

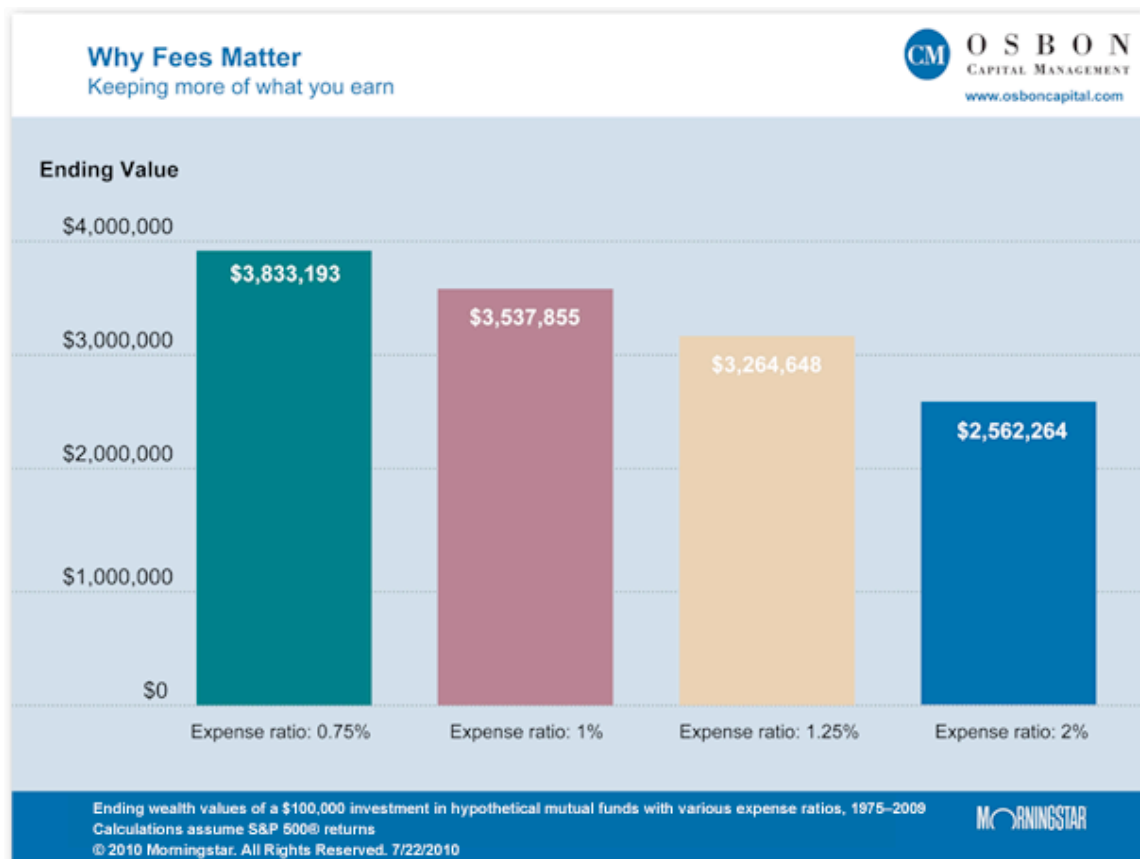


The Osbon Minute

Fees: A portfolio’s silent killer

When investors track the performance of their investments, they typically focus on one number: annualized return. It’s the obvious choice, distilling months or years of ups and downs into a single data point. It’s easy to understand, discuss, and compare. But there’s another number, often ignored, with a big impact on long-term outcomes: expense ratio.

If we think of a portfolio as bucket being filled for future use, it’s natural to focus on what goes into the top of the bucket through the purchase of securities, plus dividends and price appreciation. But portfolio buckets leak. Fees paid to money managers, mutual fund managers, or ETF managers slowly drain value from a portfolio. These fees diminish positive market results and exaggerate negative ones.





Keeping more of what you earn

The diagram above shows the impact over time of various fee levels on a portfolio's value. With an expense ratio of 75 basis points, a \$100,000 investment in the S&P 500 in 1975 would have grown to more than \$3.83 million by 2009. At 125 basis points, fees would reduce the 2009 value to \$3.26 million. And a 2% expense ratio silently evaporates another \$700,000 of portfolio value.

With huge sums dripping out of the bottom of the bucket, management fees deserve far more attention than most investors give them. Fortunately, by choosing investments carefully, investors can greatly reduce what's lost to fees.

At Osbon Capital, we favor index ETFs because they are designed specifically to keep costs low. Intended to track, rather than beat, published indexes, index ETFs do not demand high fees for analysts, economists, and fund managers hoping to outsmart the market through elaborate stock picking or market timing strategies. In fact, many index ETFs keep fees to less than 25 basis points.

As you consider your own portfolio bucket, stay focused on what goes in the top, but don't forget about that leak in the bottom. By keeping it as small and slow as possible, you'll keep more of what you earn.

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Next time: The fallacy of annualized return.

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Example is based on a hypothetical \$100,000 investment in 1975, growing at the return level of the S&P 500. Ending values represent portfolio value at year-end 2009 after expenses. Data provided by Morning Star.

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