QUAERO *JOURNAL*

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HERE'S THE THING!

"This is not just an individual investor issue; this is really a social issue."

Larry Bates

FEES AND SOCIAL INEQUALITY

As I patiently await the launch of my brand-new website (https://quaeroinvest.com/) it strikes me that a posting to **Quaero** *JOURNAL* is long overdue. I should be more disciplined about writing—the best way I know of to organize and communicate our thoughts towards identifying, prioritizing and then acting upon the issues that matter most to us, individually and collectively. So I will resolve to do so through 2019! And hopefully the fall term Creative Writing course that I recently completed will inspire my technique and provoke more interaction with my many (humor) dedicated readers.

Yesterday I re-read my first seven **Quaero** *JOURNAL* postings. They dealt primarily with two subjects—the cost of investment management services and social inequality—the latter in a broad sense and also more narrowly, as it impacts the entrepreneurial spirit and potential of independent players within the investment management community. For whatever reason, these two issues have beset me for at least two decades, and I can only imagine that I am destined to pursue them to their death, or to mine! So in the next few issues of the Journal I will continue my journey, reflecting on my findings from recent readings, research, travel and conversations pertaining to these two issues.

Actually, I was encouraged just today to write more on my favorite topics when I ran across someone else who seems smitten by the same concerns. A friend pointed me to Larry Bates' website (http://larrybates.ca/). Larry's theme (and his book) is "Beat the Bank" and in one of his several posted videos he links my concern regarding the high cost of investing with my concerns for social inequality when he says about investment industry fees that "This is not just an individual investor issue; this is really a social issue. The Canadian retirement system is now dependent on the individual performance of Canadian retirement accounts. Guaranteed retirement pensions are becoming a thing of the past, certainly in the private sector." I haven't yet had the opportunity to meet or speak with Larry but I should add that to my growing list of resolutions for 2019.

In prior postings I have advocated for more transparency of investment fees and I proposed a flat fee/performance fee concept that I believe will serve the interests of investment managers and their clients more fairly. In the May/2018 issue of **Quaero** *JOURNAL* I acknowledge however, that it will likely be some time before the world finally sees it my way, so in the interim we would do well to focus on educating ourselves on the importance of fee awareness.

To that end I registered for the "Inside ETFs" conference last June, here in Montreal. Over the past ten years the growth in ETF product availability and in ETF assets under management ("AUM") is remarkable and lower fees are a good part of the rationale supporting their popularity. At the conference I learned a lot from hosts Dave Nadig and Matt Hougan and from representatives of numerous ETF providers. The following chart in particular from the "Matt & Dave Show" caught my attention.

The World's Cheapest Canadian ETF Portfolio

NOT GOOD ENOUGH

Asset Class	Weight	Fund	Ticker	MER
Canada Equity	20%	BMO S&P/TSX Capped Composite Index ETF	ZCN	0.05%
U.S. Equity	30%	Vanguard S&P 500 Index ETF	VFV	0.08%
Developed Equity	20%	Vanguard FTSE Developed ex North America Index ETF (VDU)	VDU	0.20%
Emerging Markets Equity	5%	BMO MSCI Emerging Markets Index ETF	ZEM	0.25%
Fixed Income	15%	Horizons Active Global Fixed Income ETF	HAF	0.15%
REITs	5%	Vanguard FTSE Canadian Capped REIT Index ETF	VRE	0.35%
Commodities	5%	iShares Gold Trust	IGT	0.25%
All-In Costs				0.14%

Inside ETFs Canada

I was pretty excited by the idea that I could help my daughter (a UK resident with savings then sitting idly in her personal bank account) find a well-diversified, multi-asset portfolio for just 14 bps and given Dave and Matt's contention that the set structure was still "Not Good Enough", perhaps I could even do better!

To simplify my research, I narrowed the choice of providers to Vanguard and Blackrock with a focus on passively managed, global balanced fund product. A couple of conversations later and I was convinced that Vanguard would be our best choice so I went directly to their UK website to learn more about their products. The "Vanguard LifeStrategy 60% Equity Fund" seemed to fit the bill—"investment objective predominantly through investment in passive, index-tracking collective investment schemes"—so I entered the required information to get a handle on relevant fees. Page 1 was clear – 22bps. I was a little disappointed that we were already above my 14 bps target but I pressed on.

