CURRENT AND POSSIBLE RISK MANAGEMENT STRATEGIES FOR INVESTMENT FUNDS - CASE OF MACEDONIA

Vera Karadjova, PhD[19]

Katerina Angelevska Najdeska, PhD[20]

ABSTRACT

Performing mediation between individual investors and securities issuers Investment Funds as non-bank financial institutions take up an important position in countries with developed financial structure. Risks diversification as a fundamental principle of investment policy requires a need for investments in a full range of securities, versus investing only in a few of them. Investment Funds provide just that, which means collection of financial funds from individual investors and invest them in the potential range of securities or other assets. Thus, Investment Funds provide a mechanism of "teamwork association" of small investors in order to gain the benefits of large-scale investment. In this sense, Investment Funds can play an important role in the investment activity of small and medium-sized businesses.

Republic of Macedonia as a country with bank-centric financial structure despite the stimulation of non-bank financial institutions such as insurance companies and pension funds, stimulate the development of Investment Funds too. Having in mind their relatively recent occurrence and the small participation in the financial system, risk management in Investment Funds have no experiential elements. The process of risks management must rely on theoretical knowledge, as well as on the experience of countries with many years of tradition. In this sense, the paper explored current and potential strategies for managing risks in Investment Funds.

Key words: *Investment Funds, Risk Management Strategies, Risk Diversification, Republic of Macedonia, Financial Structure*

JEL Classification: *G23*

UDK: 336.07(497.7) 330.322.12:005.334

[19]Vera Karadjova, Faculty of tourism and hospitality, Ohrid, Republic of Macedonia, verakaradzo@yahoo.com

[20]Katerina Angelevska Najdeska, Faculty of tourism and hospitality, Ohrid, Republic of Macedonia, k_angel_naj@yahoo.co.uk

INTRODUCTION

Investment funds (mutual funds) that function as non-bank financial institutions perform mediation between individual investors and issuers of securities as surplus and deficient economic entities. In this, they implement the strategy of risk diversification as a fundamental principle of investment policy which in turn implies a need for investment in a whole range of securities, as opposed to investing in only a few of them. Investment funds provide just that, i.e. mobilization and accumulation of "small" amounts of surplus subjects and their investment in the potential range of securities with different risk and maturity. Thus, investment funds allow the use of the benefits of large-scale investment. Funds are managed by investment companies - Companies for managing Investment funds that provide professional management of the fund. Basic activities that investment companies (management companies) pursue for the investment funds are:

- Administration and documentation recording;
- Diversification;
- Increased liquidity;
- Professional management;
- Tax incentives; and
- Low cost of transactions.

The management companies often own and manage several investment funds. The main feature of the investment funds in terms of legal separation of the assets collected and invested in different targets gives them a character of professionally managed groups of securities that are owned by a group of investors. Monetary assets of the members are units in the fund, and the basic difference of the units from stocks is that units entitle the profits from investments of the fund, but not the right of management or that right is limited. The founders of the fund itself undertake the organization of the fund assets professional management.

TYPES OF FUNDS AND FUNDS YIELDS

Two basic types of investment funds are known as *open* and *closed* investment funds.

- Open-ended investment funds (open - end, Mutual funds, Unit trusts) are ready at any moment to buy or sell their shares. Thus, the extent to which the fund dispose has not been fixed, but continually adapt to the mood of investors. By investing money in the fund new shares are created and the volume of the fund increases. At the request of its members, the fund is obligated to buy back the sold shares, and any such repurchase means reducing the number of units and the size of the fund. At any moment the

fund is ready to sell new, but also to buy back the issued units by the current market price. Funds spread or lower depending on demand. Emitting additional units, the fund collects funds for buying new securities. The limits of expansion and reduction of the fund is determined solely by market demand and investor interest.

- Closed Investment Funds (closed - end, Investment trusts) emit a fixed amount of securities which will initially will be sold on the primary market by public offer. The number of units is fixed and the Fund shall not buy back. Securities of closed-end funds are sold on stock exchanges or on the OTC market at a price determined by supply and demand. This means that the price may rise above or fall below the net value of the security. According to the directives of the European Union, open funds are treated as investment funds, while closed-end funds are treated as companies. Closed funds function as classical joint stock companies and funds collected from the sale of shares invest in securities.

Although historically closed investment funds occurred before the open, today dominate open investment funds. "The relationship between the assets of open and closed funds is approximately 20:1 in USA. In Germany and some other countries of continental Europe only open investment funds exist", (Ćirović, 1995, pp. 205). In developed countries, investment funds dominate the traditional markets of other financial institutions, including those of banks when we talk about time deposits and loans, pension funds when we talk about pension plans and insurance institutions in the field of life insurance. This dynamic growth of investment funds is due primarily to: (Maksimović, 2006, pp. 3)

- possibility of achieving relatively high yields (much larger than the interest on term deposits);
- greater diversification of the portfolio, which provides a greater degree of certainty;

High level of liquidity (ability to obtain invested funds in short term on the attached bank account).

