Focus on Fees - Spring 2016, Issue 5
Dragged Down by Sales Loads

As part of SIM's analysis of "investment turnover" (see ***Financial Jargon – Turnover***, **Spring 2016**), I looked into the actual turnover ratios for the largest actively-managed funds. My source for comparison was the list published periodically by The Wall Street Journal (in this case the 4/4/16 edition). After excluding the passively-managed / index funds, the pool was left with a surprising number of American Funds products. It fact, there were so many American Funds listed that I chose to limit them in my sample in an attempt for the sampling to be more broad based.

The prominence of American Funds was striking. Looking at the largest 25 funds on the WSJ list, 11 of them were index funds (7 being Vanguard offerings). Of the remaining 14 actively-managed funds, 10 were American Funds issued products. In a very large and evolving financial services industry, **what contributes to American Funds remarkable level of concentration on the list?**

American Funds, through its Los Angeles-based parent Capital Group, dates back to 1931 and has grown to be the 3rd largest mutual fund group, trailing only Vanguard and Fidelity. Unlike its two larger peers, **American Funds are sold primarily through advisers and that may be the reason for their prominence and persistence.** While they may otherwise be a great collection of mutual funds, of the ten American Funds products referenced above, nine of them had a maximum sales charge of 5.75% - which could be quite an incentive for some advisors to put their clients in American Funds products.

Investors need to be aware of these sales charges – also known as loads. These charges are typically assessed "upfront" at the time of sale or are "backloaded" wherein the commission is collected when a sale out of the fund takes place. In the following example of a $75,000 purchase of a mutual fund with a 5.75% upfront sales load, $4,312 of the investment would go toward broker, planner or advisor commissions while just the remaining $70,688 goes to purchasing the fund's underlying assets. In an investment analysis using a $75,000 purchase, a 15-year holding period, a constant 7.0% rate of annual appreciation, a no-load investment grows to $137,884 while the 5.75% upfront load is a $7,928 drag, reducing appreciation to $129,956.

One of the top stories in wealth management today is the proposed mandate for advisers to "work in the best interests" of (certain) clients. The predominance of front loaded funds might suggest that the rule change may have some merit. As a registered investment advisor, SIM does not assess or accept sales commissions.