

# Lighten Your Load

A primer on mutual fund costs

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In the past year, the brokerage and mutual fund industries have received quite a bit of publicity. Regrettably, it has been mostly negative. Mutual fund companies and the brokers that represent them have been targeted for over charging investors. While government oversight usually proves burdensome, some scrutiny is long overdue. Many mutual fund consumers (over 250 million currently) have needlessly paid high sales commissions because of misleading information and/or unscrupulous sales people. In this month's *Fiscal Fitness*, we will explain various mutual fund terminology/expenses/classes. We will also offer some helpful suggestions on minimizing mutual fund costs.

## Terminology

- **Load** – Think sales commission. 3 basic types: front end, back end and on going – see 'classes'.
- **NAV** – Net Asset Value. This is the daily price of the fund without any sales load. No-load funds are bought at NAV.
- **POP** –Public Offering Price. The price to investors for mutual fund purchases, equal to the NAV plus the sales charge. Loaded funds are bought at POP.
- **Breakpoint sales** – Think quantity discount. Investors are entitled to a reduced sales commission at certain purchase levels. Common price breaks are at \$25,000, \$50,000 and \$100,000. This has been the area of SEC investigations. Many Investors were not made aware of the breakpoint. Resulting in higher commissions for the sales person.
- **Internal Expense Ratio** – The ongoing expense of running the fund. Includes trading costs, custodial services, fund managers' salaries etc. This is not to be confused with a sales load. Every fund, loaded or not, has an expense ratio.
- **12 (b)-1 Fees** – An annual 'marketing' expense levied by the fund to compensate the sales person. Don't try to figure out the true customer benefit of this fee; it doesn't exist.

## Classes of Shares

- **"A" Shares** – Front-end load. Usually 3-5% sales commission of the principal amount.
- **"B" Shares** – Back end load. Usually based on a surrender charge schedule of 5-7 years. Basically, a penalty charge is levied if the investor cashes out of the fund before the surrender charge schedule is fulfilled. Additionally, an ongoing sales load of 1% is charged to the investor and remitted to the sales person. This is the most expensive (& arguably deceptive) class of mutual fund shares.
- **"C" Shares** – Continuous load. Up to 1% is remitted to the sales person annually. A small front-end load (1%) but no back end load is paid.
- **"No-Load" Shares** – No sales load. Available to retail investors. Vanguard, T Rowe Price, Dodge & Cox etc. are examples of no-load fund families.
- **"Institutional" Shares** – No-load class with lowest available expense ratio. Usually reserved for Investment Advisors only with higher investment minimums. This is the fund class Houlihan Asset Management utilizes for its clients.

## Some Advice

- Avoid loaded funds at all costs. With over 14,000 mutual funds offered, there are plenty of top performing funds with no-loads and low expense ratios.
- Pay attention to internal expense ratios. Keep domestic equity funds less than 1%, international/sector funds under 1.25% and bond funds less than .75%.
- If you must buy a loaded fund, avoid B shares. Mutual fund "B" shares are like a shopping commitment with my wife: expensive and hard to get out of.
- If you have invested \$25,000 or more in a loaded mutual fund, you may be entitled to a breakpoint refund. Visit [nasd.com](http://nasd.com) for more information.

Amidst all the confusion, you may be wondering whether the higher fees and sales commissions equate to better performing funds. The answer is no. There are numerous studies and rating agencies that have found no correlation between underlying costs and performance of the fund. The plain truth is that financial consultants sell loaded funds because they are paid to do so. It's generally not because the broker felt it was the best performing fund for their client among the universe of fund options.

At Houlihan Asset Management, we don't sell "loaded" mutual funds. As such, there's never a conflict of interest in the mutual funds we advise.

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