Development of the Investment funds in developed countries result in a particular specialization of Investment funds, so there are generally three different categories of funds according to the market material in which they invest: (1) funds that invest in stocks (Stock funds); (2) investment funds that invest in bonds (Time bond funds); (3) investment funds that invest in market money instruments (Money market mutual funds). Funds can also be classified according to that whether they are or they are nor the subject of tax payment. Further specialization of funds according to specific investment objectives enabled the emergence and development of many subspecies of investment funds, including: funds that invest in indexes (Index funds), for example S&P 500; branch funds; national funds; regional funds; global funds; international funds; Funds for risk covering (hedge funds); green and other ethical funds; etc.

The yield that units owners in investment funds realized consist of two components: (a) returns realized in the form of stock dividend or interest on the bonds that are in the portfolio of the fund; and (2) part arising from the current value of the net assets of the investment fund, which fully determines the market price of the units of the Fund. This earned revenues (reduced by fees and expenses) the fund distributed or paid to investors in accordance with their participation in the Fund.

After setting the investment strategy, the investment funds are required to publish the *Prospectus of the fund*, which will provide a detailed insight into the fund, the fund's objectives, expected costs, management that will manage the fund and so on. All potential investors must obtain a Prospectus, before deciding their funds to invest in a specific fund.

The most significant parts of the Prospectus are relating to:

- Investment objectives - which are divided into three categories: achieving current income, providing future growth or a combination of the previous two objectives;
- Investment programme;
- Method of management;
- Mode of buying and selling units;
- Payment of fees and costs - through with operating costs reimbursable. The fees cover the costs of portfolio managers, expenses that fund have on financial markets, as well as the cost of advertising which are especially important in open investment funds. The fees range from 0.5% to 8.5%, depending on which securities the fund invests, although fees can usually be between 3 and 5%;
- Effects of investing;
- Operations results - performances of the fund in the past or whether it was realized a profit or loss in the operation of the fund. Fund performance can be assessed in three ways:

1.By monitoring the changes in the prices of units in the fund or the net value of the property, which has grown by expanding the portfolio of the fund and it is calculated:

$$Changes\,in\,assets\,net\,value = \frac{\text{fund value}}{\text{number if units in the fund}} \quad (1)$$

2.By calculation yields

$$Yield = \frac{\text{divident by unit}}{\text{price of a unit}}\% \quad (2)$$

3.By calculating the total revenues, calculated on an investment in a specific period

$$Total\ Yield = \frac{\text{number of units} \times \text{net value}}{\text{price of the initial investment}} \quad (3)$$

INVESTMENT FUNDS IN MACEDONIA

Investment Funds in Macedonia started to work even in 2007, although it was legal possibility for that from 2000. Namely, The Law on Investment Funds was adopted in February 2000 and published in the Official Gazette No.9/2000 from 10.02.2000. It has changed with amendments of 09.03.2007, when actually starts the practical operation of investment funds in Macedonia. At the end of 2007 began working two Companies for managing Investment funds. That year there were eight private investment funds that do not sell their units publicly and did not have status of legal entity. Among other factors, one reason for opening the funds was reducing initial capital required for the work of open funds from 2,000,000 to 500,000 Euros, (Petkovski, 2009, pp. 350). The legal changes in 2007 allowed the possibility of opening private investment funds too. However, in 2009 a new Law on Investment Funds (Law on Investment Funds, No.12, 2009) was adopted, which law passed in 2000 and amended in 2007 was repeal. Law on Investment Funds provides that within two months after the announcement of the public offer for subscription of units in open-end fund, open fund have to collect funds in the amount of at least EUR 300.000,00 in Denar equivalent, using an intermediate exchange rate of the NBRM on the day when the funds are fully collected, (Law on Investment Funds, No.12, 2009, Article 58, paragraph 2).

Law on Investment Funds defines investment funds as affiliated monetary assets intended for investment, collected from investors through a public offer or private call, managed on behalf of investors by a fund management company. The value of the investment fund assets is the sum of the value of the securities in the investment fund portfolio, the fund's cash deposits in banks and other assets of the fund. The net value of the investment fund is the value of the assets less the amount of the liabilities of the fund. The Company for managing Investment funds is a joint Stock Company based in the Republic of Macedonia which has been granted a license by the Commission for the Securities to perform activities about establishment and management of investment funds. One company for managing investment funds can manage multiple investment funds. Least nominal amount the basic capital required for the establishment of a management company is 125,000 Euros in denar counter-value, at the average rate of the National Bank of the Republic of Macedonia on the day of application submission for permitting activities of managing investment funds to the Securities and Exchange Commission, (Law on Investment Funds, No.12, 2009, Article 5, paragraph 1). Supervise the operation of investment funds and investment funds management companies performed Securities and Exchange Commission.

