



Do high expense ratios predict high performance?



THE RETIREMENT GROUP^{INC.}
PARTNERS IN RETIREMENT



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Introduction

As value investors we believe in finding value in every place possible. Therefore, one of our 8-tenets, we look for funds that have a low expense ratio when compared to your peers. We believe that a higher expense ratio does not necessarily mean higher performance, and instead reduces the return on investment. While you may assume that higher expense ratio **MUST** mean you're paying for better performance, but this is actually not true. In this paper we will look at a few examples that indicate funds with high expense ratios should be avoided for cheaper alternatives, if possible.



Mutual Fund managers and investors are both starting to realize expense ratios can be detrimental returns and have started to come down across all asset classes. On average, expense ratios for long-term funds have declined substantially for more than 20 years. In 1996, equity mutual fund expense ratios averaged 1.04%, falling to 0.59% in 2017. Hybrid mutual fund expense ratios averaged 0.95% in 1996, falling to 0.7% in 2017. Bond mutual fund expense ratios averaged 0.84% in 1996 compared with 0.48% in 2017 (4).

Average Expense Ratios for Long-Term Mutual Funds Have Fallen

Percent, 1996-2017

	Equity	Hybrid	Bond	Money market
1996	1.04%	0.95%	0.84%	0.52%
1997	0.99	0.92	0.82	0.51
1998	0.95	0.89	0.80	0.50
1999	0.98	0.90	0.78	0.50
2000	0.99	0.89	0.76	0.49
2001	0.99	0.89	0.75	0.46
2002	1.00	0.89	0.74	0.44
2003	1.00	0.90	0.75	0.42
2004	0.95	0.85	0.72	0.42
2005	0.91	0.81	0.69	0.42
2006	0.88	0.78	0.67	0.40
2007	0.86	0.77	0.64	0.38
2008	0.83	0.77	0.61	0.35
2009	0.87	0.84	0.64	0.33
2010	0.83	0.82	0.63	0.24
2011	0.79	0.80	0.62	0.21
2012	0.77	0.79	0.61	0.18
2013	0.74	0.80	0.61	0.17
2014	0.70	0.78	0.57	0.13
2015	0.67	0.77	0.54	0.13
2016	0.63	0.73	0.51	0.20
2017	0.59	0.70	0.48	0.25

Note: Expense ratios are measured as asset-weighted averages. Data exclude mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Expense ratios also vary across investment style.

Mutual Fund Expense Ratios Vary Across Investment Objectives

Percent, 2017

Investment objective	10th percentile	Median	90th percentile	Asset-weighted average	Simple average
Equity mutual funds¹	0.66%	1.18%	2.00%	0.59%	1.25%
Growth	0.70	1.14	1.95	0.73	1.21
Sector	0.75	1.33	2.13	0.76	1.37
Value	0.68	1.10	1.89	0.70	1.18
Blend	0.40	1.00	1.80	0.36	1.04
World	0.80	1.28	2.10	0.73	1.36
Hybrid mutual funds¹	0.65	1.15	1.98	0.70	1.26
Bond mutual funds²	0.45	0.81	1.61	0.48	0.93
Investment grade	0.35	0.69	1.49	0.35	0.77
World	0.65	1.00	1.80	0.61	1.12
Government	0.29	0.74	1.60	0.40	0.82
High-yield	0.63	0.95	1.76	0.73	1.05
Municipal	0.48	0.77	1.57	0.51	0.90
Money market funds³	0.17	0.40	0.66	0.25	0.40
Memo:					
Target date mutual funds ²	0.36	0.77	1.49	0.44	0.85
Index equity mutual funds ¹	0.06	0.33	1.53	0.09	0.61

Expense Ratios Affect Returns

Expense ratios are naturally a drag on returns, but you may not realize the loss from expense ratio actual.

