

# Retirement Advisor

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A monthly resource for protecting your income  
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## INVESTING

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### How Do Fees Affect Mutual Fund Performance?

**W**hen investors consider mutual funds, they often hear warnings about the impact of fees and expenses on returns. But these seem invisible to investors, so what really is the impact?

A mutual fund's fees and expenses may be more important than an investor might realize. Ads, rankings and ratings will often emphasize how well a fund has performed in the past. But according to the Securities and Exchange Commission (SEC), studies show that the future often is different. Fees and expenses cannot be a reliable predictor of mutual fund performance.

When considering a mutual fund, one of the most important numbers is the expense ratio, which tells you how much the fund costs. The ratio shows how much of the fund's assets are paid to the portfolio manager and for other operating expenses. Typically, a fund pays an average of 1.5 percent of assets annually.

Three things typically figure into this ratio. The investment advisory fee pays the managers of the fund, which accounts for .50 to 1 percent. Then, administrative costs cover services such as record keeping, mailing and maintaining a customer service line, which can range from .20 to .40 percent. And often a fund will charge a 12b-1 distribution fee, which covers marketing, advertising and distribution services. This ranges from .25 percent to 1 percent of assets.

The upper range of these fees shows how high an expense ratio can be. And even though the fee seems to be just a few percentage points, it is charged in down years, when it can represent a

significant slice of the return. Also, over time, the fee can cut the ultimate return by nearly 50 percent, according to one analysis. With an initial \$10,000 invested after 30 years of 10 percent returns (a bit optimistic, perhaps), the fund has made \$174,494, but with a 2.5 percent expense ratio, it has lost \$86,944, according to an analysis by Moolanomy.com.

But even that isn't the bottom line. There are still transaction fees incurred by the buying and selling of assets in the fund that go unreported, and that can double or triple the cost, according to Richard Kopcke of the Center for Retirement Research at Boston College.

Of the 100 largest stock funds held in defined contribution plans as of December 2007, trading costs averaged from 0.11 percent of assets annually to 1.99 percent of assets, with a median of 0.66 percent, Kopcke found. But it is difficult for average investors to determine this percentage, he said.

The SEC has not been able to develop ways to report this percentage in the same way an expense ratio is reported, partly because fund managers say the number is too difficult to determine. One way to get an indication of the percentage is the fund's turnover. The percentage of turnover shows at what rate stocks in the fund have been replaced. A high turnover rate would mean more fees.

The SEC last year required fund managers to disclose one year of turnover at the front of a prospectus in addition to the already required five years of turnover disclosed in the financial highlights section, according to a March 1 Wall Street Journal article. Turnover of more than 100 percent can indicate trading costs may be high, the *Journal* reported.

## **TAX AND LEGAL**

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### **Catch Up on Some Tax Planning**

**S**ummer is a good time to improve tax fitness with a few simple exercises.

**Consider Roth IRA assets.** By keeping assets inside a Roth IRA, they can grow tax free for retirement. Also, this year people can convert traditional IRAs to Roth IRAs. Account holders are no longer subject to the \$100,000 modified adjusted gross income limit. With conversions that occur in 2010, they can also split their conversion amounts equally and report them as income for tax years 2011 and 2012.

**Take advantage of tax-deferred retirement accounts.** If you have a 401(k) or other employer-sponsored retirement plan available, contribute as much as you can afford to contribute. By increasing contributions every time you get a raise, you can increase your savings. The plans are basically funded with pretax dollars, which will reduce taxable income. Also, that money will grow tax free until it is withdrawn. If the contribution is to a Roth IRA, it is made with post-tax money, so the funds can be withdrawn tax free after the age of 59½.

**Hold assets more than a year.** Any capital gain made within a year is considered taxable income, like a salary. But gains taken after a year are considered capital gains, which in 2010 is taxed at the maximum rate of 15 percent. The capital gains rate is almost always lower than the income tax rate. Also, the capital gains rate is expected to go up to 20 percent next year, so some people are taking advantage by taking their gains this year.

**Give to charity.** Contributing to charities is always a good idea. But if you are planning a gift, it might be best to do it soon, because some in Washington have been looking at cutting back on charitable deductions as a revenue-saving measure.

## **HEALTH AND WELL-BEING**

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### **Hybrids Can Boost Dental Benefit Performance**

**E**mployee benefits such as dental insurance did not get much attention during the health care reform debate, even though some

consumers have difficulty affording them. In fact, one in four Americans under 65 lacks dental insurance, according to the National Center for Health Statistics.

It is not just employees who have difficulty paying for the coverage. Many employers are still struggling in this economy and need to trim expenses wherever possible. In some cases, rather than dropping the coverage, companies will offer voluntary benefits. That means employees pay all the costs but get lower rates through a group plan.

Another option that reduces costs for employers is the discount dental plan. Such plans feature a negotiated discounted rate for typical services such as dental exams, fillings, crowns, root canals and cleanings with participating dentists. Discount dental plans allow savings in the range of 10 percent to 60 percent. Discounts for specialty care such as orthodontia or cosmetic dental procedures range from 15 percent to 20 percent.

That helps employees keep benefits, but total costs still fall to workers. Some employers that want to provide coverage and cut costs can split the difference with a hybrid plan. Hybrid dental plans combine the advantages of a discount plan with the flexibility of a traditional plan. Discounts are extended to members who receive care from an in-network dental provider at negotiated fees once insured benefits have been exhausted, or for adult orthodontia or cosmetic care, which may not be covered by the insured portion. The discount dental plan provides access to care at a reduced fee.

Premiums are often half the cost of a typical insured plan. In addition, the insurance company may not find it necessary to impose the typical annual plan maximum benefit of \$1,000 to \$2,000.

### **BONUS INFO FOR VETERANS**

Chiropractic benefits can now be available through the VA at no cost to you. For more information, contact Dr. Corey French at United Chiropractic, 931-648-3000.

The legal and tax information contained in these articles is merely a summary of our understanding and interpretation of some current provisions of tax law and is not exhaustive. Consult your legal or tax advisor for advice concerning your particular circumstances.