According to the Securities and Exchange Commission Macedonia have 4 active companies managing investment funds, including:

Table 1:Companies for managing Investment funds

No.	Full name of the Company for managing investment funds	Nominal amount the Company basic capital (in EUR)	Date of approval on the company	Date of entry in Register
1.	Company for managing funds KB Publikum Invest AD Skopje	700,000.00	15.01.2009	22.04.2009
2.	Company for managing funds Ilirika Fund Management AD Skopje	500,000.00	02.07.2007	02.07.2007
3.	Company for managing funds Inovo Status AD Skopje	167,654.00	08.08.2007	21.08.2007
4.	Company for managing funds KD FONDOVI AD Skopje	695,000,00	19.05.2008	09.10.2008

Source: http://www.sec.gov.mk/default.aspx?item= associationsuif&subitem=associationsuiflist

Law on Investment Funds allows the existence of open, closed and private investment funds. Currently, Macedonia has active 11 open and 15 private funds. In February 2010 liquidated two investment funds that failed to cope with the consequences of the economic crisis on the financial markets were liquidated and only six survived and later 5 more open investment funds were established. Open funds which remain secured census of 300 thousand Euros, which impose to them Ministry of finance, and which is actually the legal imperative. Despite the risks and problems that are realistic in the long term is expected stabilization and profitable operation. In the investment funds in Macedonia in 2009 were invested 2.5 million Euros, which is the lowest amount of money in the region. In the funds in Serbia were invested 10 million, 160 million in Bulgaria, Croatia even 1.6 billion Euros, while in Slovenia 1.9 billion Euros. In 2012, investment funds still have very little importance within the Macedonian financial system. Despite the relatively rapid growth, their share in the total assets of financial institutions accounted for only 0.1%. Inflows of funds from the sale of unit certificates in 2012 increased, but it is also observed increased outflows of funds from investment funds based on the redemption of unit certificates. However, net - proceeds on this basis contributed to the increase in the assets of open-end investment funds. Moreover, due to favorable movements of the financial markets that investment funds have invested, in the last quarter of 2012 nominal annual yield of the investment funds received positive values. However, companies that manage investment funds continue to operate with a negative financial result, (Statement of financial stability in the Republic of Macedonia 2012, July 2013, pp. 139). The analysis in the previously mentioned Statement not include private investment funds and management companies of private funds, having in mind the fact that according to the Law on Investment Funds, (Law on Investment Funds, No.12,

2009, No.67, 2010 and No.24, 2011), in the Republic of Macedonia there is not planned supervision of private funds or companies authorized to manage private funds nor the obligation to submit regular reports to the appropriate authority.

Table 2: Open-end funds in the Republic of Macedonia

No.	Full name of the open-end fund	Date of entry of the open Investment fund in the Register	Full name of the Company for managing investment funds
1.	Ilirika Global – Emerging open-ended investment fund	31.10.2007	Company for managing funds Ilirika Fund Management AD Skopje
2.	Ilirika Southeast Europe open-ended investment fund	26.10.2007	Company for managing funds Ilirika Fund Management AD Skopje
3.	Ilirika Cash Fund open-ended investment fund	28.12.2012	Company for managing funds Ilirika Fund Management AD Skopje
4.	Innovo Status Akcii open-ended investment fund	31.10.2007	Company for managing funds Inovo Status AD Skopje
5.	KD BRIC open-ended investment fund	09.10.2008	Company for managing funds KD FONDOVI AD Skopje
6.	KD Cash Depozit – open Investment fund	12.07.2012	Company for managing funds KD FONDOVI AD Skopje
7.	KD Nova EU open-ended investment fund	09.10.2008	Company for managing funds KD FONDOVI AD Skopje
8.	KD Top Brends open-ended investment fund	12.05.2014	Company for managing funds KD FONDOVI AD Skopje
9.	KB Publikum – Balansiran open ended investment fund	22.04.2009	Company for managing funds KB Publikum Invest AD Skopje
10.	Open-ended investment fund KB Publikum – Cash	17.03.2011	Company for managing funds KB Publikum Invest AD Skopje
11.	Open-ended investment fund KB Publikum – Bonds	17.03.2011	Company for managing funds KB Publikum Invest AD Skopje

Source:
http://www.sec.gov.mk/default.aspx?item=openfunds&subitem=openfundslist

It is evident that two companies for managing investment funds (Company for managing funds Ilirika Fund Management AD Skopje and Company for managing funds KB Publikum Invest AD Skopje) manage three investment funds, Company for managing funds KD FONDOVI AD Skopje manages four investment funds and Company for managing funds Inovo Status AD Skopje manages only one investment fund.

MANAGING RISKS IN INVESTMENT FUNDS IN THE REPUBLIC OF MACEDONIA

Investment funds fall within non-bank financial institutions whose participation in countries with underdeveloped financial structure is relatively small. In this sense, Republic of Macedonia stimulates increased participation of non-bank financial institutions, including insurance companies, pension funds and investment funds. Considering their relatively recent phenomenon and the small participation in the financial system, they have no experiential element in risk management. The process of risk management must rely on theoretical knowledge and the experience of countries with many years of tradition.

When making the decision to invest in investment funds, investors are mostly governed by the amount of the yields in a certain period, while very rare or little are concerned about the amount of risk the fund has taken in the selection of securities in which investments (formation of its portfolio). "The risk of the Fund is directly transferred to investors, rather than just submitting by the fund as a financial intermediary"(Vasiljević,2002, pp.116). Very often, especially in underdeveloped financial structures, investors cannot be thoroughly informed about the relationship between the amount and impact of risk and returns that funds exercise, nor by the funds work statements. Risk as uncertainty that represents the difference between the future and the expected yields in nature is neither positive nor negative category.Therefore, the objective of risk management is not risk elimination, but finding an adequate relationship between the risk taken and the expected yield. The difference between the risk taken and the realized rate of return on risk-free securities is defined as the Risk premium. The Risk premium is determined by uniting the various types of risks including: market risk, business risk, inflation risk, financial risk, political risk, currency risk, liquidity risk etc. "Conditioning between the yield and the risk (Risk-Return Trade-off) in the investment process is the ability of a investor to estimate the extent of acceptable risk which accompany the expected yield",(Vasiljević,2002, pp.59). In this, it must be taken into mind the fact that a very little number of investors (or a fraction of their investment) would like to invest only in risk-free securities, i.e. in government bonds.