Year	10% Gain	Expense Ratio				
		0.50%	1%	1.50%	2%	2.50%
0	\$ 10,000	\$ 10,000	\$ 10,001	\$ 10,002	\$ 10,003	\$ 10,004
1	\$ 11,000	\$ 10,950	\$ 10,901	\$ 10,852	\$ 10,803	\$ 10,754
2	\$ 12,100	\$ 11,990	\$ 11,882	\$ 11,775	\$ 11,667	\$ 11,561
3	\$ 13,310	\$ 13,129	\$ 12,952	\$ 12,775	\$ 12,601	\$ 12,428
4	\$ 14,641	\$ 14,377	\$ 14,117	\$ 13,861	\$ 13,609	\$ 13,360
5	\$ 16,105	\$ 15,742	\$ 15,388	\$ 15,040	\$ 14,698	\$ 14,362
6	\$ 17,716	\$ 17,238	\$ 16,773	\$ 16,318	\$ 15,874	\$ 15,439
7	\$ 19,487	\$ 18,876	\$ 18,282	\$ 17,705	\$ 17,143	\$ 16,597
8	\$ 21,436	\$ 20,669	\$ 19,928	\$ 19,210	\$ 18,515	\$ 17,842
9	\$ 23,579	\$ 22,632	\$ 21,721	\$ 20,843	\$ 19,996	\$ 19,180
10	\$ 25,937	\$ 24,782	\$ 23,676	\$ 22,614	\$ 21,596	\$ 20,619
11	\$ 28,531	\$ 27,137	\$ 25,807	\$ 24,537	\$ 23,323	\$ 22,165
12	\$ 31,384	\$ 29,715	\$ 28,129	\$ 26,622	\$ 25,189	\$ 23,827
13	\$ 34,523	\$ 32,537	\$ 30,661	\$ 28,885	\$ 27,204	\$ 25,614
14	\$ 37,975	\$ 35,629	\$ 33,421	\$ 31,340	\$ 29,381	\$ 27,535
15	\$ 41,772	\$ 39,013	\$ 36,428	\$ 34,004	\$ 31,731	\$ 29,601
16	\$ 45,950	\$ 42,719	\$ 39,707	\$ 36,895	\$ 34,270	\$ 31,821
17	\$ 50,545	\$ 46,778	\$ 43,281	\$ 40,031	\$ 37,011	\$ 34,207
18	\$ 55,599	\$ 51,222	\$ 47,176	\$ 43,433	\$ 39,972	\$ 36,773
19	\$ 61,159	\$ 56,088	\$ 51,422	\$ 47,125	\$ 43,170	\$ 39,531
20	\$ 67,275	\$ 61,416	\$ 56,050	\$ 51,131	\$ 46,624	\$ 42,496
\$ Less		\$ (5,859)	\$ (11,225)	\$ (16,144)	\$ (20,651)	\$ (24,779)
% Less		-8.71%	-16.69%	-24.00%	-30.70%	-36.83%

For illustrative purposes only, not indicative of any specific investment product.

The above table shows the impact that fees have on returns. It is easily apparent to see just how much expense ratios can drag on returns. If you invested \$10,000 in a fund with an expense ratio 0.5% (i.e. an index fund), after 20-years you have \$61,416 and paid \$5,859 in expenses. If you invested in a more “sophisticated” mutual fund with an expense ratio of 2.5%, you would only have \$42,496 and paid an incredible \$24,779 (almost 37%) in expense fees!

A high expense ratio can really hurt your investment performance; therefore, you should consider the expense ratio carefully when investing in mutual funds.

Sources

[1] <http://www.moolanomy.com/20/how-expense-ratios-impact-your-investment-performance/>

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[3] https://gsm.ucdavis.edu/sites/main/files/fileattachments/edelen_sheddinglighttradingcosts.pdf

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[5] Maverick, J.B. "What Is Considered a Good Expense Ratio?" Investopedia, Investopedia, 26 Sept. 2019, www.investopedia.com/ask/answers/032715/when-expense-ratio-considered-high-and-when-it-considered-low.asp.

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Each advisor was selected based on their pension knowledge, experience in financial planning, and portfolio construction knowledge.

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