, Nova Investment, BAUART Capital Investments Fund, Micro Investment Fund, ALSAR First Hedge Fund - a private fund.

- Six authorized Banks: Komercijalna Banka AD Skopje - Directorate for providing securities, Stopanska Banka AD Skopje - Department for work with securities and brokerage - intermediary services, TTK Banka AD Skopje - Department for work with securities, NLB Banka AD Skopje Office services in securities, Eurostandard Banka AD Skopje - Management services in securities, Sparkasse Bank Makedonija AD Skopje - Department for work with securities.

- Two depository custodian banks: NLB Tutunska banka AD Skopje, Komercijalna Banka AD Skopje

All the above mentioned institutions and organizations constitute part of the legal framework which handles matters related to mutual funds in Republic Macedonia. Like Cvetanovski and Kožuharov (2016) recommended further reforms are required, which encompass the entire financial system which in essence provides the framework for overall functioning of financial markets, institutions and investment companies. These recommendations relate to: amendments of the Banking Law, establishing a coordinating body responsible for improved financial education among regulatory institutions, drafting a new law on insurance aligned, preparing an act on final settlement in payment systems and settlement of securities aligned with EU Directives and additional amendments to the Law on Investment Funds aligned with EU Directives and by deriving from it.

CONCLUSION

Mutual funds have a number of advantages, but also have their drawbacks. Although revenue from mutual funds is smaller comparing with investment directly in stocks, they mean achieving more profit than getting interest from a bank with a more acceptable level of risk than investing in stocks independently directly in the stock exchange.

Studies show that in the Republic of Macedonia there is little awareness about the benefits of mutual funds. Promotion measures should be directed for greater familiarization with the possibilities of mutual funds and not only by the funds themselves, but also from government and non-governmental organizations dealing with this topic. They should implement a number of information campaigns to increase awareness of mutual funds and the benefits they offer.

The legislation is not perfect, but corresponds to the situation in the Republic of Macedonia, and should continue its improvement. Only by the improving of the economic condition in Macedonia and strengthening the middle class will mean improving the conditions in Macedonia for investment in mutual fund and these itself will pull a review of the legal framework for the operation of mutual funds.

BIBLIOGRAPHY

- [1] About, Inc (2017) The Best Advantages of Investing in Mutual Funds Available at: <https://www.thebalance.com/top-benefits-of-mutual-funds-2466564> [Accessed 05.04.2017].
- [2] Ajay Khorana, Henri Servaes and Peter Tufano (2003) the World of Mutual Funds,
- [3] Albert J. Fredman (1996) The Mutual Fund Route to the Growth Potential of Emerging Markets, AAI Journal. Available at: <https://www.aai.com/journal/article/the-mutual-fund-route-to-the-growth-potential-of-emerging-markets> [Accessed 06.04.2017].
- [4] Canadian Securities Administrators (2012), Understanding mutual funds. Available at: http://www.osc.gov.on.ca/documents/en/Investors/res_mutual-funds_en.pdf [Accessed 03.04.2017].
- [5] Darden School of Business Working Paper No. 03-04; Harvard NOM Working Paper No. 03-23; EFA 2003 Annual Conference Paper No. 804 Available at: <http://www.worldlii.org/int/journals/lsn/abstracts/399723.html> [Accessed 04.04.2017].
- [6] Dragica Odzaklieska, Kosta Sotirovski, Marinela Todorovska, (2013). Development Perspectives of Investment Funds in Republic of Macedonia, TEM Journal, 2(4), 341-349.
- [7] Eurobank.gr (2017) Advantages and Disadvantages of Mutual Funds Available at: https://www.eurobank.gr/Uploads/pdf/UCITS_Advantages_Disadvantages.pdf [Accessed 05.04.2017].
- [8] Franklin Templeton Investments (1999-2017) Benefits of investing in a mutual fund. Available at: http://www.franklintempletonindia.com/en_IN/investor/investor-education/fund-basics/mutual-fund-advantages [Accessed 05.04.2017].

