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PLANNER RESOURCES

HOW TO MINIMIZE RISING MUTUAL FUND COSTS

Mutual fund fees and expenses are on the rise, but investors can take steps to minimize their impact.

A recent federal government study found, for example, that fees rose 11 percent between 1999 and 2001 among the biggest stock mutual funds. Investors didn't pay much attention to mutual fund costs during the bull run of the 1990s, but now that many funds have been losing money, the impact of costs has become more apparent.

Costs matter. How much impact costs have on a fund's total return is a matter of debate. One prominent proponent of index funds contends that total costs, ranging from management fees to sales charges to trading costs, can eat away up to 50 percent of many mutual funds' return over 30 years. Studies have also shown that among funds with similar investment objectives, the funds with lower fees and expenses tend to outperform funds with higher expenses. Others point out that the impact of fees on bond funds is especially critical because interest rates are so low.

That's why it's important when comparing funds that you look not just at return performance but expenses. One fund might outperform a competitor, but once costs are taken into account, the lower-returning competitor might end up putting more money in the investor's pocket.

Operating expenses matter. According to data from Lipper Inc., the expense ratio of the median stock fund, a ratio that covers management and back-office expenses, was 1.46 percent in 2002—a nine percent increase since 1999. Moreover, the range of expense ratios among funds can be much lower—or much higher. Yet a recent study by researchers from the University of Michigan and the University of California at Berkeley and Davis concluded that investors were focusing more on sales charges than operating expenses.

Pick the sales charge that's right for you. Mutual fund investors have several ways to invest in a fund, through what's known as share classes. Class A shares, known as front-end loads, are shares you buy through a financial advisor or broker. B shares have a back-end load, but no front load. Class C shares don't have front- or back-end loads, but typically carry higher 12b-1 marketing fees.

There is much debate about which share class is the best, but much can depend on how long you plan to invest. Investors who bounce in and out of funds (usually not considered a good idea) may want to stick with C shares because front-end and back-end loads would take a bite every time they reinvest. Investors who plan on staying with a fund for several years are probably better off with A or B shares, according to the research of two professors published in the summer 1998 issue of *The Journal of Financial Research*.

Get a break. A study released by the Securities and Exchange Commission (SEC) in March found that a third of the investors who made large purchases of funds didn't receive the reduced front-end load price break they were entitled to. For example, where you might pay a 5.75 percent commission for a \$10,000 investment, you might pay only 4 percent for a \$100,000 investment in the same fund or family of funds.

Shop carefully. The SEC requires nearly all prospectuses—the document that outlines the basics about a mutual fund—to publish fee tables. One table usually shows sales charges, the other the annual operating expenses. A look at the operating expenses table shows how fees vary according to the class shares bought—for example, while Class C shares have no upfront sales charge, annual operating expenses might actually be higher for the Class C shares than the Class A shares.

To see the impact of these fees and operating expenses in dollars and cents, all prospectuses must show the same example: a \$10,000 investment earning five percent a year, with total expenses shown for one, three, five and ten years. This table illustrates not only the total differences in cost for different class shares for different time periods, but provides a way to compare funds.

Ultimately, however, investors shouldn't buy a fund based on costs alone. The first decision is to pick the type of funds that fit your portfolio needs, then identify the best-performing funds in that category. Only then should expense comparisons come into play.

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