

Are You Confused About Investment Costs?

Part 1: Fund Management Fees

What are your investments really costing you? If you're not sure, you're not alone. It's not like you're handed a menu of charges to choose from when it's time to place your order. Even when you know where to look for investment costs, the information can be difficult to digest.

Let's fill in some of the blanks by covering two significant sources of investment costs: **fund management fees**, and **custodian/brokerage (trading) costs**. Today, we'll talk about fund management fees. We'll cover custodian/brokerage costs next time.

Fair Fund Management Fees

One reason we typically recommend investing in a mix of lower-cost, index-like funds is their ability to efficiently capture global market returns without your having to juggle thousands of individual securities at a time personally.

What a hassle that would be. That's why you instead hire a fund manager, investing in their funds, and letting them do the heavy lifting for you. In exchange, fund managers deserve **reasonable** compensation for services rendered.

Evidence-Based Investing

What's "reasonable"? To discover how much fund management is costing you, start by looking for each fund's **expense ratio**. You can find this information in the fund's **prospectus**, or by searching online for its name or ticker symbol. Many broad market index mutual funds or ETFs have annual expense ratios of 0.10% (10 basis points) or less. If a fund's annual expense ratio approaches 1% (100 basis points) or more, you

should question if the manager is adding enough value to justify its higher expense.

Some fund managers also pile on extra fees, or loads, beyond the ones reflected in their expense ratios. These should also be disclosed in the fund's prospectus, and can include:

- A one-time front-end load when you buy shares of the fund
- A one-time back-end load when you sell shares of the fund
- Similar contingent deferred sales charges (CDSCs) and other redemption fees

Hiding and Seeking Fund Fees

Because fund management fees are typically bundled into each fund's share price, you'll barely notice they're there. But they still cost you real money.

For example, in a recent working paper, "**Obfuscation in Mutual Funds**," academics from the University of Washington, MIT, and The Wharton School at the University of Pennsylvania compared the 2019 costs and performances of two S&P 500 Index mutual funds. Before fees, their gross returns were nearly identical at 31.46% vs. 31.47%. But one fund manager charged a lean 0.02% (2 basis points). The other one charged up to an all-in 5.08% (508 basis points). Once you know that, it's easy to tell which fund will leave more money in your pocket after fees.

Are you having trouble finding a fund manager's fees to begin with? Consider this central finding from the same paper:

"Using bespoke measures of complexity designed for mutual funds, we find evidence consistent with funds attempting to obfuscate high fees."

In other words, the study found that lower-cost funds usually provided short, easy to understand fee disclosures; **the higher-cost funds often buried their costs in lengthy and complex legalese.**

Why complicate things? When searching for a particular type of investment, there are almost always funds available that do **not** charge loads and similar add-ons, and **do** clearly disclose their costs. We prefer transparency and simplicity and believe our clients do as well.

Comparing Costs

Low costs are important. But they're not the **only** reason to favor one fund over another. Some funds cost more to manage because it's more expensive to participate in their target market.

For example, an emerging markets fund will usually have higher expense ratios than a general U.S. market fund. So, first, identify available funds that fit your unique investment goals. Compare their expense ratios, apples to apples. Weed out any funds that charge sales loads, or bury their fee disclosures in long-winded blather. **Then** select suitable funds with the lowest costs.

Up Next ...Custodian/Brokerage Costs

In addition to your fund management costs, custodians, brokers, and trading platforms also make money off your investment activities. We'll cover what those costs look like next.

Until next time, no regrets!



Eric Hutchens
Chief Investment Officer

You make most of your money in a bear market, you just don't realize it at the time.

Shelby Cullom Davis

Upcoming Webinar

January 26, 2023 at 3:00 – 4:30 PM Central Time

Navigating the Sustainable Investing Landscape with Author Samuel C. Adams

Allodium is thrilled to present Samuel C. Adams, author and CEO of Vert Asset Management, to help us understand the growing field of sustainable investing. Sustainable investing is becoming more popular in the U.S. and globally. Many people have questions about the difference between sustainable investing, impact investing and ESG. Sam will clarify the terminology, explain the academic research, and offer tips for effectively choosing your asset allocation strategy.

For more information about how to register for our webinars, please contact iavraamides@allodium.com.



