The Cost Confusion

It isn't what we don't know that gives us trouble, it's what we know that ain't so. -Will Rogers

There is a convention in the manner in which investment advisory fees are disclosed and explained which has always bothered us. We certainly do not intend to cast dispersions on anyone or accuse any professional of underhanded tactics. But…frankly there are a lot of underhanded tactics going on particularly as it relates to the costs and the benefits one receive when investing their assets.

For the most part when engaging a professional service there are two primary fees incurred- time and implementation. In the case of engaging an investment advisory service- time is equivalent to the fee an investor is charged for the advisors advice. Advice generally will consist of the advisor understanding the investors goals and articulating that in an investment policy statement, developing appropriate allocation across asset classes (stocks, bonds etc.), evaluating and selecting appropriate investment vehicles (asset managers) and monitoring or adapting that process as warranted. That is the advisor's fiduciary charge and a charge for which the advisor is compensated either via a fixed fee or some percentage of assets.

Implementation, which may come in various forms, is another fee that investors are subject to. Implementation fees generally consist of custodial fees (the cost of having a custodial relationship with Schwab, Fidelity, BNY Mellon or the like) and research fees. Implementation fees also exist when investing in any investment vehicle such as a mutual fund or separately managed account. All investment vehicles have a management fee whether they be 'embedded fees' such as with an ETF or mutual fund or explicit fees such as is the case with a separately managed portfolio. Regardless of whether the fee is embedded or explicit, you as the investor are paying the fee.

What is troubling is that many advisors actually mix and match the two fees causing a tremendous amount of confusion for the investors. Unfortunately, current pricing convention does a very poor, some might suggest fraudulent, job of explicitly disclosing embedded fees; particularly in the case of fees for mutual funds and/or ETFs. While this rationale does not sit well with us- here's the thinking:

- Let's say your advisor suggests you invest in the Flinstone and Rubble Equity Mutual Fund. He is required to provide you with a prospectus. Somewhere in that 40-100 page prospectus is the underlying fee the fund manager charges. Somewhere in that same document is the explanation of the shares class (different fees for different share classes) you are invested in. Ever try reading one of these documents? But, the advisor has fulfilled his/her obligation of disclosure. Really?

- The embedded fee for a mutual fund or ETF comes out of the 'performance of the fund' or the NAV so it really isn't a fee to you. Again, really? So, if I have $100 in a fund which rises by 10% and has a 1% management fees is my investment worth $110 or $109…$109. Or, heaven forbid if the fund goes down in value am I still charged…yes you are.

Let's take a look at the exact same investment program and compare total costs to those that are conventionally disclosed:

Strategy	**Mgt Fee**	**Allocation**	**Total Fee**	**Disclosed Fee**
Equity SMA	0.40%	30%	0.12%	0.12%
Equity Mutual Fund	0.60%	20%	0.12%	
Int'l SMA	0.50%	10%	0.05%	0.05%
Int'l Mutual Fund	0.75%	10%	0.075%	
Int'l ETF	0.60%	10%	0.06%	
Core Bond Fund	0.25%	10%	0.025%	
Global Bond Fund	0.40%	10%	0.04%	
Research Fee	0.30%		0.30%	0.30%
Total Fee			**0.79%**	**0.47%**

The above table is, admittedly, a little busy but it is worth walking through. We have simply outlined a hypothetical investment portfolio consisting of differing investment strategies. Some strategies are what are know as SMAs or separately managed accounts while the others are mutual funds which most folks are familiar with. We have also included potential investment management fees and allocations to each. The third column is simply the weighted fee for each strategy while the last column provides the conventional disclosure of the management fee. Notice that total fee disclosure for the SMA portion is complete but the disclosure for the mutual fund portion is not. That is what troubles us.

Keep in mind that the cost of implementation such as investment manager fees is unavoidable…there is no free lunch even index funds have a management fee. However, as an individual investor you have a right to know all fees and as a fiduciary you have an obligation to disclose and understand all fees in order to discharge your fiduciary obligation!