The classification of the risk of investment portfolio to systematic and unsystematic risk leads to the development of modern portfolio strategies. Analyzing the systemic risk as the risk connected to the market, and unsystematic as a risk connected to unique factors (conditions) of certain specific portfolio of the investment fund, the risk management of investment funds may use some of the already developed statistical measures that help in determining the level of the investment risk. By using these methods, can be determine:

- The volatility of the fund (standard deviation);
- The extent to which the fund has expressed particular market index (R^2);
- β index (volatility related to the corresponding market index);
- α index (level of risk depends on the managers abilities).

The standard deviation as a measure of dispersion represents the oscillation of individual returns in correlation to average returns in a certain period of time. Although it may be acceptable as average expressed yield, the risk that has large oscillations (several extremely good and extremely bad years in a long time) can be evaluated by investors as unacceptable.

Coefficient R^2 shows the results of the Fund expressed in percentages, or the results depending on the market impact (systematic risk). The difference among the value of the R^2 and 100% shows how much the yield of the fund is the result of the fund specific characteristics (unsystematic risk) and how much is it is under the influence of the market actions. As the risk category in general, the R^2 coefficient itself is neither good nor bad, but the resulting value only helps to better reflect and determine the risk characteristics of a particular fund. Thus, investors who chose passive strategy should choose funds whose coefficient R^2 is close to 100%. Active investment approach means that fund managers will choose to invest in specific securities or sectors they believe are undervalued. The interpretation of the value of the R^2 coefficient depended also on its comparison to adequate benchmark index. Depending on the specifics of the portfolio and the calculated coefficient R^2 should be put in relation to the index (fast growing - high risk stocks, moderately risky stocks, sectors, markets ... etc.).

β coefficient sorts the changes in yields in relation to the market as a whole, that shows the expected percentage of change in the fund value in accordance to the percentage change in benchmark index. The calculated value is a relative number. If for example the calculated value of the fund amounts to β 0.86 (<1), which means that the fund have a volatility of 86% compared to the observed market (growth/decline of the fund would be reflected in a change of +/- 86%). In performing the conclusions it is important to emphasize that it is of a great importance to compare the obtained β coefficient with the corresponding benchmark index, in order the results make sense.

The coefficient α represents the difference between the results derived by the fund and the results that are expected based on the degree of risk that the fund manager takes. Proper determination of this indicator provides an opportunity to separate the contribution of the manager of the fund for its yields. Like the coefficient β, the coefficient α is also a relative indicator of the performances. If the fund achieved a result that is equal to the perceived risk, then the coefficient α for this fund will be equal to zero. Positive value of α indicates that the manager produces a yield which is higher than expected, considering the taken risk. In order to calculate the value of the coefficient α, the actual performance of the fund is compared to the expected income adjusted to the undertaken risk.For example, if the income of the S&P 500 (as a benchmark index) during one year was 10% higher than the income of T-bills (such as risk-free securities), then the coefficient β has the value 1.2 (volatility relative to the benchmark index is 120%), and the fund had a score of 15% better than T-bills, it shows that the coefficient α is 3% (i.e. the contribution of the risk managers strategy can be perceived through increasing the yield of the fund for 3%). A negative value of the coefficient α indicates that managers do not adequately reward investors for the risk they are exposed, respectively that the investors yield is lower because of the risk managers strategy.

Managers whose α coefficients have a positive value during a long period of time, have a good recommendation to investors to invest in funds headed by them.

In Macedonia these and similar indicators for the performances of the investment funds, especially relative indicators for their performances are not available. Because of that, only remains mandatory to be respected the provisions for risk management that are prescribed by the Low, as: (Law on Investment Funds, No.12, 2009, Article 5, paragraph 22)

- The management company must establish a system of risk management that will enable the calculation and monitoring of risks in investment portfolios of individual clients in every time, and also for the total investment portfolio of the Fund.
- The system of risk management must provide accurate and independent determination of the values of derivative financial instruments traded on regulated markets and financial derivative instruments traded over the counter.
- The management company shall notify the Commission for each investment fund and individual client, for the types of derivative financial instruments in the portfolio of the investment fund and for the portfolios of the individual clients, associated risks, the quantitative limits and implemented methodology for calculation of the risks associated with positions and transactions connected to those derivative financial instruments, in accordance with the rules prescribed by the Commission.
- Exposure of the investment fund to individual financial instruments on which a financial derivative instrument is based on must not be inconsistent with the investment limits prescribed by law, the prospectus and the statute of the fund.
- When the security or the instrument on the money market contains embedded derivative financial instrument, it must be considered in accordance to the calculation of exposure of the investment fund referred to in paragraphs (3) and (4).
- The Commission prescribes the methodology for calculating the risks of investments in financial derivative instruments.

