ETF Fees Continue to Fall

Competition between fund providers continues to result in lower fees on exchange traded funds (ETFs).

A very good thing if you are a proponent of cost minimization when investing.

I read a short article that discusses this subject and makes a couple of useful side points.

"In the Trenches of the ETF Fee War" offers some thoughts that should be kept in mind when investing in ETFs.

Diminishing Returns on Reducing Fees

> *We've come to the point where the ETF industry's fee war is becoming inconsequential for investors*

The point here is that there is not much difference between many ETFs in the same peer group (e.g., large cap Australian equities). True, but be sure to make apples to apples comparison. Fees may not differ significantly within a fund category, but they will still vary between fund categories (e.g., mega cap U.S. equities versus small cap U.S. equities).

Further, that the minimal differences between offered funds is not worth shifting money from old to new. Again, true. Even over very long periods, 2 basis points difference in fees will not make or break you. That said, every penny in your pocket is preferable.

Again, compare apples to apples. The article notes:

> *the average ETF costs 0.65% today, compared to the 0.56% charges in 2010, according to Morningstar data. Apparently, the higher costs niche or specialty ETFs are pushing the average higher even as large providers are cutting costs on*

> *large, broad-based ETFs.*

You can invest in a S&P 500 index fund for less than 10 basis points per annum. iShares costs 0.07%. The difference between this fund and the 0.65% "average ETF cost" will add up over time. And as you get more exotic, the ETF costs will continue to rise. For example, the iShares MSCI India Small-Cap ETF (SMIN). It carries a 0.74% expense ratio.

For a few more thoughts on fees, please read "ETFs Over Funds: Investment Costs".

Need to Consider More than Price

> *investors should not base an ETF purchase on price alone, there are many other factors that play into the equation of an outperforming fund.*
>
> *Efficient trades, low bid-ask spreads and tax treatment are especially pertinent for total return.*

Yes, that is true. The smaller the fund, the more exotic the fund category, the more active the fund strategy, the less efficient the capital market, etc., the greater the cost to the fund.

Until you develop a substantial investment portfolio, I suggest you stick with the larger funds and passive index strategies. These will tend to have higher efficiency and (on average) less turnover than a smaller, more actively managed, fund.

Your Trading Habits are a Cost

> *Operating expenses are another area investors must consider. Every trade that is executed costs the investor, so for those who trade frequently, an ETF can be expensive.*

There are an increasing number of funds that are “transaction free” or “no-transaction fee”. Availability and number differ between brokerage houses, so see what is offered where you trade. Or, if considering creating a brokerage account, factor this into your comparison.

If you use a general buy and hold strategy, your portfolio turnover will not be significant.

Where you may need to be careful is in using a dollar cost averaging approach to build your holdings. Dollar cost averaging is an excellent tool for small investors. But watch the transaction fees.

If you invest $100 each month and pay $10 in brokerage commissions, transaction fees will ruin your returns. Instead, accumulate capital in a cash account or low cost, no-load money market mutual fund. When you reach a critical mass – maybe 4, 6, or 12 months out – then invest in the chosen ETF.