Your investment choices

	Key investor information	Ongoing Charge (OCF)	Lump-sum payment
LifeStrategy® 60% Equity Fund - Accumulation		0.22%	£300,000.00

I got on the phone with a UK representative who helped guide me through the product description where I learned that the 22 bps is the “Ongoing Charge” portion of the “Product Cost”. The other portion of the Product Cost is the “Transaction Costs” which can only be estimated but the estimate was 11bps. So Product Costs in total are 33 bps. In addition I was told that the LifeStrategy 60% Equity Fund also has an annual “Service Cost” of 13 bps for rebalancing and the like so now our estimated annual costs looked like this:

Estimated annual costs and charges	Total Invested	£300,000.00
	Cost in £s	as a %
Service Cost	£375.00	0.13%
Product Cost	£1,005.90	0.33%
Total	**£1,380.90**	**0.46%**

My findings[i] were a long way off my 14 bps dream and were enough for the moment, to dissuade me from moving forward with the Vanguard alternative. I was very impressed with Vanguard’s reporting, transparency and availability to answer questions, but it must be said that one has to know what questions to ask in order to get to the bottom of this cost conundrum. And needless to say, drawing comparisons between investment options entails undertaking the same bit of research for each of your considered alternatives. The lesson is simple—DO YOUR RESEARCH! Because simply, there is such a disparity of fee structures between competing products that to do otherwise is to risk sacrificing the better part of the growth in your life savings to those managing those assets on your behalf (see Quaero Journal, Volume 1, Issues 2,3 and 4).

And lest we forget, there is also disparity of product availability and pricing from one regulatory jurisdiction to another. To explore differences between the UK and Canadian markets for example, I surfed the Vanguard Canadian website for passive, global balanced fund product. I found the FTSE Global All Cap ex Canada Index ETF (VXC) at a posted Management Expense Ratio (“MER”) of 27 bps—not unreasonable! I did not invest the time required to explore the extent of other fund related costs but I was quickly reminded of the importance of regulatory differences between national jurisdictions when I read the following disclosure on the Vanguard Canada website:

> “Vanguard's current registration in Canada only allows us to discuss our products with registered dealers and financial advisors. As a result, we're limited in our ability to assist individual investors directly.”

This uniquely Canadian constraint serves to reduce product competition by obliging non-Canadian providers to work through our Canadian dealers and advisors, most of which are owned by our large banking institutions. Otherwise excellent providers of global investment product consequently choose to limit their product offering to the institutional market in Canada, disadvantaging the individual investor in terms of his/her product and pricing opportunity set. If an individual investor wants to access the VXC for example, without paying an intermediary’s full-service investment advisor fees (typically 1% per annum), they would need to open a self-directed brokerage account, confirming first that having done so they would be able to enter a purchase order for the VXC on the bank’s self-directed platform. Not all products are available through all bank platforms, so again the lesson is simple—DO YOUR RESEARCH!

And my research continues. Over the past few months I have had several exchanges with one active investment management firm that purports to charge performance fees ONLY, i.e., NO FEES unless they outperform the passive benchmark set for their various fund options. The idea certainly seems well aligned with client interests: I will do some more research and report my findings in our next **Quaero** *JOURNAL*.

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OUR HOPE:

- **FAIR FEES . . . FOR ALL INDUSTRY PARTICIPANTS.**
- **ALL OF THE PEACE, JOY, LOVE AND HOPE IN GOD'S UNIVERSE TO READERS OF Quaero JOURNAL FOR THIS FESTIVE SEASON AND FOR THE YEAR THAT AWAITS US.**

[i] As this research was conducted half way through 2018 and industry fees are dropping rapidly, information gathered and cited herein may have changed markedly in the interim. Parties interested in these or any ETFs, funds or fund management services are encouraged to undertake their own research prior to any decision to invest.