PERMISSIBLE AREAS FOR INVESTMENT, RESTRICTIONS ON INVESTMENTS AND OVERDRAFT OF THE RESTRICTIONS

Investment funds as financial intermediaries that collect funds from many small investors through the sale of shares and use the revenue so collected to purchase securities, are facing a number of financial risks. Through the process of transformation of assets, issuing shares in small denominations and buying large blocks of securities investment funds use a range of advantages over brokerage fees, and purchase diversified portfolios of securities, creating on a that way an opportunity for risk management.

In terms of legal solutions to the risk management of investment funds, the Macedonian Law (Law on Investment Funds, No.12, 2009) stipulates that the management company must establish a system of risk management that enable in every moment the calculation and monitoring of risks in investment portfolios of individual clients, as well as for total portfolio of the investment fund. The system of risk management must provide accurate and independent determination of the values of derivative financial instruments traded on regulated markets and financial derivative instruments traded over the counter. The management company shall notify the Commission of each investment fund and individual client, of the types of derivative financial instruments in the portfolio of the investment fund and portfolios of individual clients, associated risks, the quantitative limits and implemented methodology to calculate the risk associated with positions and transactions to those derivative financial instruments in accordance with the rules prescribed by the Commission, (Law on Investment Funds, No.12, 2009, Article 22, paragraph 1-3).

Exposure of the investment fund to individual financial instruments that is based on financial derivative instrument must not be inconsistent with the investment restrictions prescribed by law, the prospectus and the statute of the fund. When the security or instrument of money market contains embedded derivative financial instrument, it must be considered in accordance with the calculation of exposure of the investment fund. Securuties and Exchange Commission shall prescribe the methodology for calculating the risks of investments in financial derivative instruments, (Law on Investment Funds, No.12, 2009, Article 22, paragraph 4-6).

The law also specified allowable areas for investment, restrictions on investments and restricted investments overdrafts, separately for open and closed investment funds. Such rigid legislation imposes towards investment fund risks exposure minimization, i.e. protection of the entities that have invested in it.

In addition, within the allowable investments, stipulating that the assets of the open-ended Fund may only consist of: (Law on Investment Funds, No.12, 2009, Article 66)

- Transferable securities and money instruments traded on regulated markets in the Republic of Macedonia, the EU member states and member states of the OECD and applied to official listing on the stock exchange or other regulated markets of countries that are not members of the EU and the OECD, provided that the statute and the prospectus of the Fund provide such investment;
- Newly issued transferable securities under certain prescribed conditions;
- Units or shares of investment funds registered in the Republic of Macedonia or countries which are members or not members of the EU and the OECD, also under conditions prescribed in the Law;
- Deposits in authorized banks in the Republic of Macedonia, which mature within a period not exceeding one year;

- Forwards and options contracts and other derivative financial instruments traded on regulated markets as defined in the first paragraph of this listing and/or financial derivative instruments traded over the counter, stating specific requirements to be met;
- Instruments on the money market which are not traded on regulated markets, as well as the conditions under which it can be done; and
- Money on the account.

The following are restrictions which aggregate can be expressed through two basic types: (a) percentage limitations for certain types of investments from of the Fund assets net value and (b) restrictions on investments in securities of a single issuer, also as a percentage the net value of the assets of the Fund.

Managing risks in a closed fund is also instructed by the Law on investment funds by setting the allowed investment opportunities. In this sense, the assets of the closed-end fund can only consist of: (Law on Investment Funds, No.12, 2009, Article 90)

- Securities;
- Units of investment funds registered in the Republic of Macedonia, EU Member States and OECD countries;
- Deposits in authorized banks in the Republic of Macedonia which mature within a period not exceeding one year;
- Forwards and options contracts and other derivative financial instruments traded on a regulated market of securities and/or derivative financial instruments traded OTC under the conditions indicated; and
- Money on the bank account in the Republic of Macedonia.

In the closed-end funds just as with the open-end funds regulatory authorities regulate restrictions on investments, as well as exceeding the limits. The limits are expressed as a percentage of the net value of the fund's assets in terms of the types of investments and in respect of the instruments issued by a single issuer. In any case, the principle of the risk diversification and protection of the interests have to be respected. In a case of exceeding the legally specified limits, which are a consequence of the market prices movements, the management company tries to protect the interests of the shareholders. Management Company also is required to harmonize the investment of the closed investment fund within one year starting by the day the overdraft occurred, taking into account to minimize the risks of incurred overdrafts in investments.

BASIC RISK MANAGEMENT STRATEGIES FOR INVESTMENT FUNDS

Human resources are the decisive factor for the success of every kind business entity, so human resources are of greatest importance for determining risk management strategies in investment funds. Logically managers pay great attention to the staff management in order to create an appropriate staff structure and to lead a personnel policy aimed at achieving strategic goals and directions for the investment fund development. Therefore, it is necessary staff planning, as well as training, developmentandstaff improvement policy, in direction of their acceptance and learning of the modern trends in the business they perform. In this way conceptualized business entity staff structure makes so called subjective factor, i.e. the philosophy of the institutions management.

Basically there can be two basic philosophies of the risk management:

- Aggressive philosophy and
- Philosophy of risk aversion.

