Fund Fees Continue Their Downward March

Good news for investors! Average fund fees declined again in 2016. The decline was across the board, with equity, bond, and hybrid mutual funds coming in lower than in 2015. Ratios for both active and passively managed mutual funds fell, as did those for exchange-traded funds.

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According to data compiled by the Investment Company Institute, the average asset-weighted expense ratio for equity mutual funds fell to 0.63% in 2016; that of bond funds dropped to 0.51%; and that of hybrid funds decreased to 0.74%. The average index equity exchange-traded fund ratio came in at 0.23%.[1]

The declines represent the continuation of a long-term trend of lower fees. Since 2000, expense ratios have dropped significantly, with equity mutual fund expenses dropping 36% over the 16-year period (see chart). The drop is attributable to several factors. First, as fund assets rise, some fixed costs are spread over a larger base, bringing down average costs. Second, the downward trend reflects a shift toward no-load share classes and changes in how investors pay for services from brokers and other financial professionals. Third, lower expense ratios reflect competition among fund providers and economies of scale. And last, there is the growth in mutual funds with below-average expense ratios, such as passively-managed index funds, which are generally less expensive to manage than actively-managed funds. From 2004 to 2016, index mutual fund assets grew nearly fivefold, from $554 billion to $2.6 trillion. Over the same period, index mutual funds' share of long-term mutual fund assets more than doubled, from 9.0% in 2004 to 19.3% in 2016.[1]

Keep in mind that expense ratios differ considerably from fund to fund. A given fund's expense ratio depends on many factors, including investment objective, fund assets, and payments to financial intermediaries.

What's in Fund Fees?

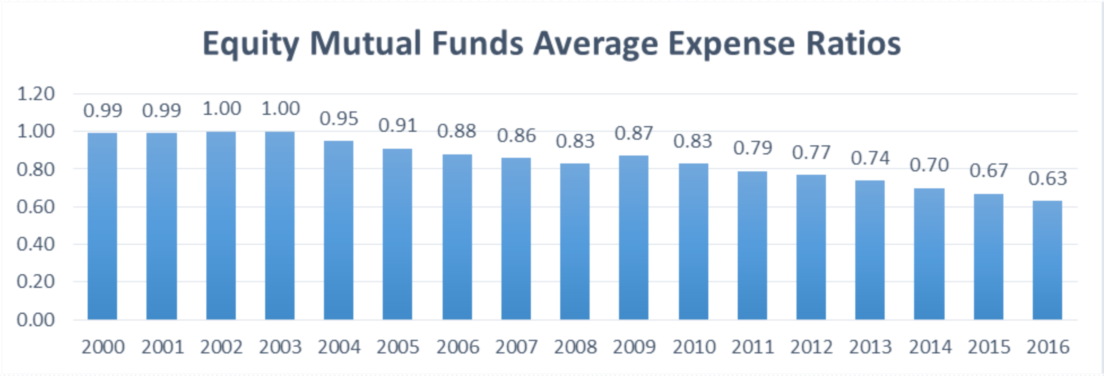
Fund fees represent the ongoing costs of running a fund. They include expenses such as portfolio management, fund administration, daily fund accounting and pricing, shareholder services, distribution charges (known as 12b-1 fees), and other operating costs. These expenses are paid from fund assets and are deducted from fund returns.

Note that fund fees should not be confused with "sales loads," which are separate and paid at the time of share purchase (front-end loads), when shares are redeemed (back-end loads), or over time (level loads).

Why Fees Matter to Investors

At first glance, the difference between expense ratios may seem insignificant. Even a ratio of 1.0% translates to only $1 per $100 investment. But over time, the difference can be significant. For example, a $10,000 investment that earned 8% annually for 20 years would have a gross market value of $46,610. If that investment were in a security with a 1.0% expense ratio, it would cost you $7,913 in expenses over that time period, and you would end up with an account balance of $38,697. On the other hand, an identical investment in a security with a 0.25% expense ratio would cost you only $2,111 over 20 years, and your account balance would grow to $44,499.[2]

Of course, expenses are only one factor to weigh when choosing funds for your retirement plan or investment portfolio. You'll also want to consider how well they match your goals, time horizon, and risk tolerance. But keep an eye on expenses as well -- they can make a big difference over time.



Source: Investment Company Institute, 2017 Investment Company Fact Book. Ratios are calculated on an asset-weighted basis.

[1]Investment Company Institute, 2017 Investment Company Fact Book. Ratios are calculated on an asset-weighted basis, which gives more weight to funds with greater assets. Asset weighting reflects where investors are actually putting their assets, and thus, better represents the actual expenses and/or fees incurred by investors than does a simple average (weighting each fund or share class equally).

[2]DST Systems, Inc. Example is hypothetical and does not include the effect of taxes, loads, or other fees. Your results will differ.