The Rennie Quarterly Return

Rennie & Associates
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Mutual Fund Fees

When Rennie & Associates was founded almost 15 years ago, we already had more than 15 years of experience in institutional investment management. From this, it was abundantly clear that some advisors, brokers, etc. recommended funds based on the commissions and fees that they would receive rather than recommend funds that would optimally satisfy their client's needs, but which paid the advisor less. The power of the paycheck is oooh-sooo-strong.

We also knew that superior portfolio managers, who actually buy and sell the securities within mutual funds, are few and far between. For sure, they don't all work for one company. Therefore, if Rennie & Associates was to be successful, we needed to construct client portfolios by carefully selecting only these superior fund managers. To remove all temptation to focus on our own paychecks, we adopted a fee-only model. Our income comes solely from the checks our clients send us. We receive no fees, commissions, etc. from other sources. So for Rennie & Associates, the fee issue is a non-issue.

Fees, however, are a major issue in the mutual fund world. Indeed, the news media is constantly raising the issue implying that the best funds over the long-term are low-fee funds. John Bogle, founder of The Vanguard Group, is probably the most enthusiastic proponent of low-fee funds, index funds to be more specific. And, with some justification. Studies show no evidence that high-fee funds outperform low-fee funds over the long-term.

The Basics

Many mutual funds charge investors commissions, or loads, to purchase fund shares. For example, some equity funds charge a load of 5.75%. This means that for every $10,000 invested, only $9,425 purchases fund shares. Usually, most of the $575 load is paid to the advisor who sold the fund; the remainder benefits the mutual fund company. According to Jason Zweig of the Wall Street Journal, fund commissions have been banned in the U. K. and Australia; Holland is soon to follow. Rennie & Associates has never recommended a load fund.

Funds may also charge contingent deferred sales charges or back-end loads. These are generally in the 1% or 2% range. Although these fees used to apply regardless of when a fund was sold, today they typically apply when a shareholder sells the fund within a very short period of time—usually within three to six months of purchase.

A fund's annual expense ratio is the fee that is deducted from a fund's net assets, pro-rata on a daily basis, to cover operating costs. For example, if a fund's expense ratio is 1.2%, fund assets are reduced by 0.1% each month.

Finally, there are distribution fees, or 12(b)1 fees. These benefit the mutual fund company and are not included in the expense ratio. But, to be sure, they are expenses just the same.

Investors

Fortunately, investors seem to be paying close attention to fund fees. For example, according to the Investment Company Institute, the simple average expense ratio of the thousands of equity mutual funds is 1.41%; however, the asset-weighted average expense ratio is 0.77%. The same is true for bond mutual funds; the simple average expense ratio is 1.01%; the asset-weighted average is 0.61%. Clearly, lower-fee funds are now attracting the majority of investor dollars.

Our View

Our recommended mutual funds have expense ratios which are generally consistent with the asset-weighted average expense ratios previously discussed. Our objective in making fund recommendations appropriate for our client's portfolios, however, is not fees but performance. To optimize client returns and therefore the value of client portfolios, performance is the key.

Mutual Fund Performance

Published mutual fund performance is calculated after deducting annual expenses. Thus, if a fund returns of 2.0% for a month and the expense ratio deduction is 0.1%, the gross return was 2.1%. All returns used in semiannual client Reviews are realized returns—real in every sense of the word.

The mutual funds that we recommend are reviewed six-ways-to-Sunday. However, higher-fee funds get even extra scrutiny. We almost agonize in recommending them but do so in recognition of their long-term, consistent, superior after-fee performance at acceptable levels of risk.

To date, this strategy has served us and our clients well.

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Our Two 1¢

Just because you can do something doesn't mean you should.

Annonymous

Quarterly Trivia:

If the U.S. began paying down its debt at the rate of $10 million per day, how long would it take?

Almost 5,000 years