Samuel Adams, CEO and Co-Founder
Vert Asset Management

Samuel Adams is CEO and co-founder of Vert Asset Management. He also chairs the Investment Research Group. Sam leads the development of new products to help make sustainable investing easier for investors. He has been a featured speaker on sustainable investing at financial advisor conferences in the US, UK, Europe, and Australia. Prior to launching Vert, Sam spent 20 years at Dimensional Fund Advisors where he led the European Advisor business and launched the Global Sustainability Core Fund.

Sam has a BA in Philosophy from the University of Colorado, Boulder and an MBA in Finance from the University of California, Davis.

Headlines

- Allodium was excited to host Kathleen McBride and Allan Henriques for their presentation of *8 Ways to Enhance Donor Trust by Improving Your Investment Stewardship* on October 20, 2022.
- Allodium was pleased to welcome four new clients in the third quarter of 2022.
- Our office will be closed December 26, 2022. We will also be closed January 2 and 16, and February 20 for company holidays in 2023.

To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

WE APPRECIATE YOUR INTRODUCTIONS

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Steward is published quarterly by Allodium Investment Consultants. Please contact iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.



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FINANCIAL PLANNING TIP

What's new in 2023?

With a new year comes new "key numbers" for Social Security, Medicare and the Gift and Estate Tax. Here is what will be changing in 2023.

Social Security

The cost-of-living (COLA) adjustment will be 8.7% for 2023. If you are receiving benefits of \$2,500 per month, your check will go up to \$2,718 per month, an increase of \$218. The maximum Social Security benefit for a worker retiring at full retirement age (FRA) is going from \$3,345 in 2022 to \$3,627 per month in 2023.

Also, the amount of income that working adults will pay Social Security tax on is going up. For 2023, income of up to \$160,200 will be taxed at 7.65%. In 2022 the income threshold was \$147,000.

If you take your benefit before your full retirement age and are still working, \$1 in benefits will be withheld for every \$2 in earnings that you make above the "earnings limit" of \$21,240 in 2023. Additional income limitation rules apply as you get closer to your FRA. The good news is that this earnings limit goes away entirely once you reach full retirement age. After full retirement age you can earn any amount and still collect your full benefit.

Medicare

Premiums for Medicare Part B are going down from \$170.10 per month in 2022 to \$164.90 per month in 2023. There is no cost for Medicare Part A. The actual premium you pay for Part B is based on modified adjusted gross income. You can find a Fact Sheet showing the income thresholds and the associated premium amounts via the link below:

<https://www.cms.gov/newsroom/fact-sheets/2023-medicare-parts-b-premiums-and-deductibles-2023-medicare-part-d-income-related-monthly>

Annual Gifts and Estate and Lifetime Gift Exemption

In 2023 the annual gift tax exclusion will be \$17,000. You can give up to \$17,000 per person to as many individuals as you wish, and the gifts will not be subject to gift tax, nor will they reduce your lifetime gift and estate tax exemption amount. Speaking of which, the gift and estate tax lifetime exemption will be going up to \$12.92 million per person in 2023 from \$2.06 million in 2022. A married couple will have \$24.84 million of exemption available to them in 2023.

Note that the lifetime exemption is scheduled to revert to the pre-2017 level adjusted for inflation of about \$6.8 million at the start of 2026. This reversion was part of the 2017 Tax Cuts and Jobs Act. Congress could act to make it permanent, but there are no guarantees. If your estate is projected to be greater than \$12 million, we recommend you meet with your estate planning attorney to see if you could take advantage of the current exemption amount prior to the end of 2025.

1. Social Security Changes – COLA Fact Sheet; <https://www.ssa.gov/news/press/factsheets/colafacts2023.pdf>
2. 2023 Medicare Parts A&B Premiums and Deductibles 2023 Medicare Part D Income-Related Monthly Adjustment Amounts, September 27, 2022; <https://www.cms.gov/newsroom/fact-sheets/2023-medicare-parts-b-premiums-and-deductibles-2023-medicare-part-d-income-related-monthly>
3. Novack, J. (2018). *Lifetime Estate and Gift Tax Exemption Will Hit \$12.92 Million in 2023*. Forbes; <https://www.forbes.com/sites/janetnovack/2022/10/18/new-higher-estate-and-gift-tax-limits-for-2023-couples-can-pass-on-extra-172-million-tax-free/?sh=14f4d6e27dd8>