

Smart Money: Cost effective investment solutions

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Brad Brain: "Once you have come up with a short list of viable investment options, take a look at your expenses. Because the bottom line is the less you pay in costs, the more you keep for yourself." | Sean Gladwell / Getty Images



One of the things that gets a lot of scrutiny in the Canadian financial world is the cost of it seems like all the cool kids like to bemoan “the high costs of investing.”

Believe it or not, costs are not the most important thing when it comes to making sound investment choices. Don’t get me wrong, costs are important. They just are not the most important thing.

There are plenty of examples of investments that may be cheap to own but have resulted in the destruction of wealth. If you lose 95% of your principal, who cares what it cost to buy the thing?

There are also plenty of examples of investments that have costs on the higher side but have turned out to be excellent creators of wealth. Sometimes you get what you pay for.

Rather than costs, the most important thing is making decisions that are consistent with your objectives. If an investment does not fit your objectives and your risk tolerance, then its cost is moot. Please don’t buy investments that don’t fit your objectives, regardless of how cheap they may appear.

But let’s assume that we have already identified the long list of potential investments that are suitable for your needs, and now we want to figure out the best way to buy them.

Most retail investing in Canada is done through mutual funds. One of the features of mutual funds is that most of the costs to own the fund are embedded in the product. I don’t mind that as a feature as it greatly improves the convenience of investing.

But, without question, having costs embedded in the product is not very transparent. Indeed, many Canadians have no idea what they are paying to own their mutual funds.

Believe it or not, some people are even under the impression that they don’t have costs at all. Trust me on this, if you own mutual funds you have costs. There is no free lunch. If you don’t know what you are paying you can ask your mutual fund advisor, or email your investment portfolio to me and I will look it up for you.

This next part might be a little tedious, but stick with me, because the potential payoff is reducing your costs, and turning some of your costs into tax deductions, and who doesn’t want that?

I will simplify this a bit, but here is how it works in general terms: The typical mutual fund, which we will call Series A, might cost you about 2.5% per year to own. This comes right off the top, so if what you see is a return on your investment of 7.5%, that means the gross return before the costs are deducted will actually be about 10%. Of that 2.5% that you pay in embedded costs, about 1% goes to compensate your advisor.

Alternatively, rather than having what you pay your advisor bundled in with all the other costs, a potentially better way is to separate part of your costs from your investment. This is called Series F, and

there are three advantages: its more transparent, it has the potential to reduce your costs, and usually the investment counselling fee is tax-deductible on non-registered accounts.

Here is an example. We looked up a random Canadian mutual fund. The Series A version costs 2.54%, with 1% going to your advisor. The Series F version costs 0.99% and then you pay your advisor on top of that. Assuming your advisor still charges 1%, the total costs are 1.99%, saving you 0.55% annually. That might not sound like much, but on a \$250,000 portfolio that adds up to \$1375 in cost savings, every year, to own the same investment! And if this is a non-registered portfolio, the amount you pay your advisor is tax deductible!

Again, costs are not the most important thing. But once you have come up with a short list of viable investment options, take a look at your expenses, including taking a look at the F class version of mutual funds. Because the bottom line is the less you pay in costs, the more you keep for yourself.

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