

## **5. Investment Considerations**

- I. Investment Considerations
- II. Mutual Fund Expenses
- III. Fees Matter
- IV. The Limits of Fund Rating Services
- V. Traditional Asset Allocation Generates Excess Turnover

# Investment Considerations



- Reduce expenses.
- Diversify systematically.
- Minimize taxes and turnover.
- Think long-term.
- Apply discipline.
- Hold low-cost funds.
- Maintain asset allocation.

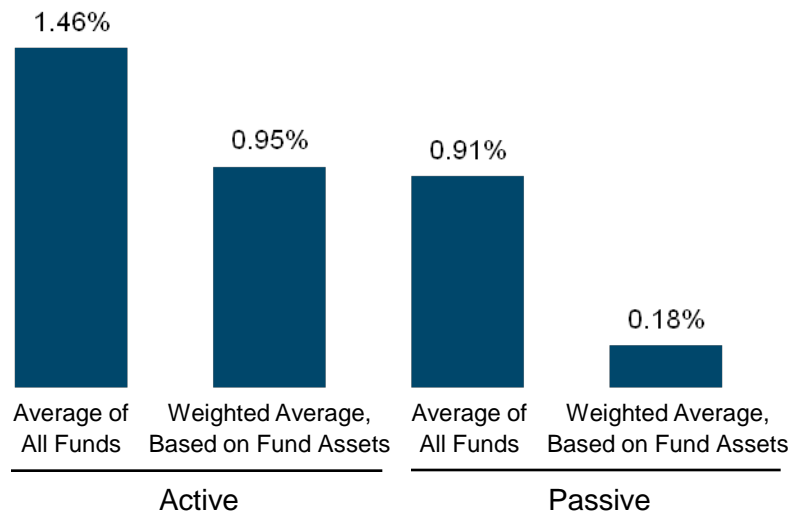


# Mutual Fund Expenses

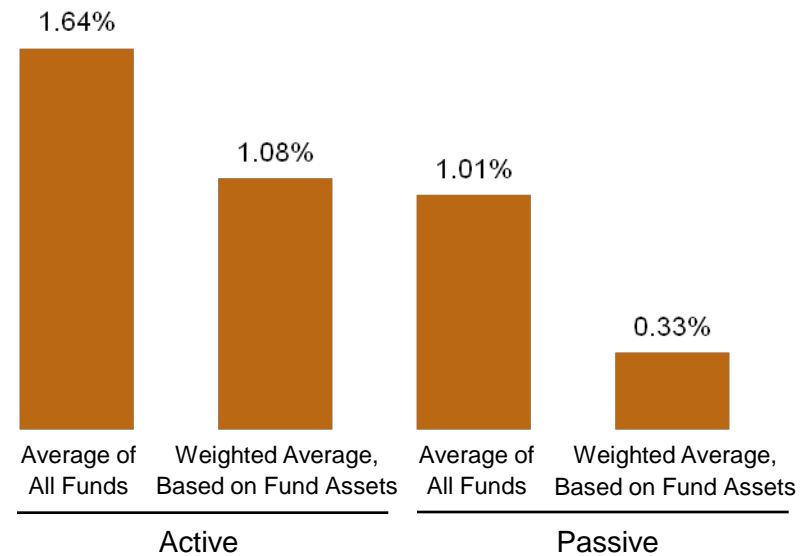
“After costs, the return on the average actively managed dollar will be less than the return on the average passively managed dollar for any time period.”

—William F. Sharpe, 1990 Nobel Laureate

## Domestic Mutual Fund Expense Ratios



## International Mutual Fund Expense Ratios



William F. Sharpe, “The Arithmetic of Active Management,” *Financial Analysts Journal* 47, no. 1 (January/February 1991): 7-9.

Mutual fund expense ratios as of April 9, 2010. Asset weighting based on net assets as of December 31, 2008. Data provided by Morningstar, Inc.

