

THE IMPACT OF INVESTMENT FEES

Over time, those little mutual fund charges can really pinch you.

Provided by Timothy C. Hucks, CEP, President, Rising Tide, Inc.

Funds come with fees. In fact, so do IRAs, 529 plans, brokerage accounts and many other types of investments. Over time, the impact of these little fees is significant.

Back in 2006, the Government Accountability Office (GAO) studied 401(k) plan fees and found that just a 1% increase in these fees could whittle a worker's 401(k) savings down by 17% across 20 years.¹ How would you like to have 17% less retirement money?

Fees are inevitable, but it pays to shop around. When you think of the compounding and potential annual gains that 1% or 2% of your current fund balances could enjoy over 10 or 20 years, you see how fees matter. No mutual fund or retirement plan is going to operate for free, but trying to minimize fees could help you save more and retain more for retirement and other goals.

Expense ratios. The proper name for a mutual fund fee is the expense ratio. (The expense ratio represents the total operational cost of running the fund.) You can find mutual funds with expense ratios as low as 0.1% ... and you can find others with expense ratios above 3.0%. Hence the popularity of exchange-traded funds (ETFs), which commonly have expense ratios in the 0.1%-0.7% range. ETFs also have no minimums, while you can find mutual funds with minimums of \$50,000.^{2,3}

Why are some mutual fund expense ratios so high? Here are some contributing factors.

12b-1 fees. Most investors have no idea what these are, but they are common even among funds offered through discount brokerages. A 12b-1 fee is a fee used to pay the company or brokerage through which you buy fund shares. Mutual fund investors paid around \$9.5 billion worth of these fees in 2009.⁴

An example: let's say you happen to buy into a fund via a discount brokerage. You may be assessed a 12b-1 fee, usually 0.25% (though it can run as high as 1.0%). Charging you a 0.25% fee helps to cover the typical 0.4%-of-shares cost that the fund pays out to the brokerage. A "no-load" fund can still have up to a 0.25% 12b-1 fee.⁴

Loads. In addition, many mutual funds ding investors with loads. There are front end loads (entry fees) on A share mutual funds and back end loads (surrender charges) on B share mutual funds.

Transaction fees. Brokerages commonly charge these fees when they get a buy or sell order. These fees often run \$10-50 per trade at a full-service brokerage, less at a discount brokerage. If you aren't selling or buying big, these fees can really pinch you.

Custodian/account fees. IRAs charge custodian fees (to help them pay for IRS reporting expenses) and mutual funds can charge annual account maintenance fees. Annually, these charges are usually under \$100 in each instance - but think how much even \$30 or \$60 could grow and compound through the years.

Read that fund prospectus. It isn't exactly light reading, but you can usually find the expense table in short order. Fund fees are always worth checking out - and if you don't understand what a fee represents, ask a financial advisor.

Timothy C. Hucks, CEP, is a Certified Estate Planner, Registered Investment Advisor and President of Rising Tide, Inc. He may be reached at www.risingtideinc.com, 919-968-8675, or tim@risingtideinc.com. Securities offered through [Capital Investment Group, Inc.](#) Corporate Office: 17 Glenwood Avenue, Raleigh, NC 27603 • 919.831.2370. Member [FINRA/SIPC](#).

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Citations

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