

Mutual Funds Are Stealing Your Money

The other day I was talking with a friend about saving and investing (my favorite conversation). This friend of mine, Jamie, was trying to wrap her arms around her company's 401K and its investment offerings. Jamie wants to start contributing to her 401K to save for retirement and get the company match, but remembered a conversation she overheard about how I hated mutual funds.

She wanted to know specifically why I was not very fond of them.

I went on to explain to Jamie that it's not all mutual funds I despise, just those actively managed ones that are riddled with high fees and under performance. I told her the thing that peeved me most was the fact that the excessive fee they charge is supposed to be justified due to outperforming their benchmark, meaning you're paying them to get you better than market returns vs. the benchmark. The problem is that something north of 85% of all fund managers actually under perform their benchmark (google it for the exact number).

So wait...why are you paying them the high fees again???

Let's use a quick example and assume you invest in mutual fund that uses the S&P 500 as the benchmark and that has a 1.25% management fee associated with it. The fund returns 9% before fees and the S&P 500 returns 8.75%. At first glance you're like "woo hoo." However, after the fund takes their 1.25% cut, you are left with a 7.75% return.

You pay the 1.25% every year no matter what!

The fund is down for the year; you pay the fee.

The fund manager under performs the benchmark, you pay the fee.

Even if they match the performance of the benchmark, you pay the fee.

Even if they beat the benchmark by less than the 1.25% fee, you pay the entire fee.

This doesn't make sense to me, especially when there is an alternative.

The alternative is to look for the mutual funds that are known as passive index funds, and come with a significantly lower fee. Vanguard has some of the most popular funds, VTSAX comes to mind with a 0.05% fee. This guarantees you the return of the benchmark less the incredibly small fee. If the benchmark returns 9%, you're looking at 8.95% that you get to keep.

The reality is that **fees matter**, especially over decades of investing.

Why would you pay a premium when 8 or 9 times out of ten you pay for the pleasure of underperforming the market???

Fees; The Stealth Wealth Heist

If you're investing in actively managed mutual funds you're being robbed and you don't even know it (now you do). It's happened right under your nose. A gap of just 1% adds up to an insane amount of money. You will be amazed when I show you how much of your money is being skimmed from your brokerage account.

For illustration purposes let's assume you have two options:

1. Invest in a passive index mutual fund with a 0.05% annual fee (\$0.50 per \$1,000 invested)
2. Invest in a actively managed mutual fund with a 1.05% annual fee (\$10.5 per \$1,000 invested)

In order to illustrate the havoc that fees can play on your wealth, I am going to use [Personal Capitals free fee analyzer tool](#) (try saying that 10 times fast). But before we go into comparing the two examples, let's first define a few other assumptions:

- We will assume retirement at age 65
- We will assume you start contributing \$18,000/year to your 401K every year until retirement
- We will assume an annual compound return of 8% (the one that floats around the internet)
- We will assume an annual \$5,054/year annual match from your company

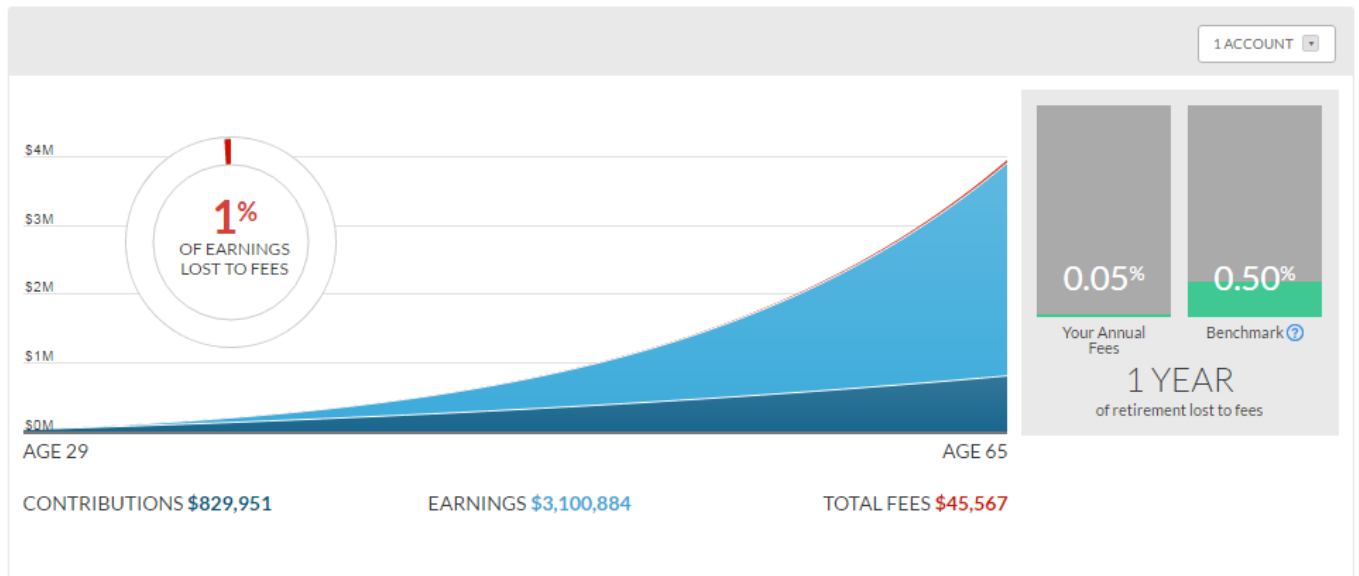
Option 1; The passive index route @ 0.05% annually

Over the course of 36 years of making contributions to your 401K, you contribute \$829,951 (your contributions + employer matches). By the time you reach retirement age your portfolio has earned \$3,100,884 due to compounding, leaving you with a total account value of 3,930,835.