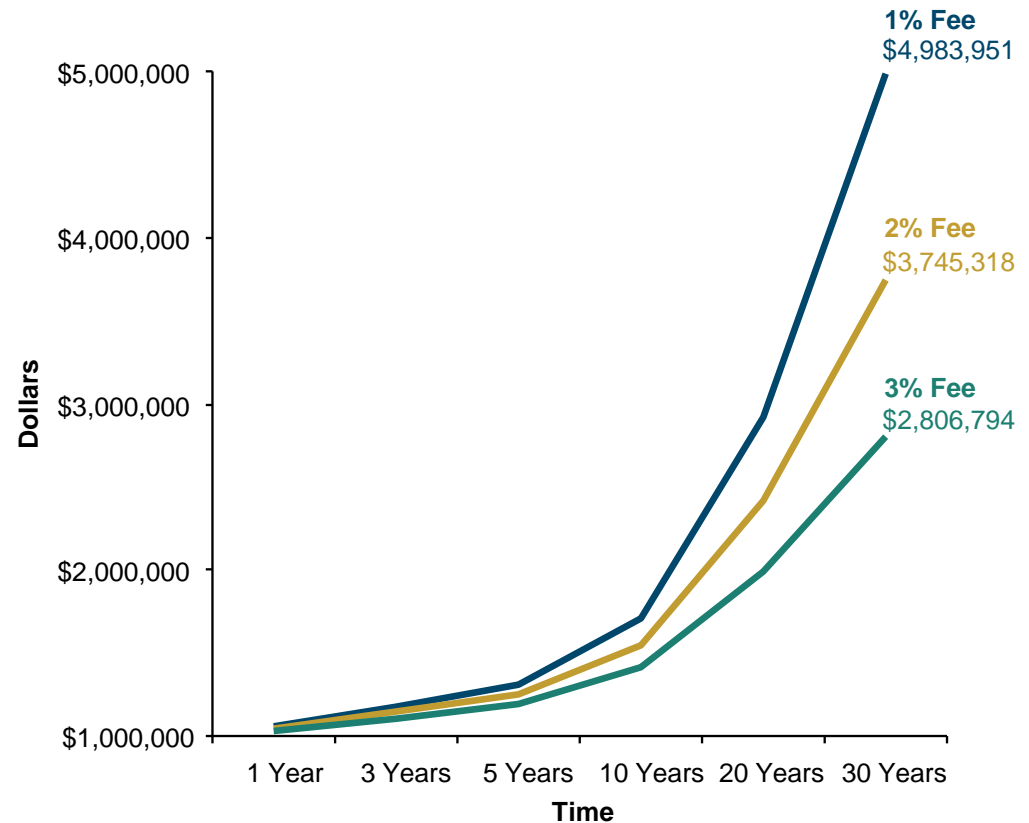
Passive funds are those coded by Morningstar as Index Funds.



## Fees Matter

- Fees matter.
- Over long time periods, high management fees and related expenses can be a significant drag on wealth creation.
- Passive investments generally maintain lower fees than the average actively managed investment by minimizing trading costs and eliminating the costs of researching stocks.

