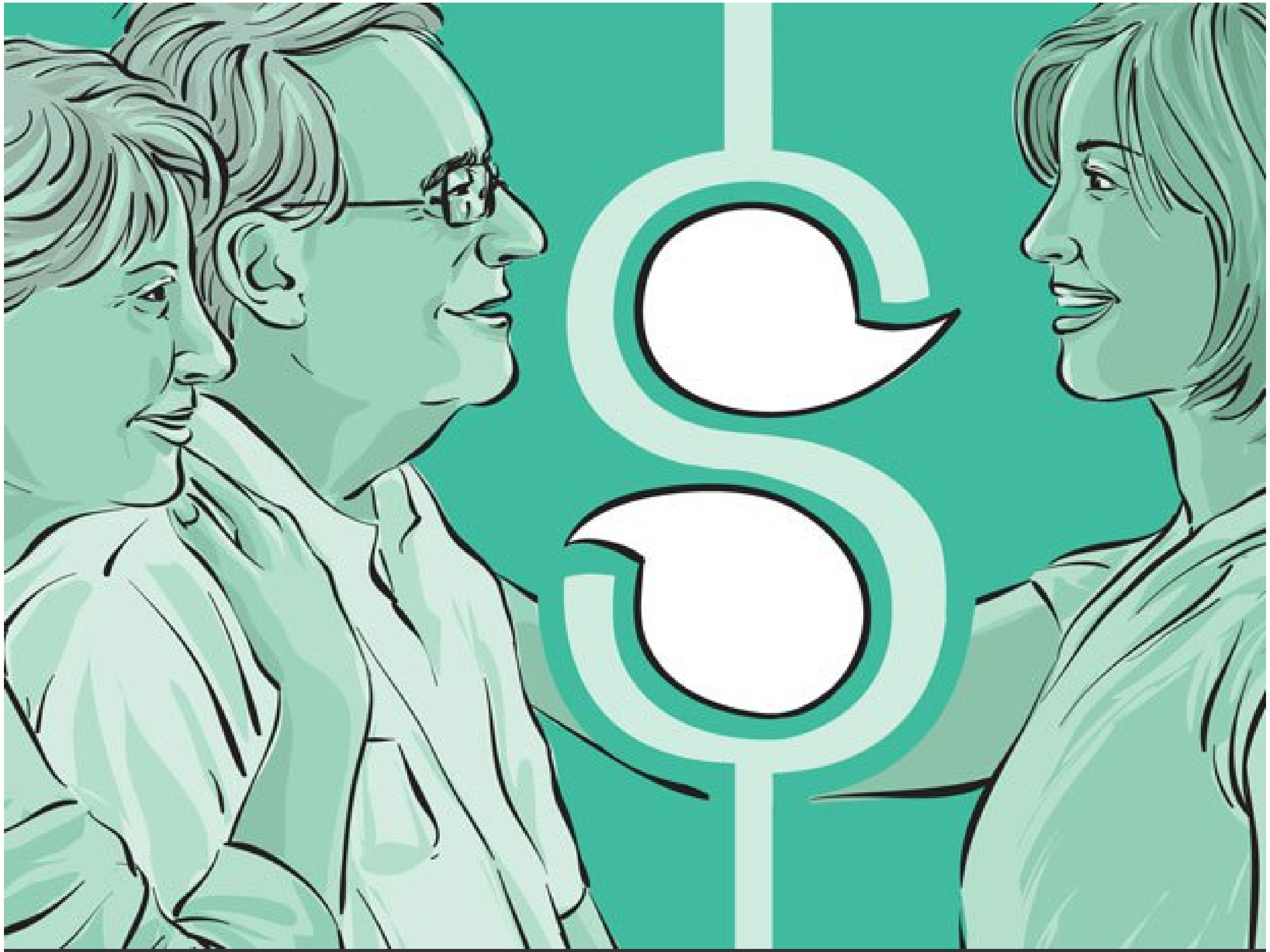
PERSONAL FINANCE

'I think I have mutual funds?' How to

cut through the confusion and get a handle on your mutual fund portfolio

MELISSA LEONG | March 1, 2014 7:00 AM ET
More from Melissa Leong | @lisleong

Republish
Reprint



According to a 2013 BMO Nesbitt Burns study, one third of investors have no clue what specific investments they hold within their portfolios and only half have a financial plan. Illustration by Chloe Cushman

Tools

Mortgage Calculator

Mortgage Comparison

Mortgage Qualifier

Savings Calculator

Investment Calculator

Home Budget Calculator

Currency Converter

How to be a Millionaire

Resource Centre

When I was in my early 20s, a financial advisor encouraged me to start a savings plan.

I needed the guidance; I was working my first full-time job and I blew one of my first paycheques on a home theatre system with surround sound.

From then on, all of my savings was invested in mutual funds. I could not tell you what types of mutual funds I had. I could not tell you how my advisor was paid.