- [9] Investor Guide Staff (2017) investorguide.com. Available at: <http://www.investorguide.com/article/11139/disadvantages-of-investing-in-mutual-funds-igu/> [Accessed 05.04.2017].
- [10] Investor.gov (2017) The U.S. Securities and Exchange Commission. Available at: <https://www.investor.gov/investing-basics/investment-products/mutual-funds> [Accessed 03.04.2017].
- [11] John B. Carlson, Eduard A. Pelz, Erkin Y. Sahinoz (2004) Federal Reserve Bank of Cleveland Economic Commentary, Mutual Funds, Fee Transparency. Available at: <https://www.clevelandfed.org/~media/content/newsroom%20and%20events/publications/economic%20commentary/2004/ec%2020040301%20mutual%20funds%20fee%20transparency%20and%20competition%20pdf.pdf?la=en> [Accessed 04.04.2017].
- [12] John B. Carlson, Eduard A. Pelz, Erkin Y. Sahinoz (2004) Mutual Funds, Fee Transparency, and Competition, published by the Research Department of the Federal Reserve Bank of Cleveland.
- [13] MoneyTips (2017) Pros and Cons of Mutual Funds, What you Need to Know before Buying Mutual Funds. Available at: <https://www.moneytips.com/pros-and-cons-of-mutual-funds> [Accessed 06.04.2017].
- [14] Nebojša Cvetanovski and Sašo Kožuharov (2016) Mutual funds in the Republic of Macedonia. Belgrade: European Center for Peace and Development (ECPD).
- [15] Snezana Mojsoska and Sase Gerasimoski(2012), Functioning of investment funds in Republic of Macedonia in terms of changing environment, Procedia - Social and Behavioral Sciences 44 (2012) 446 – 452
- [16] The World Bank (2015) Mutual Funds in Developing Markets: Addressing Challenges to Growth. Washington DC: Publishing and Knowledge Division, The World Bank.

APENDIX 1

| Best Global / International Mutual funds for 2016 | | | | | | |
|--|-------------|----------------------------------|---|-------|-------|-------|
| Mutual Fund Scheme | Crisil Rank | Value Research Rating (Out of 5) | Assets under Management (AUM) (Rs Crores) | 1yr | 3yr | 5yr |
| ICICI Pru US Bluechip Equity | NA | NA | 151 | 6.7% | 15.0% | NA |
| DSP-BR World Gold | NA | NA | 290 | 41.9% | 10.5% | -3.9% |
| Kotak World Gold Fund - Standard | NA | NA | 46 | 36.0% | 9.9% | -5.6% |
| Birla Sun Life Global Real Estate Fund - Retail Plan | NA | NA | 22 | 11.1% | 8.0% | NA |
| ICICI Pru Global Stable Eqty | NA | NA | 91 | 10.2% | NA | NA |

Myinvestmentideas.com

Data source: Moneycontrol.com and Value Research Online as on 25-Jun-16. Returns rounded off to nearest %age

APENDIX 2.

| Worldwide Total Net Assets of Mutual Fund | | | | | | | |
|--|----------|----------|----------|----------|----------|----------|----------|
| Country | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| USA | 11470489 | 13423089 | 10581988 | 12578593 | 13598071 | 13530122 | 15139998 |
| EUROPE | 7803877 | 8934861 | 6231116 | 7545535 | 7903389 | 7220298 | 8230061 |
| CHINA | N/A | 434063 | 276303 | 381207 | 364985 | 339037 | 437449 |
| INDIA | 58219 | 108582 | 62805 | 130284 | 111421 | 87519 | 114489 |
| Africa | 78026 | 95221 | 69417 | 106261 | 141615 | 124976 | 145150 |

Sources: Rajesh Kumar MBA(Finance), ACS, AIII , Sep 18, 2014 <https://www.slideshare.net/raj01fm07/mutual-fund-39257246>

APENDIX 3.

| Country | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|----------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| USA | 14475 | 15459 | 16459 | 16932 | 17993 | 19753 | 20103 |
| EUROPE | 33151 | 35210 | 36780 | 34899 | 35292 | 35713 | 34470 |
| CHINA | N/A | 341 | 429 | 547 | 660 | 831 | 1065 |
| INDIA | 468 | 555 | 551 | 590 | 658 | 680 | 682 |
| Africa | 750 | 831 | 884 | 904 | 943 | 947 | 967 |

Sources: Rajesh Kumar MBA(Finance), ACS, AIII , Sep 18, 2014 <https://www.slideshare.net/raj01fm07/mutual-fund-39257246>