MUTUAL FUND FEES EXPLAINED

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Witt's Wisdom

The topic of mutual fund fees comes up often in conversations in the office. In fact, it is the first question many investors ask as we talk about managing their investment portfolio. Personally, I think long-term performance is more important, but that's for another day.

So, what exactly do mutual fund companies charge you to manage your money?

The ***Expense Ratio*** is the annual fee that all funds charge their shareholders. It expresses the percentage of assets deducted each fiscal year for fund expenses, 12-b1 fees, management fees, administrative fees, operating costs, and all other asset-based costs incurred by the fund. Morningstar estimates the asset-weighted expense ratio across all funds was 0.64% in 2014.

Commissions are paid by the mutual fund companies for securities transactions. Commissions are not included in the expense ratio; to count commissions as an "expense" would double-count them for tax purposes. The exclusion of commissions from "expenses" contributes to obscuring them from the average investor.

The ***Bid-Ask Spread*** is the difference between what the exchanges or over-the-counter market makers charge to buy or sell a stock. The bid is the price that someone is willing to pay for a security, and the ask is the price at which someone is willing to sell. If you're a seller you receive the lower price (the bid) and if you're a buyer you pay the higher price (the ask).

Market Impact Costs, in financial markets, is the effect that a market participant has when they buy or sell an asset. It is the extent to which the buying or selling moves the price against the buyer or seller, i.e. upward when buying and downward when selling. Imagine your mutual fund manager buying one million shares of XYZ company. This large transaction could drive up the price of XYZ stock. Conversely, if your fund manager was selling one million shares of XYZ company, it could drive the price downward.

What about ***Turnover***? (And, we're not talking about grandma's apple turnover!) Turnover is the measure of the fund's trading activity. A low turnover (20% to 30%) would indicate a buy-and-hold strategy within the fund. High turnover (100% or more) indicates an investment strategy involving considerable buying and selling of securities. Generally, high turnover managers tend to employ aggressive strategies. Higher turnover generally results in higher cost and, in-turn, results in lower investment performance for the investor.

Mutual fund ***Overlap*** occurs when an investor owns two or more mutual funds that have similar objectives and hold many of the same stocks. If the two funds are investing in the same stocks, a reduction of diversification could occur, resulting in unnecessary market risk.

Conclusion: Hidden costs are incurred in many ways. Ultimately, costs, whether disclosed or hidden, are reflected in performance. A portfolio X-ray will flush out the details of the portfolio. Insist on this report from your advisor and/or fund company.