ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Fee Wars Now About Bragging Rights?
In February, we covered Charles Schwab & Co.â€™s latest shot across Vanguardâ€™s and Fidelityâ€™s bows when it announced it was reducing index mutual fund fees to align them with its ETF equivalents, while also eliminating investment minimums for those passive investment vehicles.

A week ago, a full-page ad in *The Wall Street Journal* from Schwab caught our eye and got us thinking about index funds and fees. Claiming â€œdecades of advantages,â€ the advertisement compared the Schwab 1000 index to the S&P 500 index and, not surprisingly, declared Schwabâ€™s product the winner.

A couple of things to point out here. To start, Schwabâ€™s ad was about attracting investment dollars to its funds. Thus, itâ€™s important to understand that the Schwab 1000 index is not the same thing as the Schwab 1000 Index fund (the latter is investable and charges fees, the former is not and its returns are not reduced by expenses), nor is it the best comparison to the S&P 500 index. Schwabâ€™s 1000 index includes twice as many holdings, and it has more exposure to mid-cap stocks than the S&P 500.

The Schwab 1000 Index fund was one of the beneficiaries of Schwabâ€™s fee reduction earlier this year, and from a cost perspective, it is now much more competitive with similar offerings from Fidelity and Vanguard. All three of the firms have taken turns touting lower fees than each other and the rest of their competitors on their index funds and ETFs of late, but sometimes the difference is as small as a half of a basis point, or 0.005%, on a fund already charging single- or low-double-digit operating expenses.

To focus on a basis point or two is pretty ridiculous at these already low levels. Why? Letâ€™s put it in real dollar terms. One basis point on a $10,000 investment is a measly $1. At $100,000, thatâ€™s just $10, which, depending on where you live, is little more (or less) than the cost of a lunch out these days.

To take it a step further, halving a 0.10% expense ratio down to 0.05% is a 50% reduction (percentage terms is typically how fund firms frame the changes when they market them), but it only represents a $50 difference on a $100,000 investment, which hardly moves the needle. If that same investor was in a fund that made a 50% reduction on a 1.00% expense ratio, they would save $500 a year in feesâ€”something worth getting excited about.

At the current rock-bottom index fund expense levels, even Vanguard has fessed up that this is all about marketing and bragging rights, which might just be an admission thatâ€™s thereâ€™s really not much lower to go (though our regular readers will surely recognize that the fund giant has been the biggest promoter of its own incrementally lower expense ratios).

Which Index Is Best?
To get back to the claim that its index is better, weâ€™ve put Schwabâ€™s 1000 index and the fund tracking it side-by-side with a number of other low-cost portfolios from Fidelity and Vanguard.

A couple of things are apparent in the table. First, all of these funds tracked fairly closely to one another over all of the time periods, somewhat weakening the argument that one broad U.S. stock market index can claim to truly be superior to any other in a meaningful way (especially using point-in-time returns, as weâ€™ve done here for simplicityâ€™s sake). Second, you can very clearly see the impact of expenses on the Schwab 1000 Index fundâ€™s return when compared to its benchmark. It may charge 0.05% in fees today, but before February 2017, its expense ratio was 0.29%, and the bite those relatively higher expenses took over time is clear. Finally, Schwabâ€™s diversification argument works against the 1000 index fund if you expand the comparison to include total U.S. stock market indexes. Both Fidelityâ€™s and Vanguardâ€™s options, regardless of share class, outperformed the Schwab 1000 Index fund over all of the different time periods. The underlying index was more competitive, but investors couldnâ€™t get those returns, because you canâ€™t invest in an index.

Weâ€™re all for people being able to keep as much of their hard-earned money as possible, and the fee wars have driven prices down for countless investors of every stripe. Just remember, while firms are racing to the bottom to lower fees, in the end, it all comes down the performance of your portfolio. Low fees are a great quality in a fund or investment, and can contribute to better returns over higher-fee competitors over time. That said, the return after expenses of the underlying investment has a far greater impact on investorsâ€™ experience, and a low fee wonâ€™t be able to hide a lesser strategyâ€™s flaws for long. Buyer beware!

Fund/Index name	**Inception**	**Expenses**	**5-Year Ret**	**10-Year Ret**	**15-Year Ret**	**20-Year Ret**
Schwab 1000	â€"	â€"	13.15%	7.61%	7.41%	8.18%
Schwab 1000 Index Fund	Apr-91	0.05%	12.85%	7.34%	7.09%	7.86%
Vanguard 500 Index Admiral	Nov-00	0.04%	13.26%	7.50%	7.08%	â€"
Vanguard 500 Index Investor	Aug-76	0.14%	13.14%	7.39%	6.97%	7.75%
Fidelity 500 Index Premium	Oct-05	0.05%	13.26%	7.48%	â€"	â€"
Fidelity 500 Index Investor	Feb-88	0.10%	13.21%	7.44%	7.01%	7.75%
Vanguard Large Cap Index Admiral	Feb-04	0.06%	13.13%	7.62%	â€"	â€"
Vanguard Large Cap Index Investor	Jan-04	0.18%	12.98%	7.48%	â€"	â€"
Vanguard Total Stock Market Index Adm.	Nov-00	0.04%	13.14%	7.69%	7.65%	â€"
Vanguard Total Stock Mkt Index Inv.	Apr-92	0.15%	13.00%	7.57%	7.54%	8.11%
Fidelity Total Market Index Premium	Oct-05	0.05%	13.10%	7.62%	â€"	â€"
Fidelity Total Market Index Investor	Nov-97	0.10%	13.05%	7.57%	7.56%	â€"

Note: Table shows annualized total returns over the periods listed through 3/31/17. Source: Morningstar.

About Adviser Investments

Adviser Investments operates as an independent, professional money management firm with particular expertise in Fidelity and Vanguard mutual funds. We advise more than 3,500 clients and have over $4 billion under management. Our investment professionals focus on helping individual investors, trusts, foundations and institutions meet their investment goals. Our minimum account size is $350,000. In 2016, Adviser Investments was named to *Barronâ€™s* list of the top 100 independent financial advisers nationwide and its list of the top advisory firms in Massachusetts for the fourth consecutive year. We have also been recognized on the *Financial Times* 300 Top Registered Investment Advisers list in 2014, 2015 and 2016.

For more information, please visit www.adviserinvestments.com or call 800-492-6868.

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