Investments: Investment Fees

How Much Does it Cost to Manage Your Investments?

By: Joe the Investor

Many people feel they are not qualified to manage their investments and they tend to hand this responsibility over to an expert. This could be their banker, investment broker, financial advisor or an equivalent thereof. People may not feel qualified because they don't have the time, are not up to date on the latest products, or don't have access to all of the market information. While this may be true for some people, it is not true for others compared to 20 years ago. There can also be consequences to handing over your control as is discussed below.

Does this Scenario Sound Like You?

Consider this scenario: Do you have $100,000 invested in an account such as an RRSP? If you invest this money in the average equity mutual fund, you are paying about 2% in management expense ratio fees (MER) every year. This assumes that your investments are primarily in equities as opposed to fixed income, but this is true for most people as bonds have not been yielding much in the last few years. If you do have primarily fixed income funds, the average MER would be about 1%, so the numbers will be smaller. If you have a typical mixture of half stocks and half bonds, the average MER you would pay is about 1.5% per year. This figure will be used as the example for this situation. (1)(2)(3) For every $100,000 invested, 1.5% equates to $1500 in fees each year, in up and down markets. In a 30 year time frame, this amounts to $45,000 in fees, excluding compounding, which is 45% of the money you started with. If this fee was reduced to 0.5% each year, you would only pay $500 per year. This would amount to $15000 in fees over 30 years, excluding compounding. Note that if you compound the numbers, the savings would likely be higher, but this depends on what return you would get over the next 30 years, which is not possible to predict. For every $100,000 you have invested, you would pay $45,000 in fees versus $15,000 over a 30 year period, or $30,000 less in fees. This is a lot of money!

If in this same account, you are also paying an advisor fee of 1% to provide advice, this is an additional $1000 per year, or another $30,000 in fees for that same $100,000 portfolio over 30 years. If this fee were only 0.5%, this would save you an additional $15000 for every $100,000 you have invested for 30 years. This calculation can also be compounded because you would typically take these savings and reinvest them in the same account – but the calculation is not done here due to the uncertainty of future returns. For every $100,000 invested, you would create an additional $15,000 in savings for every 30 years, for a total of $45,000 in savings for the products and the advice. If you have invested more than $100,000, the proportion of savings remains the same, and the same is also true for amounts less than $100,000. As examples, if your portfolio is $50,000, the amount of savings would be $22,500 less in fees over a 30 years period. For $200,000, the amount would be an additional $90,000 less in fees over a 30 year period.

Is this really true? Keep in mind that the essential nature of what you are invested in is not changed. The only variable that is being considered here is fees being saved over time. You would have essentially the same stocks, the same bonds, the same accounts and potentially the same advisor if they are willing to look after your accounts for 0.5% less in fees each year. This is definitely possible, but you need to create a situation where this would be done. If you have a specific fund and want to find out how much you are paying, lookup the “get smarter about money” link on the internet. (4)

Does this sound like it is too good to be true? It may sound like it – but all you are doing is substituting one investment for another and saving on fees. Keep in mind that if the investments do well, these savings are *on top* of the returns generated. If the investments do poorly, these returns will *reduce* the amount of the losses incurred. You are taking what you would have already done and making it cheaper to do, and you pocket the savings. If you have ever bought something at a discount store versus paying full price, this is the same idea.

Keep in mind that there are more costs that exist that are on top of the fees mentioned in the scenario. The largest of these costs is sales fees, which are costs to buy a fund (also called front end load) and costs to sell the fund (back end load or deferred sales charge). These are one time fees but they can be avoided entirely if you buy products that don’t have these costs. There are also referral fees which are charged between companies for selling products, but may be charged back to you as well even though you don’t see them. Now that you know that cheaper alternatives do exist, it is time to find them and do a comparison.

If this is so simple, why isn’t everyone doing it?

There are reasons why many people are not investing for less cost. To see these reasons, ask yourself some questions. Did you realize the effect that a 1% reduction in fees has on your portfolio? Do you know what you are paying each year to have your portfolio managed? Do you know how many different ways you are paying for the management? If you didn’t know, chances are many people do not know either unless they want to find out.

In general, costs will arise from the advice and from the product you are buying. Many institutions bundle these two things together and you pay only one price. You generally don’t get to see this price because it comes out of your return. Is a dollar paid in expense cheaper if you see or you don’t see it? The answer is that it is the same. Does a dollar paid in expense feel better if you see it or you don’t see it? The answer is that it feels better if you don’t see it. In other words, would you rather go to the bank and cut a cheque for them to manage your RRSP, or would you rather they just did it and you didn’t pay separately for it? Most people don’t like to pay for services directly – out of sight, out of mind. The catch is that if you don’t see it, you can’t question it, and you can’t find better ways of doing it. The follow through to this argument is that you cannot see the charges if they are too high.

Why Are People Letting this Happen?

For many people, having their money being managed for them is about the experience. There are many beliefs that people have which cause them to do things in this way. One of them is touched upon earlier – out of sight, out of mind. If you don't see the costs, you think they are not there. Many people believe that the advice they get is free. It is not free! You are paying with your future return and it can be quite expensive as the scenario illustrates! The second belief is that people think they cannot manage their money because it is too complicated. The solution to this idea is to give money to an expert so they can solve the problem. The issue is that you have to trust the expert and ensure that the expert is prioritizing your needs. Comfort comes from the belief that they are taken care of. Due to this giving away of the power, people don't realize all of the investment choices that exist out there. People believe they are being given all of the options when they see their advisor. Has your advisor told you how much money you can save on fees?

What Can You Do?

Generally speaking, people have less time than ever today, but trading can be done much more quickly than ever before. The playing field is being leveled more each day. You can do a lot for your portfolio without spending a lot of time. You can also ask your advisor two questions: How are you being paid? How much am I paying in fees on my current portfolio? A third question you can ask yourself is: What is the experience I am receiving from my advisor? The first two questions should reveal to you what your current situation is. Make sure to ask for something in writing or that can be researched to back up the responses you get. If the responses are vague, one red flag has gone up. Fees should be pretty exact and calculated. The third question is to ascertain what kind of service you are getting, whether you trust your advisor and whether they add value in terms of what they have told you in the past. If they are really looking out for you and provide you a good experience, they would be worth keeping. Keep in mind that if they seem to be serving you well, but you are losing tens of thousands of dollars in fees in your investments over 30 years, you need to weigh out these priorities. If they tell you that they can only sell certain products, this may be true. If they tell you they don't understand or believe in certain products, this may be true as well. In both cases, make sure to find out why.

It is time to unbundle the price you are paying for advice and products and find out what value each of these items contains for you. You can then understand how to maximize the value of your investment situation.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what these options are. **Note: This site is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**

Sources:

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