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COROMANDEL WEALTH MANAGEMENT

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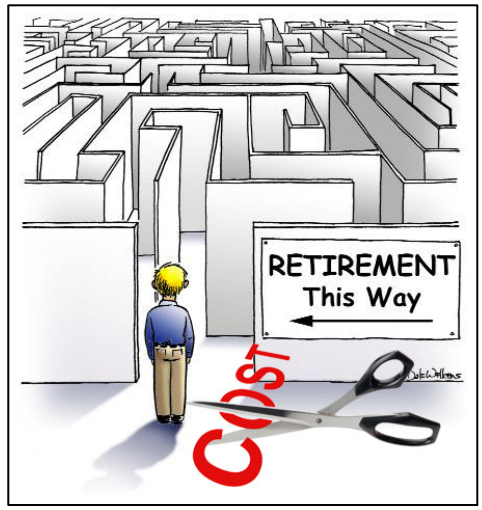
Resolve to put your investment fees on a diet

Navigating the Retirement Maze



"Money often costs too much."
- Ralph Waldo Emerson, American writer, philosopher (1803 – 1882)

With the New Year comes new resolutions to change your behavior for the better this year. Health club signups always see a surge this time of the year, and those overpriced Peloton video games that masquerade as exercise machines are flying off the shelves. These well-meaning actions usually last a few months, as any health club owner could tell you. So instead of shedding pounds, how about shedding unnecessary investment expenses? This is a resolution that takes a little effort up front, but will pay you back year after year.

Find less expensive and more tax-efficient funds

In investing, cheaper is not always better. Long-term performance and adequate portfolio diversification to reduce volatility are what matter most. But for what are essentially equivalent funds, such as passive index funds for the same geographic region, lowering your fund expense will increase your returns over the long term. An example would be comparing passively managed emerging market exchange traded funds (ETFs), most of which use the same three indices to select their holdings. The management fees for the available choices can range from 0.11 percent up to 0.89 percent. Yet the five-year returns for most of these funds are nearly identical – with the lower fee funds doing slightly better – so why pay extra for the same stock holdings?

Tax efficiency is also important in fund selection and location. Mutual funds hit their owners with capital gains bills at the end of the year, so these should be in retirement accounts. Use ETFs, most of which have no capital gains distributions, for your taxable accounts. High turnover mutual funds tend to generate the largest taxable gains each year, so if you are going to have mutual funds in taxable accounts, choose those with the lowest turnover ratios in order to reduce your tax bill. Morningstar, a well know financial services firm, includes turnover ratios in their fund profiles. Be careful when changing one fund for another in a taxable account, as it could trigger capital gains that you weren't planning on. A tax-efficient way to do this is to look at the individual tax lots in an account, and to sell the ones with lower gains and donate the high gain lots, sidestepping the capital gains tax.

Bail out of overpriced annuities

There is a saying in the finance industry: "Annuities aren't bought, they're sold." High commissions on variable annuities (VAs) – those that provide a range of mutual fund choices – have resulted in many individuals purchasing these high-fee financial instruments sold by aggressive insurance salespersons. I believe that annuities have a place in many investment portfolios, as they can do things that stocks and bonds can't, such as providing guaranteed lifetime income. However, some annuities are better than others when it comes to providing benefits that are commensurate with their cost. The riders that are sold with annuities can often be valuable to the policy owner, but they should fit the needs of the individual. Having your variable annuity reviewed for their costs versus the rider benefits could potentially save you money much over time, as the total fees for variable annuities can easily run over 4 percent a year, significantly cutting into your returns.

Assuming that your surrender fee period – another "gotcha" of VAs that typically last seven years or more – has expired, there is a lower cost alternative to VAs. Called Investment Only Variable Annuities (IOVAs), these annuities tend to offer more investment choices at a considerably lower cost than traditional VAs. They have the same tax deferral benefit of regular VAs without the high expenses. To sidestep the capital gain that results when a VA is cashed out, they can be transferred to an IOVA with no tax consequences using what is called a 1035 Transfer. Most IOVAs make it easy to do this. Take a critical look at your existing VA to decide whether the costs exceed the benefits, and make an informed decision about whether to move your VA assets into an IOVA.

Get your money's worth from your advisor or broker

Over the past several years, there has been a proliferation of so-called "robo-advisors" offered by investment management firms. Currently, there are at least a dozen choices available that, once you have answered a series of questions, will create a portfolio for you that supposedly fits with your investment needs. The cost of the various robo-advisors ranges from free to 0.89 percent plus the cost of the ETFs used, which are typically around 0.1 percent. Compare this with a typical investment firm that charges 1 percent or more a year as a management fee, and might be using mutual funds with fees of 1 percent or more. (Many firms are now using lower cost ETFs in order to reduce this cost.) What determines whether you are getting your money's worth is what else you are getting in the way of services from your investment firm.

Some robo-advisor firms are now offering financial advisor support by phone for around an additional 0.3 percent a year, as an inducement to investors who appreciate having some human advice along with computerized portfolio management. A few firms will assign an advisor to you, while others will give you whoever answers your call. You will most likely get your basic retirement assessment, portfolio analysis, and assistance with common investing and financial questions on an "as requested" basis. A few even provide answers to questions about Social Security claim strategies. What you won't get is answers to complex financial, estate planning, and tax issues. (Many advisors at these firms are recent college graduates with limited experience.) If you don't have a particularly complex investment situation and are comfortable with not meeting with your advisor face-to-face, then these robo/phone advisor services might be a better alternative than a full-price advisor, particularly if you're not getting the advice that you need from the latter.

Zero cost trades? Ignore 'em

The recent elimination of trading commissions by all of the online brokerage firms is mostly a boon to day traders. If a 7-dollar trading cost was having an impact on your investment returns, then you're not investing. You're speculating. Better keep your day job.

The competition for financial services has driven down investment costs over the past several years, and this trend is likely to continue as more major brokerages and investment firms compete to manage your assets. Determine what level of financial assistance you require, then compare the alternatives. Every dollar that you save on investment fees is another dollar towards your retirement. Compounded.

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