I was just happy that I was on a path to retirement. It didn't bother me that I wasn't driving or that I didn't understand how I was getting there.

Here are the 3 most important questions you need to answer about your investments

You want to make sure that your investment portfolio is fit and working for you. We take a look at three important investment questions and their answers.

While I do feel sheepish about that (the same way I feel about spontaneously buying a home theatre system because, well, it was in a store window, staring at me like a big silver puppy), I know I am not alone.

Two-thirds of investors (69%) say when they first contacted their financial advisor, they had little (29%) to no (40%) investment experience, says the Investment Funds Institute of Canada.

"I just don't know what's happening…It's really, really terrible," admits Dianna Lai, a 31-year-old technology public relations consultant, in Toronto. She's saving to buy a house.

"Every month, [the bank] takes money out of my checking account and puts it into my RRSP. I have actually asked for explanations. My eyes totally glaze over. I feel like it's rocket science. I just don't get it."

Fifteen percent of her paycheque gets automatically withdrawn. She thinks she has mutual funds and that her portfolio is made up of products that are low-to-moderate risk. But she is not sure.

According to a 2013 BMO Nesbitt Burns study, one third of investors have no clue what specific investments they hold within their portfolios and only half have a financial plan.

Sixty-three percent of Canadians say they have only a basic understanding or very limited understanding of investing, a new survey for Standard Life says. (Women were more likely to say they have a very limited understanding — 26% versus 20%).

Nearly two in 10 (17%) Canadians spend less than 15 minutes a month managing their investments and nearly one in 10 (8%) don't spend any time at all.

Related

Why do we spend? What science says about our personal finances

How I spent my first year of retirement

Meanwhile, Canadians held $1-trillion worth of mutual fund assets as of the end of 2013; mutual funds make up a third of the investments that people own, says Investor Economics. Younger or novice investors often opt for mutual funds because they are uncomfortable managing their money and can benefit from the diversification with a modest amount of funds.

Twenty-two percent of investors say they are either not very or not at all knowledgeable about mutual funds, says the latest report from the Investment Funds

Institute of Canada.

“It’s so embarrassing but I do want to learn and I want to become a little more financially savvy,” Ms. Lai says. “I wouldn’t know where to begin.”

Let’s begin here. We spoke to some financial experts to help us get a handle of our mutual fund portfolios and clear up some confusion:

Confusion #1: I don’t pay my advisor anything.

Did I think my advisor was a financial fairy who sprinkled free advice upon the citizens of Canada for the good of the world?

No advice is free.

Mutual fund fees include those paid when you buy or sell shares in a fund — they’re called sales loads – which could be a couple percent to 10%. There are front-end loads: if you invest $100,000 with a 2% front-end load, a one-time fee of $2,000 goes to the investment firm/advisor. With back-end loads or deferred sales charges, you pay a fee if you sell a fund within a certain time frame. (A typical DSC starts at about 6% of your investment in one year, declining to 0% by year seven.)

The other thing to look at is the management expense ratio. These so-called invisible fees are collected before returns are reported. If the annual management fee is 2.5%, for example, and the total return is 12.5%, you’d see a return of 10%. You can’t see it, but it still gets paid.

The documents that you receive from your mutual fund provider will indicate what the fees are, says Bob Stammers, director of investor education at the CFA Institute.

MERs are controversial. According to a 2013 Morningstar report, Canadian mutual funds have the highest MERs in the world (they're generally are between 2-3%).

Some argue that investors are better off doing it themselves or investing in exchange-traded funds, which are more passively managed, mirror the performance of a particular stock market index and typically have lower fees.

"There's this long-standing discussion of whether active investing is better than passive...The longer you're in the game, the less it matters," says Adrian Mastracci, president of KCM Wealth Management Inc. based in Vancouver.

However, not all mutual funds have MERs that are as high as 3%. Take a look at your fund's MER and compare them to other funds with similar holdings. Also, take a look at your fund's direct ETFs competitors (the average expense ratio of ETFs were reportedly about 0.6% last year). If your ETF carries an expense ratio of 0.45%, the fund will cost you $4.50 annually for every $1,000 invested.

"We're not looking for the cheapest alternative or we'd never buy Mercedes or go to a nice steak house. We're looking for value. It's important that [investors are] receiving value from those investments," says Scott Plaskett, a certified financial planner and CEO of Iron Shield Financial Planning. "Is it in line with what you need your portfolio to do for you? You don't always have to have the latest and greatest and best... That just encourages chasing returns and the exact wrong behaviour to be successful in investing."

News Releases

Flare Industries and Jordan Technologies Announce Formation of Parent Company

SimCorp Dimension Version 5.5 Released to Equip Front Office with New Risk and Performance Insight

Sierra Wireless Completes Acquisition of In Motion Technology

Contextual Genomics Appoints Chris Wagner as President & CEO

STC life, Ltd. Successfully Treats Stroke Patients at Stem Cell Research Treatment Center

Confusion #2: Mutual funds are all similar.

