The FINANCIAL SUCCESS Library

Money Minute

Financial Planning & Investing Newsletter

"Smart Ideas for Secure Finances"

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Inside This Month's Issue:

PROVIDED BY

R1 FINANCIAL GROUP

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FEATURE

Mutual Fund Fees: The Complete Story

In last month's "Ideas for Success" story, I highlighted the huge disparity in mutual fund performance that exists among different funds and how tens and even hundreds of thousands of dollars are at stake for an individual when selecting one fund versus another. One of the key factors to consider when evaluating a mutual fund is its fees. Understanding exactly how these fees work is crucial, and I decided the topic was important enough to be this month's feature story. If you are one of the roughly 60% of households in the U.S. that own mutual funds through a 401(k), IRAs, college savings accounts, and/or general investment accounts, read on....

How Fund Expenses Work

All mutual funds carry investment management and other fees, which are expressed as an "expense ratio." This total annual fee is expressed as a percentage of a fund's assets, and the fee is deducted directly from a fund's assets. This is reflected in the net asset value (NAV) of a fund, a.k.a. the fund's share price. Therefore, fund owners will not see specific transactions on fund or account statements showing a deduction of a fund's expense ratio.

How Much Should You Pay?

Reasonable expense ratios should generally range from 0.8% - 1.3% for actively-managed stock mutual funds. For a $75,000 investment in a fund, this equals roughly $600 - $975 in annual fees. Actively-managed bond funds are generally less expensive and should be from 0.5% - 1.0%. Funds investing in foreign stocks/bonds tend to be on the higher end of those ranges, as are funds that invest exclusively in smaller company stocks. Fees at these levels are reasonable and represent fair compensation as long as a fund's long-term performance is well above average.

Overpriced Funds Are Everywhere

I've spent hundreds, perhaps even thousands of hours researching funds in my years as a financial adviser and can testify that there are thousands of overpriced (and underperforming) mutual funds out there. Just how bad can it get? For example, there are thousands of

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QUOTE OF THE MONTH

"The time to repair the roof is when the sun is shining."

~ John F. Kennedy,
35th President of the United States

DID YOU KNOW?

50 years ago, the price of a 1st class stamp was increased from 4 cents to 5 cents. There have been 20 rate increases since, most recently in January 2013 to 46 cents.

Source: Wikipedia.com

Ideas for Success

Grading Your Mutual Funds: The Truth About Expenses

"Ideas for Success" articles are adapted from conversations with Money Minute readers and R1 Financial Group clients. Strategies mentioned should not be construed as investment advice or offers to purchase any product. Always consider investment risks and your goals before making any financial decision.

SCENARIO:

Last month, I highlighted the huge disparity in mutual fund performance that exists among different funds and the many thousands of dollars are at stake when an individual selects one fund versus another. One of the first things that should be considered when evaluating a mutual fund for potential investment is the annual cost to own the fund, a.k.a. its expense ratio. The bulk of this expense ratio goes towards compensating the fund company and fund manager for his decision-making in buying and selling the stocks and/or bonds for the benefit of shareholders. I believe fund managers deserve to get paid for the work they do, especially if they deliver above-average returns to their shareholders. The problem is that the level fund expenses and what investors get in return often do not align.

In any buying situation, the price of a good or service is almost always one of the top considerations. With regard to investing in mutual funds, many individuals are not aware how, how much, or how often they pay management fees in their 401(k)s, IRAs, college savings plans and taxable investment accounts. This can lead to unintended and harmful consequences: namely, individuals neglecting to truly "shop around" as they would for other products and services, resulting in paying far higher than necessary fees on their investments.

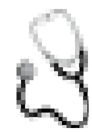
Mutual fund expenses are deducted directly from the value of fund shares, making it easy to overlook their impact on performance. It is clear, however, that these fees have a huge impact on investors' bottom line and, thus, should be monitored carefully.

STRATEGY:

I felt that this topic deserved more than the half page usually dedicated to this section, therefore I've continued this month's "Ideas for Success" story in this month's feature story. Enjoy!

When you are done reading, there are several places you can go to determine your funds' expenses: fund company websites, fund prospectuses, your investment account(s) website and/or 3rd party research websites like Morningstar. Account statements usually do not contain this information.

YOUR HEALTH



Cooked vs. Raw Vegetables: Which is Healthier?

