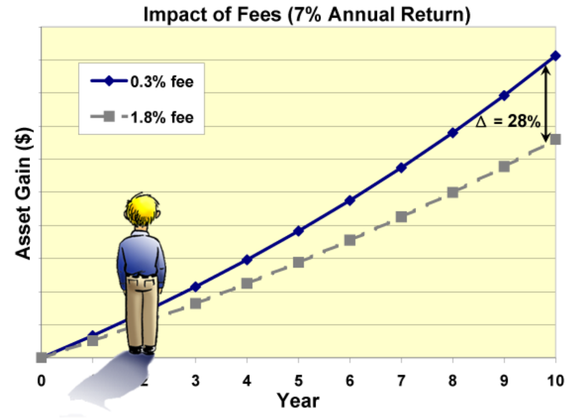
Reprinted from the
Lexington
Minuteman

COROMANDEL WEALTH MANAGEMENT

October 2011

401(k)s: Beware the "Killer Fees"

Navigating the Retirement Maze



Investment fees are a lot like termites: they are small, out of sight, and go unnoticed until it is too late to undo the damage they cause. Unlike termites, though, fees can't be completely be exterminated, as they are the "cost of doing business" in the investment world. However, keeping fees to a minimum can greatly improve your investment performance, and therefore increase the size of your retirement assets.

Check out the chart at which our "Retirement Man" is looking. It illustrates the difference in performance of two identical funds over a period of ten years, but with respective management fees of 0.3% and 1.8%. The 0.3% fund is 28% higher. In dollar terms, a $500,000 investment in the 0.3% fund would end up with $126,250 <u>more</u> than the 1.8% fund.

Active vs. Passive Funds: Getting Your Money's Worth?

Until the advent of index funds, the default investments in 401(k) funds were actively managed mutual funds, where managers made the portfolio selections and charged a fee that could range from 1% to over 2% per year. There have been many studies done on actively managed funds. They point to two major conclusions:

- The average fund manager <u>underperforms</u> the index that they are trying to beat; and
- It is difficult to pick those managers who will be the outperformers going forward.

Even Morningstar, the company most widely recognized as the arbiter of mutual fund performance, acknowledges that their "star" rating system is a measure only of past fund performance, not future. However, in a study that Morningstar released last year, they concluded that the single best indicator of future fund performance was lower expense fees, more reliable than even their own star rating system. To quote Morningstar's Director of Research:

> *"In every single time period and data point tested, low-cost funds beat high-cost funds."*

That's a fairly strong argument for searching out low-expense funds from which to assemble your 401(k) portfolio, or any portfolio for that matter. However, uncovering 401(k) fund expense ratios isn't an easy task. Plan providers are not currently required to disclose this information, so one has to go digging into fund prospectuses and plan documents in order to obtain this information.

DOL to the Rescue

Last year, the Department of Labor (DOL) announced that it is going to put an end to this scavenger hunt by requiring 401(k) plan sponsors to fully disclose their fees. Recently, the DOL issued a requirement that this information be made available no later than May 31, 2012. So as of that date, all of the fees – fund management, administrative, and recordkeeping– for 401(k) plans will be readily available to participants in those plans.

info@CoromandelWM.com Phone: 781.728.9001

This will likely have three effects over time:

- Get employers to seek lower cost 401(k) plan providers because, as legal fiduciaries, they are required to act in the best interest of plan participants.
- Employees will push their employers to lower plan costs, now that they can see exactly what their current plans are costing them.
- Force plan providers to lower their fees, as more employers migrate to the lower cost fund alternatives.

For the individual investor, this is great news, as better information makes for informed investment decisions.

What to Do For Now

While waiting for the new 401(k) disclosure rules to take effect, plan participants can still be proactive in their efforts to reduce their investment fees, and thus improve their portfolio performance:

- Fund fees aren't inaccessible, just not readily available. Ask your company's plan administrator to provide them to you.
- Use online databases to check the fees of the funds in your plan. See whether there are some suitable lower cost alternatives to your existing choices.
- Start prodding your employer to offer lower cost funds, and remind them that they are a legal fiduciary. (Many employers aren't aware of this, let alone know what "fiduciary responsibility" means. They'd better know by this time next year.)

The performance of your retirement investments is too important to just ignore. Do a little research and make some informed investment choices, and you may find yourself sitting on a larger nest egg at retirement than you would have had otherwise.

George Gagliardi is a financial planner with Coromandel Wealth Management in Lexington, and helps clients develop and implement retirement strategies. He is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor, and can be reached at (781) 728-9001 or george@coromandelwm.com. *This article is intended for general information purposes only, and may not be appropriate for your specific circumstances. Investment advice is particular to each individual, and should only be given after an individual situation has been reviewed.*