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***— Lindsay Speed**, legal counsel, FAIR*

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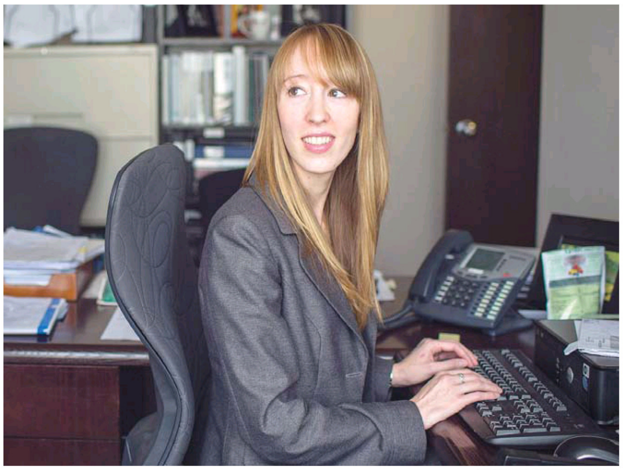

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Lindsay Speed, legal counsel to FAIR, urges investors to be vigilant with the fees they are charged.

Reduction in investment fees improves returns

Doing the math

By Kathryn Boothby

With returns at historical lows, it's tough to make a decent buck on investments these days. Add in fees that are taken off the top and those meagre returns head even farther south.

"If you're not doing the math, you don't realize how much of your investments are eaten away by fees," says Lindsay Speed, legal counsel for the Toronto-based Canadian Foundation for Advancement of Investor Rights (FAIR). "Investors need to know what they are paying in fees, and most retail investors do not."

One of Ms. Speed's biggest concerns is trailing commissions.

Trailing commissions are paid by investment fund managers to advisors and sales people on an annual basis to provide advice for as long as an individual remains invested in the fund. But this creates a conflict of interest, she says.

"Instead of competing to provide investors with the best value at the lowest cost, fund managers are competing to provide advisors with the highest fees to encourage them to sell their products."

Trailing commissions are not the only fees associated with investments: management and administration fees, trading costs and incentives can also have an impact on the bottom line for Canadian investors.

A 2011 Morningstar Inc. study found that among the 22 countries it surveyed, Canada has the highest fees for equity and money market funds and the third-highest for fixed-income funds.

The principles of compounding increase the importance and effects of those fees over time.

"Fees are based on the amount invested and are paid by the individual irrespective of portfolio performance," Ms. Speed says.

"One organization calculated that fees of as little as 1% per year equate to giving away more than 25% of your wealth over 30 years. Most investors don't appreciate that."

Not a lot has changed in Canada since the Morningstar study, says Atul Tiwari, managing director with Vanguard Investments in Toronto. Mutual fund fees are still extremely high. One reason is a lack of awareness. If investors were more aware of the fees they pay on these funds, there might be some move for the industry to change, he says.

But what has changed is the growth of the exchange-traded fund (ETF) industry, which now represents about $54-billion in assets under management and is growing at 20% to 30% a year, Mr. Tiwari says.

"We are now seeing dramatic differences in fees between the accelerated growth in the ETF industry and the slowing growth in the mutual funds industry. The ETF world is very competitive, and that is being reflected in reduced prices, which is great for investors and something that we like to see happening."

> The ETF world is very competitive, and that is reflected in reduced prices

Average management expense ratios (MERs) for mutual funds are over 2%, compared with the average fees for ETFs at less than 1%.

Fees are not typically at the forefront of discussions between industry and investors. This is an important factor that is being overlooked, says Tom Hamza, president of Investor Education Fund (IEF), a Toronto-based not-for profit organization founded by the Ontario Securities Commission.

"Two per cent in fees taken out of a 5% return equates to 40% of the return — that is a massive number," Mr. Hamza says.

"But the impact is less obvious to the investor because they are advised of their returns after fees have been deducted." In years with lower returns, the effect is even more dramatic.

This lack of transparency needs to change, Ms. Speed says. "It should be a given that investors are told the fees they are paying in a clear way rather than buried in a disclosure document or cost reporting."

Until that happens, how can investors manage the cost of fees associated with their investments?

On a product basis there are a number of tools that can help investors, including IEF's online mutual fund fee calculator, Mr. Hamza says.