The aggressive philosophy and aggressive type of managers are largely oriented to liabilities management and acquiring liquid assets by using credits on financial markets. The aggressive strategy and its nature largely depends on the nature of the personality of the manager who selects and implements that strategy, and it suits to progressive, young, ambitious, creative, entrepreneurial manager spirit who accepts hazard ventures, but normally with the necessary dose of sanity and measurement of risks that may occur, as well as the possibilities for its coverage. Such an aggressive strategy means intentionally entering into risky ventures, when it is expected favorable movements of the market performances and the opportunity to increase earnings.

The managers showing risk aversion are mainly oriented towards providing liquidity through asset management, or through the use of secondary reserves in the assets of the institution, why they are called assets managers. This type of managers increasingly accept situations in which there is not a great risk, and such transactions mean less risk of loss, but smaller yields too. In their specific actions managers with risk aversion tend to establish:

- Less interest exposure,
- Lower FX (foreign exchange) exposure,
- Coverage risk ventures by hedging, other forward transactions, and
- Using of derivative financial instruments (futures, options, warrants, etc.).

Behind numerous quantitative procedures in determining the risk management objectives, identifying existing risks, their measurement, quantification and monitoring, procedures and methods of planning and selection of the best tools for managing such risks, management control etc., it is necessity to combine all these procedures and the application of certain qualitative methods and procedures. The

models that are based on mathematical-statistical risks quantification by a probability distribution for losses on risk positions exercise intention of enforcing them, and found wide application in large and sophisticated financial institutions, but they always do not give enough good results. Having in mind the uncertainty of the future and the possibility of the occurrence of unforeseen situations, there is always a probability of occurrence of extra unforeseen events, which if occur they will disable further prediction and quantification by extrapolation of past trends. Due to the existence of the possibility of such events, it is considered that the most effective risk management strategy is a combination of qualitative and quantitative approach. This means that successful risk managers must find ways to harmonize the mathematical modelling with market experience. In this context Risk Management models based on quantitative procedures are complemented with qualitative methods such as stress tests that large institutions prepare for the event of any catastrophic disruptions. It is a high stress scenario that carries very small possibility to occur, but large and sophisticated subjects often think that they have to be prepared for such situations.

Before definitively state the basic Risk Management strategies, it must be mentioned the basic forms of Risk Management:

- risk management by avoidance;
- risk management by retention;
- risk management by transferring (hedging);
- risk management by sharing (diversification); and
- risk management by reducing.

One of the essential goals of the risks analyze is to detect existing theoretical - application risk management strategies, as well as to identify potentially possible combinations thereof for use in the certain business entity such as investment funds. In this sense, as the most important among them, can be list: (Karadjova, 2012, pp. 325-382)

- Strategy of internal rating systems;
- Strategy of protective clauses;
- Strategy of limits (institutional or custom);
- Diversification strategy (portfolio diversification and products diversification – diversification of the products range);
- Insurance and reinsurance strategy (as well as some other forms of guarantees);
- Liquidity and liabilities structure strategy;
- Strategy of capital adequacy;
- Securitization strategy;
- Hedging - a strategy of hedging risks with financial derivatives (forward contracts, futures, options contracts, swap agreements); and
- Strategy of prices variability (commodities prices, services prices, interest rates and premium rates).

The strategy of internal rating systems means setting criteria and standards for financial institution or other entity that approves some kind of credits customer rating in respect of debtors and other securities issuers that participate in the mentioned subject financial portfolio. It is a system of quantitative or qualitative criteria that the creditor management sets (i.e. solely internally for their own needs), and which obligation is based only on the subjects business policy. So set value systems that must be meet by the customers practically shows the minimum level of rating (reputation) that the customer should have to be considered that it will not jeopardize the operations and financial position of the creditor – because of default or untimely payment of interest, dividends and other cash flows expected from the investments. That would mean that in this way an internal rating system is constructed as a strategy for risk management, completely independent of the rating agencies and institutions involved in the ranking of business subjects. Through internal rating systems, financial institutions and other entities that exercise some kind of crediting, rate the subjects of their business - technical cooperation and the fundamental criteria for ranking is the credit risk or widely default risk.

Investment funds and other lending entities can also apply the Strategy of protective clauses that would prevent such debtors conduct during the duration of the credit relationship which may exacerbate their creditworthiness or prevent from some customer behaviour during all the time of the credit relation which would put them in a position of not being able to pay regular payments. Also, during the terms of any contractual relationship, parameters of the subject would be followed and avoid its irrational behaviour by which it would put into a situation that cannot pay regular cash payments previously agreed. As clause against credit risk for example can be mentioned that if the borrower violates any of the protective clauses, the entity that gives the loan have the right to terminate currently the credit relationship and to seek redress for the former default. This clause is used to put pressure on debtors to adapt their behaviour to the provisions of the protective clauses and to return the level of their credit risk on its previous level.

There are several important reasons for that the financial system is one of the most regulated in the certain countries economies. Basically it happens because:

- Increase of the information available to investors; ;
- Ensuring the stability of the financial system; and
- Increased control over the conduction of the monetary policy.