However, you have \$45,567 less than you could have had due to the 0.05% fee. Said another way your total earnings could have been \$3,146,451 (\$3,100,884 + \$45,567). Therefore, fees ate up 1.45% of your earnings.

That is not bad at all. I can live with that!

Retirement Fee Analyzer



Option 2; The actively managed route @ 1.05% annually

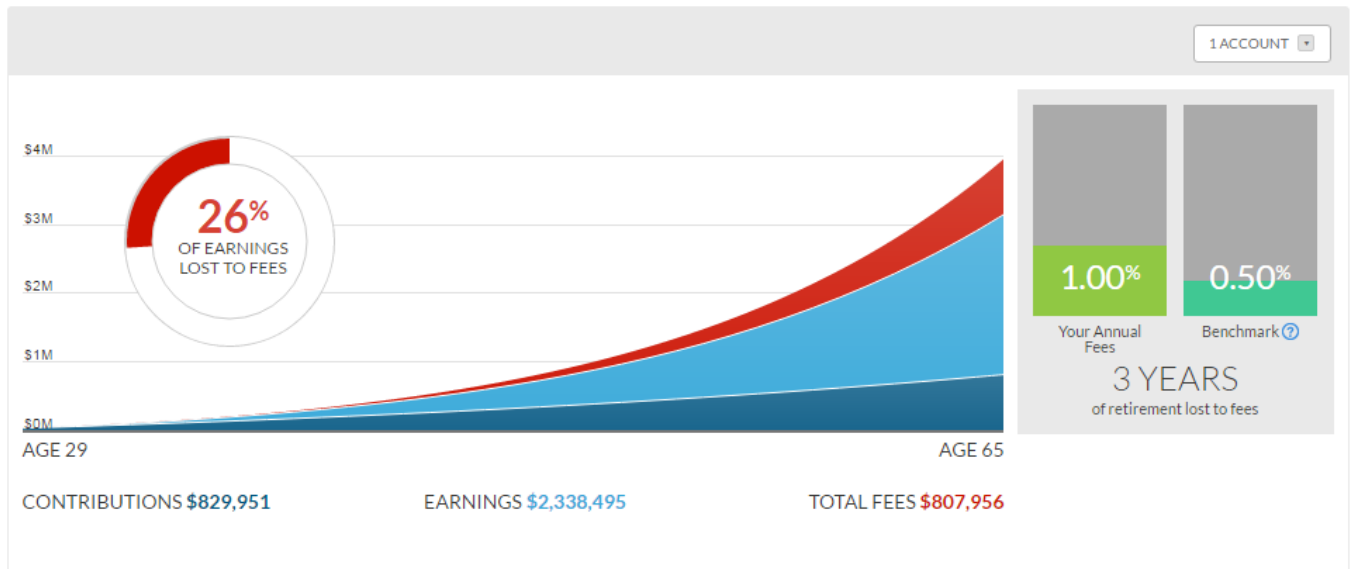
Over the course of 36 years of making contributions to your 401K, you contribute \$829,951 (same amount as above). By the time you reach retirement age your portfolio has earned \$2,338,495 due to compounding, leaving you with a total account value of \$3,168,446.

However, you have **\$807,956 less** than you could have had due to the 1.05% fee. Said another way your total earnings could have been \$3,146,451 (\$2,338,495+ \$807,956). Therefore, fees ate up 25.7% of your earnings.

WTF!

That is almost \$1M in fees and you end up with less money. It would be one thing if you paid that much in fees and ended up with more money than in option 1 above. But the fact that you pay \$807K in fees and end up with 26% less money if absolutely nuts!

Retirement Fee Analyzer



Conclusion

Fees matter and actively managed funds suck (in my opinion of course)!!!

Feel free to try and find a diamond in the rough, but outside of a hand full of investors, you will be hard pressed to find a fund that legitimately outperforms their benchmark for any sustained period of time. Anyone can get lucky for a year or two, but I will let the probabilities guide my decision, and with 85%+ underperforming, I will choose the passive index fund every time.

Now that you know how important the consideration of fees is in your investment selections, maybe it's time for you to finally pull the trigger and open up that [FREE Personal Capital account](#), so you can perform this analysis on your current investments now.

Full disclosure: This site does get a small commission for your Personal Capital sign up, but I never recommend anything that I don't actually use myself. Also, I only recommend things that I truly believe would be useful in helping you build your own wealth. Would greatly appreciate your support in signing up for an account if you don't already have one.

- Gen Y Finance Guy



Gen Y Finance Guy

Hey, I'm Dom - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own [financial stats](#). I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! [Read More](#)