

Costs Count

Our firm was founded on the principle that minimizing all costs, including fees and taxes would add significantly to our clients' investment returns over time. Unfortunately, our industry as a whole does a very poor job of trying to minimize many costs for investors. As an example, even though the investment management industry has experienced tremendous growth over the past decade, average management fees have increased.

Rising fees were characteristic of the strong equity markets of the 1990s when investors felt less sensitive to the negative impact fees have on bottom-line performance. With returns in excess of 15%, few worried about a management fee of 2½%. The industry was growing rapidly, firms were introducing new investment products to meet the rising demand and with above average returns, fees kept inching higher. However the recent bear market and the likelihood that future returns may be below the historical average of 9-10%, have left investors questioning these higher fees. As they should. If markets provide a return of 8% and an investor is paying 2½% in management fees, almost **one third** of this return is being lost to fees.

For an investor with \$400,000 or more of investable assets looking for an advisor, there is a myriad of choices available, generally falling into three categories:

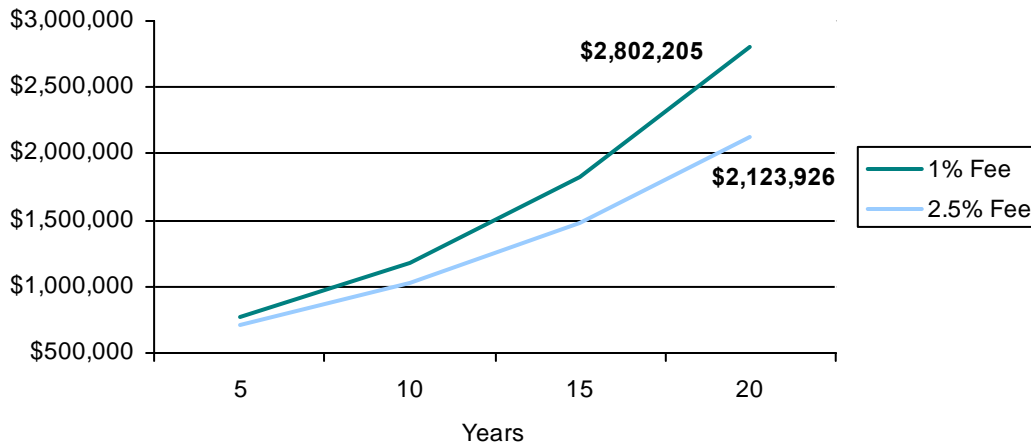
Mutual Funds – Fees are based on the management expense ratio (MER) and are charged inside the fund. A globally diversified group of funds with an overall asset mix of 50% equity and 50% bonds typically costs about 2½%, regardless of the size of the investment. In addition to the MER, there are transaction costs and often a front-end or deferred sales charge. Front-end charges average about 2% and deferred sales charges are typically 6%, declining by ½% each year for the first 6 years.

Full Service Brokerage – Traditionally, fees were charged on a transaction basis but over the past few years more brokers have moved to the practice of charging an overall fee. Portfolios usually consist of a blend of individual stock holdings, bonds and mutual funds. Total fees may be as much as 3% if the mutual fund fees are included.

Investment Counselling – Management fees typically start at 1¼% and decline on a tiered schedule depending on the size of the portfolio. Most firms have a minimum fee, which varies considerably. If investors are looking for discretionary investment management, this is the lowest cost alternative. In addition, the fees are *tax deductible* for taxable accounts, further reducing the cost.

Although the differences in fees may not seem that substantial, over longer time periods this difference has a significant impact on an investor's wealth. To illustrate, we have set out an example below. A \$500,000 portfolio achieves a 10% return on an annualized basis over a 20-year period before fees. The chart reflects the difference in terminal portfolio value using a fee of 1% and 2½%.

Growth of \$500,000



In this scenario a difference in fees of 1½% costs almost **\$675,000** in lost return over the 20-year period. Clearly, the impact of fees alone might determine whether or not an investor is able to achieve retirement goals.

As mentioned, investment counsellors provide the lowest cost alternative for investors seeking discretionary money management. Even so, fees differ substantially within the group. In general we think average fees are too high and our goal is to position our fee structure in the bottom quartile of all investment counsellors. All investment counselling firms must also have a separate custodian to hold client assets, which may result in an additional charge of 0.2%. We use a reputable custodian who does not charge custodial fees.

In this article we have focused primarily on the importance of minimizing costs from a management fee standpoint. There are other costs of which investors should be aware and those relate to portfolio turnover and the costs relating to frequent trading. This is particularly true of mutual funds where significant trading results in execution costs and higher capital gains distributions. Most funds are managed for top-line growth with very little attention given to the after-tax return to the investor. Over time, these costs may be far more devastating to portfolio value than management fees.

Containing costs and minimizing leakage from the portfolio is critical to the success of an investor's long term investment plan. At Milestone we want your top-line results to translate smoothly to your bottom line. We accomplish this by customizing portfolio management decisions, by employing a low turnover investment style and by minimizing costs that otherwise detract from our clients' long-term investment success.

Milestone Investment Counsel Inc.

May 15, 2005