Institutional limits are set in order to eliminate the problems of adverse selection and moral hazard that reduce the effectiveness of the operation of financial markets. In that sense, government regulation can reduce the problems of adverse selection and moral hazard in financial markets and to increase their efficiency by increasing the quantity and the quality of the information available to investors. In ensuring the stability of the financial intermediaries, developed economies pose numerous institutional limits, everything in direction of preventing from so-called financial panic that could lead to the collapse of financial intermediaries. On the other hand, various financial institutions, although with the same approach to risk can set various forms of their own investments restrictions due to various circumstances in which they are. In the frames of the prevalent

circumstances can be cited: the tax status, the need for liquidity, trends in portfolio incomes or different legal restrictions. Pension funds and investment funds as the most common among them, respect the legal limits concerning the structure and regulation of their activities, but also post their own in order to maintain their liquidity and increase the effectiveness of operations. Some of the possible limitations in this regard may relate to: the maximum percentage of investment in certain institution, the maximum amount of investment in one certain national economy taking into account the country risk, investments only in securities with fixed income, various percentage restrictions on investments in securities with variable income, restrictions on investments in corporate securities (with an emphasis on investment in government securities, etc.), maximum maturity of invested assets, coefficient of the correlation between risk and total assets, ratio of certain parts of the assets over their respective counterparts in liabilities, maturity structure of assets in correlation to the maturity structure of liabilities and estimating the duration of investments etc.

Diversification as a general known rule for reduction and sharing of the risk arises from the basic investment rule "do not put all your eggs in one basket". The application of such a rule provides an opportunity to reduce the overall risk or the risk of the portfolio. It means practical actions of the principle of portfolio aggregation in which the sum of all individual risks entering the portfolio is greater than the single portfolio risk, because of the existence of a negative correlation between the various types of assets.

The situation in investment funds regarding the risk management and opportunities for the use of insurance are almost identical with those of the pension funds. There is no legal obligation for regulated insurance, but insurance and reinsurance can be used as strategies for risk management. In particular, it is the practice among large investment funds, with a long tradition and those who represent some combination of investment funds, pension funds and insurance companies. It is about investment funds that raise funds through the sale of life insurance policies, and offer programs for payment of life-long rents (pensions). Often such non-banking financial institutions insure their property in large insurance companies, and they do reinsurance in reinsurance companies.

The development of liquidity strategy begins with an analysis of supply and demand of liquid assets and determining the net liquidity position at a given time (Lt). Based on this calculation of net liquidity position, liquidity managers contemplating between two extreme situations: (1) the situation when the demand for liquidity is greater than the supply and they need to prepare for the liquidity deficit, i.e. to decide when and from where they will provide additional liquidity; (2) the situation when the demand for liquidity is less than supply and they need to prepare for the surplus of liquidity, i.e. to decide when and how to invest the excess of liquidity in a cost-effective way. In terms of solving the problem of liquidity the practice has detected three basic strategies which with some modifications, depending on the specific conditions may be applied by the managers of financial institutions and other commercial entities. These include: (1) providing liquidity based on assets – assets liquidity management; (2) reliance on borrowed liquidity (liability management); and (3) compliant liquidity management (assets – liabilities management - ALM).

In reference of determining the strategy of capital adequacy, particularly in reference to determining the required level of capital for non-banking financial institutions (investment funds, pension funds etc.) legal solutions are used, that predict the level of capital required for these institutions. But, for formulating the strategy of capital adequacy for investment funds essentially important is their net worth. The minimum of net value that investment funds in R. Macedonia is obliged to maintain is legally prescribed and shall be: (Law on Investment Funds, No.12, 2009, Article 102)

- The net value of the open fund is the value of the fund's assets less liabilities. Net value per unit is the net value of the fund divided by the number of fund units at the time of calculating the net value of the fund's assets.
- The net value of the closed-end fund is the value of the fund's assets less liabilities. Net value per share is the net value of the fund's assets equally allocated to each share issued by the fund at the time of calculating the net value of the fund's assets.

The use of securities guaranteed by the capital is one of the important strategies for risk management. The changes in interest rates on financial markets affect both: interest income and the cost of interest and at the same time affect the value of the assets of the economic entity. Securitization and developing a strategy through which it will be implemented provides an opportunity for financial institutions to carry out geographical diversification of their portfolio, avoiding thus losses on a local level. Also, the strategy of securitization is a tool for managing interest rate risk whereby financial institutions adjust their portfolio of assets in a way that maturity (period) of assets at least approximately coincided with the maturity (period) of the liabilities. The non-banking financial institutions among them investment funds also are not deposit institutions and their basic function is not credit, yet they are not immune to credit risk and develop opportunities to participate indirectly in lending to deficit sectors. This further complicates the process of securitization, but does not make it impossible. Giving as collateral portions of their assets for the loans they take and raise new funds by a non-banking financial institution is a practical tool for managing their interest rate and credit risk.

Hedging as a strategy for hedging risks with financial derivatives is also useful for investment funds. An important point in the use of derivatives (derivative securities) as a hedge is the fact that although they may have a protective function, they carry their own risk and that risk mast be calculated by the managers. The four basic types of derivative instruments that may be used are:

- Forward contracts;
- Futures;
- Options; and
- Swap contracts.

There are many mathematical and graphical methods for the application of the certain proposed strategies, which exceed the space opportunities for their presentation here. All of them, can be a subject of particular analyze.