Many people assume that raw vegetables are "healthier" than cooked vegetables, and that microwaving vegetables in particular "kills" nutrients. The truth, however, is a bit more complicated. Studies released within the past eight years have concluded that in terms of the impact on your food's nutrients, microwaving is the equivalent of sautéing or heating up in a pan (just a lot more convenient). They have also concluded that although cooking vegetables does reduce the amount of certain water-soluble vitamins, it can also liberate other nutrients, like antioxidants, allowing for greater absorption by the body.

When most green vegetables are cooked, some of the B vitamins and other water-soluble vitamins are lost. Sautéing in a pan or quickly steaming allows for much better vitamin retention than boiling. Boiling leaches up to 90% of water-soluble nutrients out of veggies! On the other hand, research from the University of Oslo found that microwaving or steaming carrots, spinach, mushrooms, asparagus, broccoli, cabbage, green and red peppers, and tomatoes led to an increase in the antioxidant content of the foods (in that the antioxidants became more available for absorption). It also showed that lycopene, the powerful antioxidant that gives tomatoes and watermelon their red color, is better absorbed by the body when it's consumed in cooked or processed tomato products—salsa, spaghetti sauce, ketchup, etc.—rather than fresh tomatoes.

Overall, the research suggests individuals should eat a mix of cooked and raw vegetables, and when cooking vegetables to avoid long cooking times and boiling. ***Source(s): NY Times, Yahoo Health, Wikipedia**

Ask Money Minute

Questions can be e-mailed to: Brad@R1FinancialGroup.com

Q. "What is your opinion of buying smaller company stocks as opposed to larger company stocks? I rarely, if ever, see articles written about smaller companies."

-David – Mesquite, TX

A. The standard answer is that returns from investing in small company stocks, as measured by any number of small cap indices (Russell 2000, etc.), are more volatile but have been cumulatively greater than returns from large companies (S&P 500 index). Since 1926, small stocks have out paced large stocks by just under 2% per year, a significant advantage. Most model portfolio allocations contain some portion of small company stocks/funds for this reason.

If you are considering purchasing individual stocks, particularly smaller company stocks, I recommend you do a great deal of research on each company. Smaller companies do indeed tend to have far fewer articles written about them and much less information easily available to potential investors. This is because larger institutional investors, pension funds, etc. are simply not as interested in stocks with such limited supply. Smaller company stocks are less liquid and priced less efficiently than large cap stocks, and as an individual investor, this presents a huge advantage to reap potentially greater returns than those available from larger, well-known, mature companies. Depending on your situation, they could be a nice addition to your portfolio.

Q. "Can I do my taxes myself? I've always paid a tax preparer $200 - $400 to do them, and it doesn't seem that hard."

-Evelyn – Dallas, TX

A. Most individuals and families have relatively uncomplicated tax returns, and I believe a fair portion could successfully prepare their own tax returns each year. Virtually all tax preparers and CPAs use computer software in completing tax returns, and popular software programs for home use (Turbo Tax, H&R Block, etc.) are more than capable of preparing most returns accurately. If you decide to give it a go for the first time, I'd suggest using one of the aforementioned computer programs to help guide you. Be sure to read each form and understand all parts that apply to your situation. Use your previous years' tax returns as a reference, and remember you can always call the IRS's help line if you have questions. I have found them to be extremely helpful in the past. You'll spend money on the software, but it should be a fraction of what you've spent in the past for tax prep.

If you have a more complicated tax situation, or if you lack the desire and/or confidence to attempt preparing your return, paying a knowledgeable accountant is probably the best course of action. Mistakes can be very costly and far outweigh the potential savings of doing it yourself. Good luck!

Money Minute Trivia Question

Olympic sprinter Oscar Pistorius, famous for using prosthetic blades to run, was recently charged with murder. What country is he from?

A) South Africa *B) Netherlands* *C) Belgium* *D) Denmark*

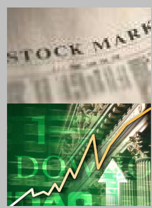
*Please email your answer to **Brad@R1FinancialGroup.com**. Each month one winner is randomly drawn out of all correct responders to receive a **$25 gift card to a local restaurant**!

Last Month's Winner – Jim K. of Garland, Texas

Question: Which pop star recently sang the national anthem at President Obama's inauguration and performed at the Super Bowl halftime show?

A) Madonna *B) Kelly Clarkson* ******C) Beyonce*** *D) Alicia Keys*

Market and Economic News



The U.S. stock market, as measured by the S&P 500 index, inched up slightly in February for a third consecutive month of gains. The Dow Jones Industrial Average eclipsed its all-time high during the week of March 4th, topping its highest previous close back in October of 2007. By that benchmark, the damage done by the "Great Recession" has been undone some five and a half years after the previous peak and almost exactly four years after market lows were set on March 9, 2009 in the depths of the recession. Corporate profits and balance sheets have recovered tremendously, and politicians, the Federal Reserve, and citizens continue to wait for a full recovery in job growth and unemployment rate reduction.