There are more than 15,000 mutual funds in North America. If, like me, you have a hard time deciding what to order on a dinner menu, then having an advisor help you choose your investments might be preferable.

If you're going to do this, at least try to understand your advisor's choices.

"It's important for people to sit down with their advisors and for them to go through their investments and [talk about] why their advisor has put them in their particular investment: why are we in a value fund, why are we in a target-date fund, why are we in a bond fund?" Mr. Stammers says.

Here are a few common types of mutual funds:

Fixed income mutual funds mostly invest in high quality bonds and are among the most secure investments.

Money market mutual funds invest in short-term debt securities such as federal treasury bills and provide a more steady, secure source of interest income.

Dividend mutual funds which invest in dividend-paying preferred and common shares, are good for investors who are looking for a steady stream of income. ("They tend to be more of a growth strategy but they tend to have less risk than non-dividend equities," says Mark Raes, head of product for BMO Asset Management. "Typically companies that are paying dividends tend to be more mature companies."

Growth/Equity mutual funds invest mostly in common stocks; they have different investment styles and specialize in different industries or countries, for example.

Balanced mutual funds invest in equities, bonds and short-term money-market instruments and are ideal for investors who want long-term capital growth.

Read your statements. Most financial firms will send you information about your funds including its MER, top investments held and year-by-year returns (look at its average return over five years versus the last year before judging its performance). If you misplaced this information in a garbage can, look up your mutual fund online.

Confusion #3: Mutual funds reduce your risk.

In comparison to someone who buys individual securities, buying a diversified portfolio does reduce your risk over all. But remember, the risk varies with different funds.

"If you're in a pure equity fund, you're going to more geared towards high returns, whereas if you're in a balanced fund or a bond fund, they would be considered lower risk."

So, think about your needs. What are your goals and your time horizon? If you need the money soon to say buy a house, you're going to be more risk adverse.

"If you're a young investor who is the accumulation phase, you'd favour equity markets in your portfolio. If you're almost at retirement and you're looking to set your nest egg, you'd be much more of a conservative investor because you don't want to take a lot of risk on your portfolio but you want to earn income on it."

Financial Post

• *Email: mleong@nationalpost.com | Twitter:* Follow @lisleong 2,812 followers

Most Popular

Warren Buffett's 23 best quotes about investing

Forbes rich list: More than 30 Canadians ranked among the...

Fairfax's Prem Watsa is about to make a bundle on his bet on...

Pimco sees Car housing marke as much as 20%

Topics: **Investing**, **Personal Finance**, **Investment Funds**, **Mutual Funds**, **Personal Investing**

7 Comments Financial Post

Sort by Best

Join the discussion…

tweets21 • 3 days ago

Before you ever begin investing, everyone needs to do two important things.1 Learn the
and 2 understand what the definition of a Snake Oil Salesmen means.

7 • Reply • Share ›

Ole Curmudgeon • 18 hours ago

I was with Investor's Group for 10+ years before I realized that their 3% MER, meant, th
take some of the blame for not being fully informed, as I thought it meant you pay 3 doll
make...)

You made 4% this year...They skim off the 1st 3% and you then made 1%.

If your only making realistically 6/7% (gross) for the past decade,
and the MER is 3%,

>>>you have effectively given up 50% of your profits.<<<

THIS, IS WHAT THE VAST MAJORITY OF AVG FOLKS DO NOT REALIZE with mutua
(Management Expense Ratios). Yeh, it's a 'ratio' all right.

When I asked them about alternatives, the response was " I believe I have you best pos
abject horsetrollip.

This, is and should be legally criminal. I have since pulled every cent out of Investor's, p
and am now paying a nice somewhat reasonable 1.5% on my actively managed mutua
tracking (non-active) funds.

Bastards !

5 • Reply • Share ›

feisty_feline → Ole Curmudgeon • 15 hours ago

not to mention the form you sign so they can churn your investments and rake f
time.

1 • Reply • Share ›

canadianpatriot68 • 2 days ago

Mutual funds are great. Operators get 2-3% +++ of your money, win lose or draw.

1 • Reply • Share ›

feisty_feline ➦ canadianpatriot68 • 2 days ago

sounds like the government - but 50%

1 • Reply • Share ›

broke ➦ feisty_feline • 18 hours ago

I should wash out my mouth with soap for what I'm going to say, but. At l
you might get some way over-priced service. With Mutual funds, no so n

1 • Reply • Share ›

Ken • 12 hours ago

There are two rules to remember when investing. Rule #1 Never buy a mutual fund. Ru

Reply • Share ›

Subscribe

Add Disqus to your site

blog comments powered by Disqus