CONCLUSION

Investment funds as specialized institutions which perform collective fundraiser to invest in securities or other financial instruments have a significant role in countries with developed financial structure. The importance of investment funds can be perceived in their success in retrieving the relatively small capital from legal entities and individuals, and investment of that capital in a carefully selected portfolio of investments, primarily in securities. In this sense, the choice of strategies for risk management is an essential segment of their scope of work. Unlike small private investors, funds are informed investors, because they know more about the functioning of financial markets and because they are managed by professional managers. Funds at first appeared primarily in the USA, but in the last 30 years they develop by strong pace in many developed countries in the whole world.

The lack of funds in a market considered a weakness in that market, in many ways. There is no mechanism in the market which will animate free private funds from small investors to invest in certain portfolio of investments. When they are gone, private investors buy shares on the capital market without having done a good analysis of the market. Competent market monitoring is expensive, and requires proper knowledge and dedication. Such monitoring reduces the risk of investment. Funds that professionally manage the collected funds are legally required, but in the same time directly interested to develop strategies to manage the risks they face during doing investments. Therefore, investment funds have professional managers who competently manage a portfolio of investments, but that does not mean they cannot misrepresent. Investors are not protected from losses due to bad investments.

The need for investment funds arising from the numerous advantages they have, among which can be included:

- Risk dispersion (funds invest in many different securities, which contributes to reduce the investment risk);
- Professional management (investment funds have professional and experienced staff who daily analyze trading on the securities markets);
- Liquidity (all investors in open-ended investment funds may at any time apply to the sale of theirs units in the fund);
- Simplicity in investment (investment funds provide a simple way of investing through electronic banking, by standing order, etc.).

The main disadvantages in investing in investment funds is variability in yields and the lack of a state guarantee for money, while in the classical bank savings yields are reliable and there is a guarantee of the state for the part of the money invested in the bank. Among the numerous risks that arise when investing into investment funds and why it is necessary to develop an appropriate strategy for risk management can be stated:

- Riskiness of the investment (consisting of unsystematic risk that can be reduced through diversification of investments and systematic risk that cannot be reduced through diversification of investments);
- Liquidity risk (liquidity risk is changing on a daily basis or depends on the amount of additional liquidity flowing into the fund);
- Risk of changes in the exchange rate - currency risk (The risk is reduced through diversification of investments in securities in different currencies);
- Operational Risk;
- Default Risk;
- Risk of investing in other investment funds (When investment fund will invest a part of the funds to another fund, the existing charges would additionally increase);
- Political Risk (political events in the country can have an adverse effect on the value of the shares on the Stock Exchange, and thus significantly reduce the value of the fund. Political risk is a systematic risk and a Company managing with investment funds cannot avoid this risk);
- Risk of change in taxes (In a case of changes in tax laws and thus this risk kind adversely affect the profitability of investing in the Funds).

For potential investors, one of the most important things when choosing a specific fund is a fund's prospectus. The prospectus of the fund includes fund objectives, investment policies of the fund, its management, fees on entry or exit from the fund, the fees that are charged to the fund, the minimum amount to invest in the fund, the fund's operation in the past and other significant characteristics about the fund. Briefly, Prospectus explains the program and policy which are managed by managers in order to achieve the investment objective. Rate of return of the fund and the expected risk can be determined on the basis of its investment policy or it can be specified in the prospectus. The general rule is that investment funds with higher yield to have a higher risk. Investors should be aware that the yield is associated with a certain risk. The main regulator of the investment funds activities (excluding private funds) on the Macedonian market is the Securities and Exchange Commission, in accordance to the Low on Investment funds and bylaws arising from the previously mentioned Low.

Legal regulation on the operation of investment funds in the Republic of Macedonia have few changes till today. Namely, the first law passed in 2000 was changed in 2007, then again in 2009. The new amendments provide greater protection of minority shareholders and greater competition on the capital market. In terms of these changes, the possibility for existence of private funds is given. The operation of private investment funds should enable the revival of the economy in Macedonia, through restructuring and entry of major new investments. This model of private investment funds could grow into a driving force of economic development. The first challenge facing investment funds is a manner to gain the trust of the citizens, who as a rule are the most numerous investors. Investing in investment funds is a kind of long-term savings that can bring significantly higher yields.

REFERENCES

[1] Ćirović, M. (1995), Bank Management. Belgrade: Economic Institute.
[2] Karadjova, V. (2012), Principles of Risk Management. Ohrid: CNIR FTU.
[3] Maksimović, P. (2006), Investment Funds. Belgrade.
[4] National Bank of the Republic of Macedonia, Sector for Supervision, Banking Regulation and Financial Stability, Department for financial stability and banking Regulations (2013), Statement of Financial Stability in the Republic of Macedonia 2012. Skopje.
[5] Official Gazette of Republic of Macedonia (2009),Law on Investment Funds, No.12. Skopje.
[6] Official Gazette of Republic of Macedonia (2010),Law on Investment Funds, No.67. Skopje.
[7] Official Gazette of Republic of Macedonia (2011),Law on Investment Funds, No.24. Skopje.
[8] Petkovski, M. (2009), Financial Markets and Institutions. Skopje: Faculty of Economics.
[9] Vasiljević, B. (2002), Basics of the Finance Market. Belgrade: Zavet.
[10]www.sec.gov.mk/default.aspx?item=associationsuif&subitem=associationsuiflist (21.06.2014)
[11]www.sec.gov.mk/default.aspx?item=openfunds&subitem=openfundslist (21.06.2014)