Assumed 6.5% Annualized Return over 30 Years





## The Limits of Fund Rating Services

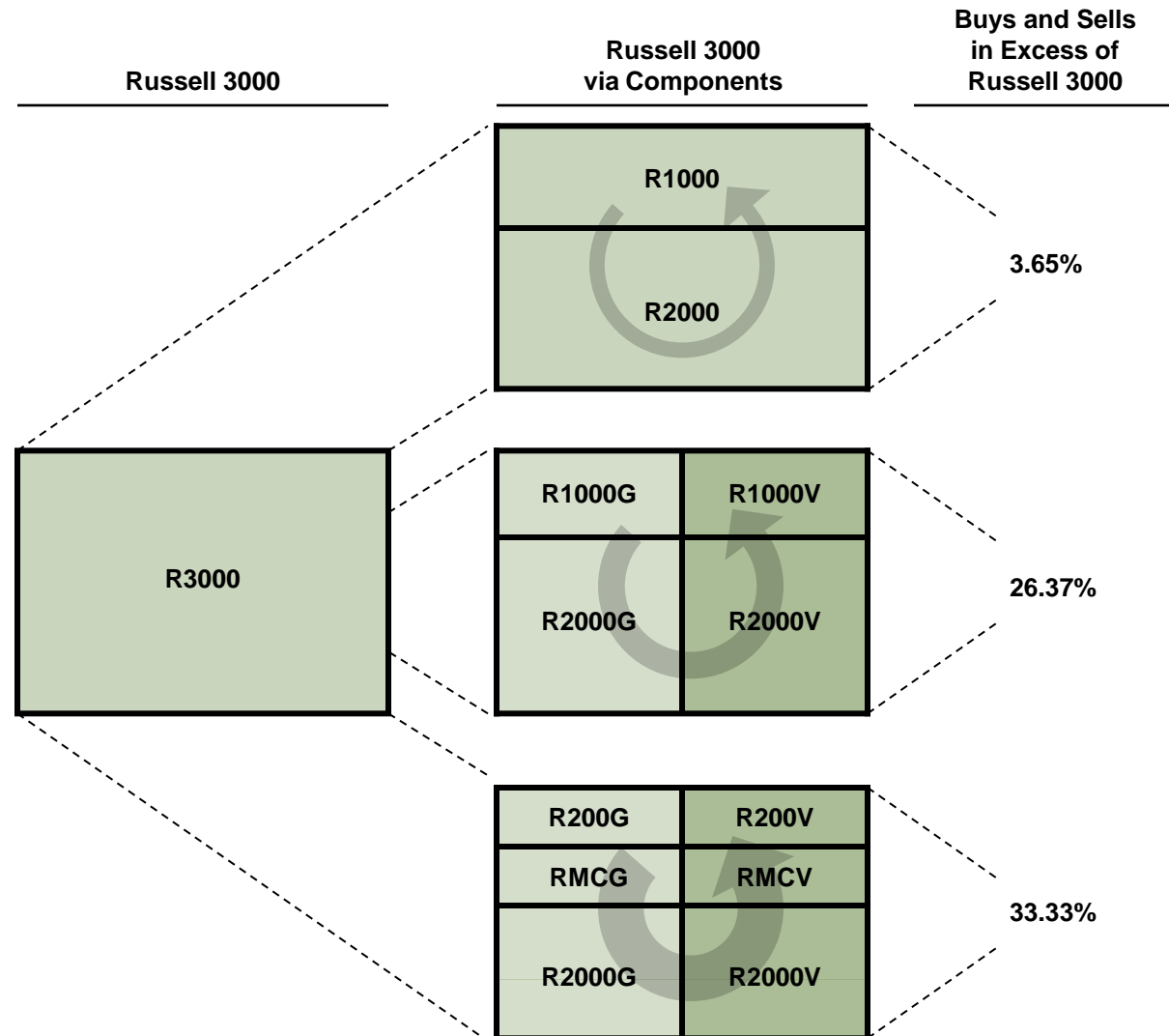
	Fund A	Fund B	Fund C	Fund D
<b>Morningstar</b> (Dec 2000)	★★★★★	★★	★★★★	★★★★★
<b>Forbes</b> (Dec 2000)	C	A	A+	D
<b>US News &amp; World Report</b> (Dec 2000)	34	50	10	93
<b>Wall Street Journal</b> (Jan 2001)	E	C	A	B
<b>BusinessWeek</b> (Jan 2001)	A	No Rating	B+	C

Funds A, B, C, and D are actual funds. They are not identified because the purpose of this illustration is to emphasize that ratings, by themselves, do not provide enough information to make a sound investment decision.



# Traditional Asset Allocation Generates Excess Turnover

- In effect, a component portfolio buys and sells from itself, generating needless costs and taxable events.



Annual: January 1989-December 2009.

Russell components are Russell indices weighted according to Russell 3000 market value weights (buys and sells measured by the weight of each component). Estimated annual cost assumes transaction costs of 50 bps.

For illustrative purposes only.