At a Glance…
(as of March 6) **DJIA** – 14,265 **S&P 500** – 1,540 **NASDAQ** – 3,220 **10-yr T-note** – 1.89%

Mutual Fund Fees: What You Need to Know

(Continued from page 1)

run-of-the-mill, large-cap domestic stock funds that have expense ratios over 1.9%. That may not sound like a tremendous amount, but it is; it is over 46% more expensive than what I consider to be the top of the "reasonable expenses" range. In terms of dollars and cents, here's how big a difference that can make:

Expensive Fund vs. Reasonably-Priced Fund

- "Expensive Fund" has an expense ratio of 1.95%.
- "Reasonably-priced Fund" has an expense ratio of 1.05% (midpoint of range previously mentioned).

A hypothetical $100,000 is invested into each fund, and each fund earns a 9% average annual return (before fees).

After 10 years - The investment in "Reasonably-priced Fund" is worth over $16,000 more than that in "Expensive Fund" due to the difference in fees.

After 20 years - The investment in "Reasonably-priced Fund" is worth over $67,000 more than that in "Expensive Fund" due to the difference in fees!

High expenses are a huge hurdle that is almost impossible to overcome, and funds with far above average fees have been shown over time to have virtually no chance of being good for the investor.

What Good and Bad Funds Do

-Good funds deliver above average performance with average or below average expenses.

-Good funds also tend to lower their fees over time as their funds grow. A $5 - $6 billion fund charging 1.1% would be wise to lower its fee if and when it reaches $40 - $50 billion+ in assets. Fund companies that are good stewards of investors' capital have done this over time, and I believe it says a lot about the integrity of the fund company. It's also good business; the more money a fund manages, the harder it can be to continue to generate ideas to outperform, and a lower expense ratio provides somewhat of an equalizing effect to these larger funds.

-Bad funds charge significantly higher than average expenses and deliver average to below-average relative returns for investors. They tend to have smaller asset bases.

-Bad funds have a tendency to raise their expenses dramatically when fund assets decline, whether due to redemptions or market declines.

A Few Final Notes

-If you bought mutual fund shares through a broker, you may have purchased shares that carry sales charges. Funds that label themselves "A-shares" or "Class A", "B" or "C" carry additional sales charges that go towards compensating your broker, a.k.a. commissions. If you have these, be sure you are getting on-going attention from your broker. If not, move your money into funds without sales charges (a.k.a. "no-load funds") like those referenced throughout this article.

-If you choose to invest in passively-managed index funds, your funds should carry expense ratios significantly smaller than the ranges listed previously. (Refer to last month's feature story)

Bottom line: It may not be tremendously exciting, but there is a lot of money at stake when it comes to fund expenses. Either spend the time to do it yourself or pay an advisor to check and see if your funds' expenses are reasonable or if improvements could be made.

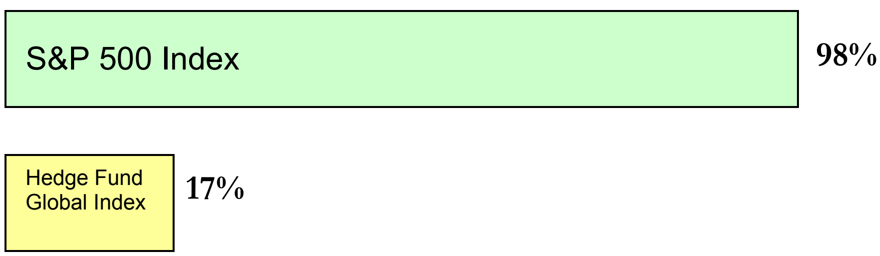
As always - carefully consider your personal financial situation, investment goals and risk tolerance before making any investment decisions.

Hedge Funds Underperform S&P 500 Index for 9 out of Past 10 Yrs

In last month's feature story, I compared passively-managed index funds to actively-managed funds. Hedge funds are actively-managed pooled investment vehicles as well, but they often employ more aggressive investment strategies such as short selling, the use of stock options, highly concentrated investment positions, and varying exposure to stocks in general, a.k.a. market timing. Hedge funds are generally considered more advanced investment vehicles only available to high net-worth investors. So - how does their performance stack up? HFRX Global Index is a widely-used gauge of the hedge fund industry's performance, and below we'll see how it's done over the past 10 years.

