An Investor's Guide to Fees and Expenses 2014

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Illustration by Dennis Pacheco

(Updated from 2012.)

About 140 years ago, a Philadelphia retailer named John Wanamaker figured his customers and salesmen had better things to do than spend hours haggling. His invention: assigning one price, "plainly marked," to every product.

The price tag caught on nearly everywhere, with one major exception: financial services. Investors still have a surprisingly difficult time figuring out what they'll pay for financial advice, mutual funds and retirement plans.

A fee that eats up 1 percent of assets each year might not seem like much -- except that the charge bleeds assets from your account year after year. Say you invest $10,000 and earn 5 percent per year. That 1 percent fee will cost you a total of $1,487 after 10 years and $4,622 after 20 years.

To help you figure out if you're paying too much, this guide details the typical costs of various investment products and services. If you are overpaying, try to negotiate a new rate. Think of it as an instant investment return.

- ## Actively Managed Mutual Funds

What they cost: On average, investors pay 0.65 percent of the value of the fund per year for bond funds and 0.89 percent for equity funds.

Why: With actively managed funds, you're paying a fund company to get access to its investment professionals. The numbers above reflect what the average investor pays in expense ratios, according to the Investment Company Institute (ICI). An expense ratio is the cost compared to the value of the assets in the fund -- for bond funds, investors pay $65 for every $10,000. The average fund charges much more, but most investment dollars favor less expensive options. The cheapest 25 percent of equity funds held 73 percent of assets at the end of 2013.

The priciest mutual funds are so-called "alternative" funds, which have an average asset-weighted expense ratio of 1.35 percent per year, according to the ICI. Alternative funds buy up commodities or other assets that, in theory, will perform differently from stock or bond markets and so provide a hedge.

- ## Index Mutual Funds

What they cost: On average, 0.12 percent of assets per year for equity funds and 0.11 percent for bond funds.

Why: Index funds are so much cheaper because they dispense with hiring a professional to manage the portfolios. Instead of trying to "beat the market" with individual stock picks -- which most managers can't do consistently anyway -- index funds invest in a set, broad range of bonds or stocks, such as the Standard & Poor's 500 Index and the Barclays U.S. Aggregate Bond Index.

One extra cost for all mutual funds, both active and index, is transaction costs. These costs are largely invisible to investors, but they can take a big bite out of returns depending on how often managers buy and sell holdings and which assets they're buying. Large-cap value funds may lose less than 1 percent per year to trading costs, a 2013 study found, while small-cap growth funds can lose more than 3 percent.

- ## Exchange-Traded Funds

What they cost: 0.5 percent of assets (average expense ratio for U.S. non-leveraged ETFs).

Why: The vast majority of exchange-traded funds invest based on an index, which keeps their costs similar to those of index mutual funds. The average ETF expense ratio is increased by new actively managed ETFs coming on the market, as well as specialty ETFs such as commodity funds. They can have expense ratios of

1.5 percent.

ETFs trade on an exchange all day, unlike mutual funds, whose net asset value is calculated at the end of the trading day. That means one additional cost of ETFs can come from trading activity. Investors must trade carefully to get fair prices, especially in less liquid ETFs.

- **401(k) Plans**

What they cost: Total fees on 401(k) retirement plans average 0.35 percent of assets for plans with more than $1 billion in assets, according to Brightscope. Plans with less than $50 million have average fees of 0.94 percent.

Why: Employees are charged for two services. First, there's the cost of running the plan -- administrative expenses, paperwork, marketing, mailings. Second, there are the costs of managing investments, usually through mutual funds. Those account for about 85 percent of 401(k) fees, BrightScope estimates. Small plans pay more overall because they have less bargaining power and fewer participants to cover fixed costs.

Administrative costs aren't always spread evenly among employees. That's because investors who choose low-fee index funds often avoid "revenue-sharing" fees. Those charges are included in pricier funds' expense ratios but actually help cover the retirement plan's administrative costs.

- **Financial Advisers**

What they cost: Most clients with more than $100,000 pay less than 1.25 percent of assets per year in account management fees, according to Cerulli Associates. But fees vary widely, exceeding 2 percent for some less-affluent investors. Of those with just $100,000 in assets, a quarter pay more than 1.5 percent per year.

Why: Financial service providers go by many names -- fee-only planners, financial advisers, wealth managers, family offices, private client groups, bank trusts. The basic business model is the same: Provide investment and other financial advice, usually for an annual charge based on the size of assets being managed. The wealthier you are, the less you tend to spend for advice, at least as a percentage of your fortune. Of clients with more than $10 million in assets, Cerulli Associates estimates, two thirds pay less than 0.75 percent per year.

- **Brokerage Charges**

What they cost: flat service charges of $5 to $10 for stock and ETF trades; up to 5 percent front-end sales loads on fund purchases.

Why: When you buy stocks or funds directly from a brokerage, your costs can vary widely. Discount brokerages often charge a flat fee for each transaction. For example, Charles Schwab charges a $9 commission for each online stock or ETF purchase and an extra $25 if you get help from a broker.

Other traditional brokers may charge much more, with commissions to pay the broker built into fees or expense ratios of the products they sell. For example, a mutual fund company may charge a fund buyer a recurring "12b-1" fee (which increases the expense ratio) or a one-time "sales load." Both are used to compensate the seller of the fund. A typical sales load on a share purchase of less than $25,000 is 5 percent, according to the Financial Industry Regulatory Authority (Finra). Purchases of $1 million or more usually avoid such charges entirely. Such load funds are rapidly losing popularity to no-load varieties.

- **Real Estate Investments**

What they cost: 6 to 7 percent in total transaction costs.

Why: Add up all the costs of buying a piece of real estate -- brokers, attorneys, paperwork -- and the total can reach 6 to 7 percent of the property's value. Of course, almost everything is negotiable, including broker fees. Also, rather than buy real estate themselves, investors can buy funds that buy real estate. Mutual funds that specialize in real estate investment trusts (REITs) have expense ratios that vary from less than 0.5 percent for index funds to as much as 3 percent for the priciest actively managed options. The median real estate fund costs 1.03 percent. However, beware of private, non-traded REITs, which often impose extra fees on individual investors.

- **Hedge Funds**

What they cost: An annual management fee of about 1.5 percent of assets, along with 18 percent or so of any investment gains.

Why: Though recent underperformance has caused some investors to think twice about whether hedge funds are worth it, many wealthy investors and institutions still rely on them to diversify portfolios.

The conventional wisdom is that hedge funds charge "two and 20" -- 2 percent of all assets and 20 percent of any gains. But data from Hedge Fund Research show investors pay slightly lower fees depending on the fund’s strategy. Relative value funds charge an average of 1.45 percent in management fees, while macro funds charge 1.62 percent. The incentive fees, which come out of investment gains, also vary, from 16.4 percent for relative value to more than 19 percent for event-driven funds.