

# Value for Money Investing by Gordon Stockman, CA, CFP

## Fees revisited.



We are constantly reading in the newspapers how Canada has the highest cost mutual funds in the world. However, nobody seems to explain why, adequately. The most prevalent argument put forth by the industry just does not hold water. It postulates that the US has a market over 10 times the size of Canada's so costs are lower due to volume. This fails to explain how many large popular funds in Canada, that are much larger than many US funds, have Management Expense Ratios (MERs) significantly higher.

We propose a simple explanation. It is you, the investor!

In the US, more attention is paid to the cost of advice, by all participants, the clients, the advisors and the mutual fund companies. This is largely due to the competitive pressure from the clients to gain access to the markets in a cost efficient manner. The result is four significant differences between the two countries.

First, too much choice. Yes, too much. The US, with 10 times the population, only has 4 times the mutual funds as Canada. Canadian companies are being wasteful offering choices that will make little difference in your overall results. They are able to do so because there is no driving force for them to be frugal. They spend your money to offer more fund choice. The industry should spend some time researching the negative effects of too much choice. It actually is believed to lead to customer "dissatisfaction" and as any retailer will tell you, the more items offered the higher the overheads. Stop asking for more, ask for less.

Second, too few index funds. In the US, Vanguard and its founder John Bogle stood the industry on its head years ago, with the introduction of "managerless funds" (my description). These funds track an index and many market watchers believe that over the long term perform equally well, if not better, than funds with managers. Why pay for star managers and expensive research if it cannot be shown that it makes a difference over the long term. In Canada, the vast majority of investors are purchasing mutual funds through an advisor.

Even in Canada, where costs are high and value low, the industry has not adequately figured out how to charge you as much for a fund that has no differentiating characteristics, such as a different manager, and maintain their margins and the advisors' incomes. After all, all funds that track the S&P/TSX index would have the same result, so how to differentiate your company is a real problem. Demand more index funds. Demand differential service experiences.

Third, advisors are over paid. Or rather in fairness, they are underworked. The bottom 80 percent of mutual fund advisors in Canada only manage about \$15 million in mutual funds. Regardless of the volume of business, there is a reasonable expectation that if they are going to spend their year engaged in the providing of advisory services to clients, they should be able to make an annual income commensurate with the knowledge and efforts. For example, lets assume that means \$82,500 per year after direct expenses of \$30,000, or \$112,500 gross. To achieve this on \$15 million in assets, they must be generating 0.75% or three quarters of 1 percent. This holds the advisor portion of costs up. They often are as high as 1%. Now having worked in the industry for over 13 years, I can tell you without a doubt, that you can take great care of clients with twice that in assets. Ask your advisor how many assets he manages. Divide his total assets under administration by your assets and multiply by the number of hours he is spending on your account. This is his total client service hours. No wonder his golf handicap is so low.

Fourth, mutual fund companies are extremely profitable. Gross margins of over 50% in the industry are not unheard of. These types of margins are normally only seen in relatively new and expanding industries. The mutual fund companies are in a mature competitive business, yet they continue to earn money like they have little competition. This will only change when you change. Demand more for less. Your mutual fund company has the margin to allow it.

Remember, meaningful change always starts with one person. That person can be you!

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**COSTS DO MATTER**

START VALUE	RETURN OF %7	RETURN OF %8	YOUR SAVINGS
\$100,000	\$386,000	\$466,000	\$80,000
\$250,000	\$967,000	\$1,165,000	\$198,000
\$700,000	\$2,700,000	\$3,262,000	\$562,000

Look at the chart and determine how much more you could keep in your pocket after a 20-year period, if you could reduce the overall fees in your portfolio by just 1%

**Call us. We Can Help!**

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