Understanding passive versus active management strategies and fees also helps: Actively managed products such as mutual funds come with some level of advice to the investor. Most ETFs are passive, simply tracking an index.

The objective of active management is to try to outperform the market and realize higher gains than funds managed passively.

"Often times, more significant fees are attached to active management, yet many fund managers are unable to consistently outperform the market, especially after these increased fees have been taken off," he adds. "Generally, passive management requires less hands-on activity, which helps to keep fees lower."

The fundamental part of an investor/adviser relationship begins with a frank and open discussion about fees and performance at the outset, Mr. Hamza says. Do your homework, establish benchmarks and use those benchmarks when reviewing investments.

"Only if you have done those things up front can you determine if it is a relationship that is making your money work as hard as it can."

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Spreading the wealth for investors

ETFs

By Denise Deveau

The world of managed portfolios has expanded considerably since exchange-traded funds entered the picture.

"The idea of ETF-managed portfolios is relatively new and exciting for investors," says Tyler Mordy of Hahn Investment Stewards in Toronto. "They have completely shifted the portfolio construction process."

ETF-managed portfolios are showing rapid growth for investors who look to professionals to perform discretionary trading on their behalf. Structured as separate accounts, these portfolios typically have more than 50% of assets invested in ETFs. According to a Morningstar, Inc. report, they represent one of the fastest-growing segments of managed accounts, logging a 30% growth rate in the first six months of 2012.

There are a number of drivers behind the rise in ETF-managed portfolios, Mr. Mordy notes. "The sheer breadth of content available is one. With 3,200 listings worldwide, ETFs have colonized every asset class in the world."

The plethora of choices provides ample opportunities for managers to diversify well beyond typical stocks and fixed income vehicles, Mr. Mordy says. "ETF portfolio managers are no longer hostages to traditional portfolio construction because they can now look beyond traditional asset class allocation."

Because ETFs are traded on exchanges, they also provide greater liquidity and transparency, making them additionally appealing. In addition, management fees are relatively low, in some cases ranging from 1% or less depending on the size of the portfolio.

ETF-managed portfolios also allow managers to offer a lower entry point for investors. Conventional managed portfolios typically require a minimum of $1-million because of the cost of diversifying individual stocks and bond purchases. Because ETFs come at a lower price point, and cover multiple asset classes, minimum account requirements can be as low as $250,000.

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Tyler Mordy

The biggest advantage to ETF-managed portfolios is the fact that they help investors work with today's market forces rather than against them, says Keith Dicker, president and chief investment officer for IceCap Asset Management Ltd. in Halifax. That's especially important given the market is far different from what they experienced in the past.

"Back in the '90s, the bull market made it easy for managers to make money. As a result, traditional managed portfolios were strictly stuck in the stock and bond world. Most people go back to that period believing stocks will go up and bonds will give you a 5% to 6% return, and also think it will all get back on track. That's simply not the case. That was only a brief moment in time."

Today's market is one of rock-bottom interest rates and huge national debt loads. As such, the investment focus has changed considerably, Mr. Dicker adds. "Now it's on global market issues, such as interest rates, money supply and inflation. That's what is really driving today's markets."

With ETFs, managers can better mirror the reality of the times by making allocations across equities, fixed income, currencies, gold, commodities and other asset classes on a global scale, he adds. "Portfolios have become very flexible. More importantly, they allow you to reflect what's happening in today's difficult markets."

With such a complex market and a wealth of alternative investment options, however, comes a need for market expertise when constructing and maintaining a portfolio that suits the investment climate.

Mary Anne Wiley, managing director and head of iShares Canada in Toronto says she is very optimistic about the prospects ETF-managed portfolios can offer. "ETFs allow individual you to build portfolios the same way institutions have in the past. It's exciting to see how managers can be very precise when building out their models."

Ultimately, ETF-managed portfolios allow people to do their jobs more effectively, she says. "Investors can benefit from the fact that discretionary advisors now have more tools in their tool kit to actually position their portfolio."

Having a professional who knows the ropes is especially helpful given the investment mood these days, she says. "People are nervous in these markets and don't know what securities to pick. Because ETFs provide access to more markets, they can help managers put together a diversified and highly strategic portfolio and make trading more efficient for anyone."

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