Cumulative Return: Hedge Funds Global Index vs. S&P 500 Index (2003 - 2012)

Total returns from Jan. 1, 2003 - Dec. 31, 2012



Source(s): S&P, HFRX index returns, The Economist

It is hard to believe, but the S&P 500 Index has produced a 98% cumulative return over the past 10 full calendar years versus just a 17% cumulative return for the Hedge Fund Global Index. 2012 marked the 9th time in the past 10 years that the S&P 500 Index outperformed the Hedge Fund Global Index, with 2008 being the exception. Adding insult to injury, hedge funds typically charge a 2% annual management fee plus 20% of annual profits.

What, why and how can this be? First - the past decade, and in particular the past 5 years, has seen extreme volatility in stocks. Many hedge funds have varied their exposure to stocks in an effort to avoid this volatility and in doing so have missed out on substantial stock market gains in recent years. Risk aversion and fear of volatility have proven very detrimental to absolute returns over the past 3-4 years. This underperformance highlights just how difficult it is to make successful predictions on macroeconomic conditions and events. One could also argue that this underperformance is also a clear indication of how difficult market timing really is, whether attempted by a hedge fund or individual investor.

Hedge fund strategies and methodologies are extremely varied, and to be sure there are many successful hedge funds out there that have been around for years. There is also an extremely high failure rate for hedge funds. My hunch is that the survivors are the ones that are a bit more prudent, focused on the longer term and less speculative than most. Overall, I find the above statistics fascinating and somewhat funny given the hedge fund industry's "smarter than thou" aura, but I think hedge funds are like any other category of investment in that they need to be evaluated individually based on their own track record and merit and without prejudice.

Money Minute *Tip of the Month:* Unlimited Cell Phone Service for $19 per month...Really?

Republic Wireless offers unlimited talk, text and data cell phone service for just $19 per month. The company launched service in late 2011 and offers just one smartphone option - a specially equipped Motorola for $249 (or you can pay $99 up front and $29 / mo. for service). What makes Republic different is that phone service runs off of Wi-Fi connectivity when possible rather than a traditional cell network. When no Wi-Fi connectivity is available, a phone will run on Sprint's 3G network. Recent articles in USA Today, Wall Street Journal and Consumer Reports have all reviewed the service recently and have reported decent results in terms of call quality and functionality. One of the less desirable features of the service occurs when a user places a call from a Wi-Fi area, then moves out of range of that network. The phone senses this change, then automatically dials the number over the traditional cell network. The person on the other line then has to hit the "flash" button to answer the call on the other line - similar to using the call waiting feature.

This budget service is clearly not for everyone. Those wanting the most advanced smartphones and those needing the fastest network speeds at all times should not consider Republic Wireless. For those who are aren't concerned with these compromises, the service may be a great lower-priced alternative to traditional cell phone service. Source: Time Magazine

<u>Important Information</u> – This newsletter and its contents are produced for educational and general informational purposes only and are not intended to be personal financial advice or provide specific recommendations to any individual, nor are they an offer to purchase any financial product. To determine which investment(s) may be appropriate for you, or for more information about financial and investment planning, please contact R1 Financial Group (see below).

<u>Additional Content About Subjects Mentioned in this Newsletter</u>:

Stock investing involves risk including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise, and bonds are subject to availability and change in price.

Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield. The market value of corporate bonds will fluctuate, and if the bond is sold prior to maturity, the investor's yield may differ from the advertised yield. Municipal bonds are subject to availability and changes in price. They are subject to availability and change in price. They are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax.

Municipal bonds are federally tax-free but other state and local taxes may apply. High yield / junk bonds (grade BB or below) are not considered investment grade securities and are subject to higher interest rate, credit and liquidity risks than those graded BBB and above. They generally should be used as part of a diversified portfolio for sophisticated investors.

Government bonds and US Treasury bills are guaranteed by the US Government as to the timely payment of principal and interest, and if held to maturity, offer a fixed rate of return and a fixed principal value.

CD's are FDIC insured and offer a fixed rate of return if held to maturity.

All indices are unmanaged and cannot be invested into directly. All performance reference is historical and is no guarantee of future results.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure the performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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R1 Financial Group is an independent financial services company that provides fee-based investment management, retirement planning and financial planning services. It is located in the Dallas-Fort Worth area.

R1 Financial Group uses research-based investment strategies and proven financial planning techniques. It offers complimentary initial consultations to prospective clients.

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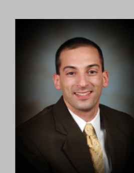

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