

EYE ON THE MARKET

The Sky Isn't Falling. Your Fees Are.

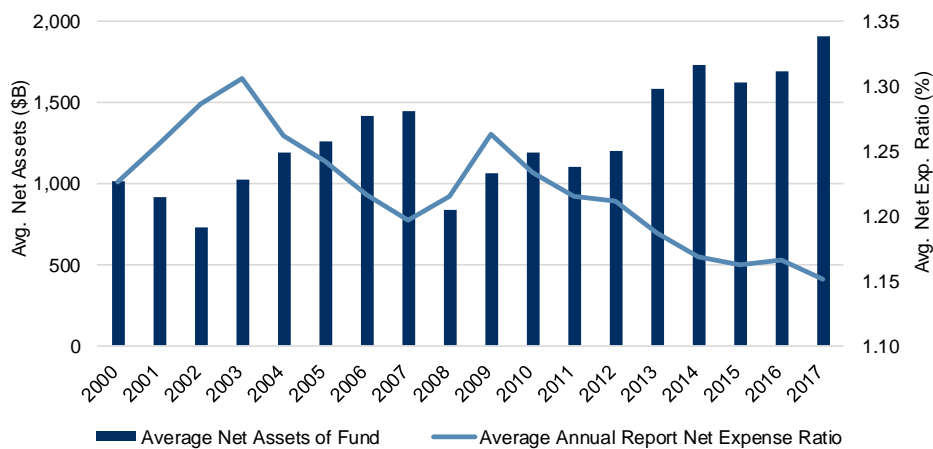
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In early July 2018, Vanguard announced it would further reduce expenses on exchange-traded funds by eliminating commissions for certain transactions. Eye on the Market (“EotM”) was surprised by this news, as Vanguard is already a low cost provider of investment products and index-oriented ETFs are the quintessential low cost investment vehicle. Earlier in the year, Fidelity announced the development of ETFs with expense ratios of zero. EotM, being curious, wanted to see how expenses for mutual funds may or may not be following this low-cost trend.

IN YOUR EYES

How can a company charge almost nothing for a product and/or service? Typically, this is the result of the company having scale and the ability to spread its costs over a broad enough client base. Just as certain retailers provide customers with volume discounts, asset managers can do the same with investment products that have reached a large enough asset size.

Chart 1 Mutual Fund Expense Ratios & Net Assets
U.S. Equity Funds: (2000 - 2017)



Source: Morningstar Direct & Raymond James

Given that most investors have some allocation to U.S. equities, this broadly-defined asset class was the focus of EotM’s evaluation. The sample population includes any mutual fund that was active prior to 2001, and remains active today. Yes, this introduces survivorship bias, but an investor cannot purchase a fund that does not exist.

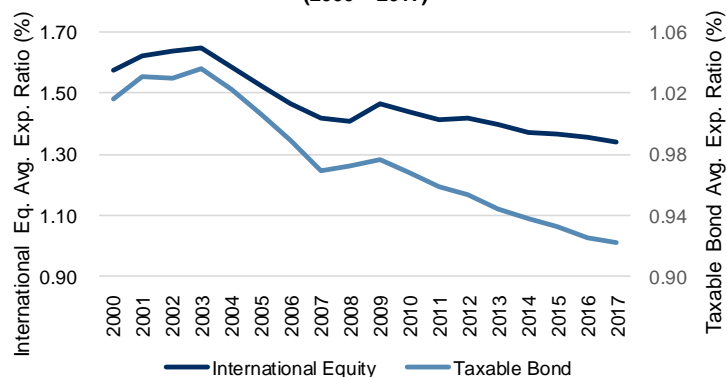
Chart 1 shows that as the average net assets of mutual funds increases, the average expense ratio declines. Why is this the case? One answer lies in the Investment Company Institute's *2018 Investment Company Fact Book*. It noted, "Some fund costs included in expense ratios are more or less fixed in dollar terms. This means that when a fund's assets rise, these costs contribute less to a fund's expense ratio." Another factor that is leading to the decrease is fees has been the shift to no-load share classes as more investors are using fee-based accounts.

SLEDGEHAMMER

EotM further examined whether or not this trend held for other asset classes including taxable bond and international-equity mutual funds. As Chart 2 shows, both asset classes exhibited similar trends over time. On a percentage basis, there was a decrease in the average annual report net expense ratio of 9% for taxable bond funds, and a 15% decline for international equity strategies.

This is a good thing that many investors may not fully appreciate given the migration away from active management towards passive strategies. Yes, many actively-managed strategies have been too expensive and delivered subpar results. That being said, long-term investors in the funds that were part of this evaluation truly benefitted. These funds represent some of the largest in terms of assets and some of the oldest in the U.S.

Chart 2
Average Annual Report Net Expense Ratio
(2000 - 2017)



Source: Morningstar Direct & Raymond James.

DON'T GIVE UP

Just as Peter Gabriel did not stop making music when he left Genesis in 1975, investors in mutual funds should not give up on proven strategies. The last EotM addressed that five key values including people, philosophy, process, price, and performance are tenets to manager selection. The key to successful investing over long periods is ensuring that these principles remain in place allowing an investor to benefit from falling fees.

SIDE NOTE

On July 4, 2018, Joey Chestnut beat his own record by eating 74 hot dogs in ten minutes. This equates to nearly 22,200 calories or nearly 10 times the recommended daily intake for an adult. In addition to his hot dog eating world record, he also holds records for eating 4.375 lbs of apple pie in eight minutes, 141 hardboiled eggs in ten minutes, and 182 chicken wings in 30 minutes. EotM applauds his efforts and his drive to succeed.

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