

174 Views | 18 CrossRef citations to date | 0 Altmetric

Perspectives

# The Arithmetic of "All-In" Investment Expenses

John C. Bogle


Pages 13-21 | Published online: 28 Dec 2018

Cite this article <https://doi.org/10.2469/faj.v70.n1.1>

Check for updates

Sample our Law Journals

>> [Sign in here](#) to start your access to the latest two volumes for 14 days



References

Citations

Metrics

Reprints & Permissions

Read this article

## We Care About Your Privacy

We and our 854 partners store and access personal data, like browsing data or unique identifiers, on your device. Selecting "I Accept" enables tracking technologies to support the purposes shown under "we and our partners process data to provide," whereas selecting "Reject All" or withdrawing your consent will disable them. If trackers are disabled, some content and ads you see may not be as relevant to you. You can resurface this menu to change your choices or withdraw consent at any time by clicking the ["privacy preferences"] link on the bottom of the webpage [or the floating icon on the bottom-left of the webpage, if applicable]. Your choices will have effect within our Website. For more details, refer to our Privacy Policy. [Here](#)

We and our partners process data to provide:

I Accept

Reject All

Show Purpose



Abstra

This arti

fund ret

ratios (u

costs, sa

time, lov

In "T

2013),

compon

expense

funds, c

extends

not only

conclusi

over four decades.

on mutual

by expense

nsaction

funds, over

investors.

ch/April

a critical

ally lower

managed

this article

including

s loads. The

lth of 65%

This comprehensive approach to the consideration of mutual fund costs has, to the author's knowledge, not previously been attempted. The reason for this vacuum seems to be that although mutual fund expense ratios can be calculated with precision, the other data are inevitably imprecise. For example, commissions paid to brokers by mutual funds on their portfolio transactions are disclosed in prospectuses, but bid-ask spreads and market impact costs are ignored and must be estimated.

Sales loads paid to brokers and recurring fees paid to their account executives and to registered investment advisers are other major drags on fund returns. Most individual investors in actively managed funds rely on these distribution-related services to select their fund investments. But because the costs are paid directly by investors rather than by the funds themselves, they are ignored in the published performance data. Changing distribution patterns in the fund industry make it challenging to estimate these amounts with precision, but they must be part of all-in cost measurement.

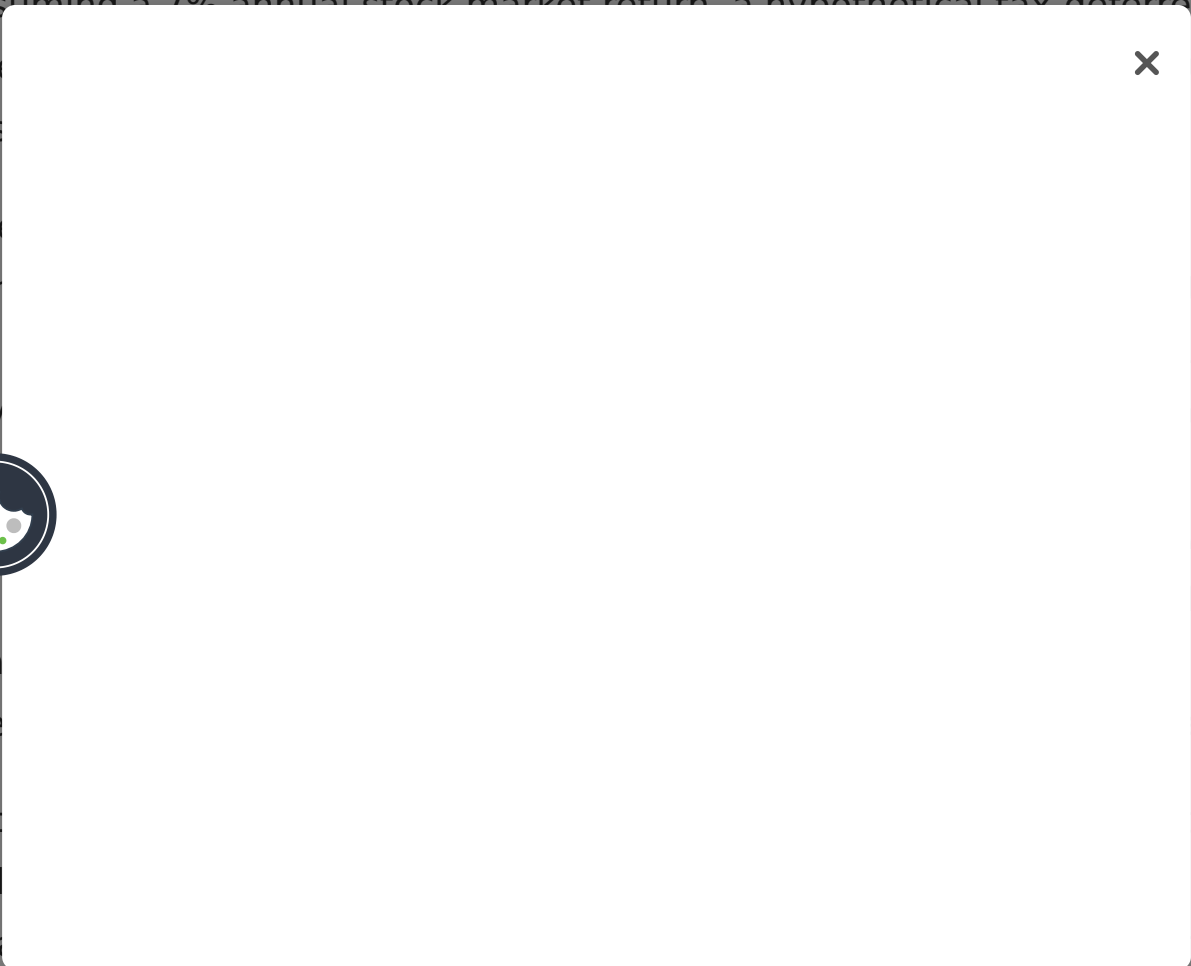
In his recent FAJ article, Sharpe compared the 0.06% annual expense ratio of an existing total stock market index fund with an average ratio of 1.12% for actively managed large-cap mutual funds—an annual cost advantage of 1.06 percentage points (pps) for the index fund. But the all-in costs raise the cost for actively managed equity funds to an estimated 2.27%, more than doubling that gap to 2.21 pps. The result is that, assuming a 7% annual stock market return, a hypothetical tax-deferred retirement

plan investor would have \$61,000 over 40 years.

Next, the author considers the impact of taxes. Investors in actively managed funds are typically more tax-efficient than those in index funds. The tax cost of the 1.12% expense ratio is 0.1 pps, and the tax cost of the 2.27% expense ratio is 0.2 pps. The net tax cost is 0.1 pps.

Finally, the author describes the impact of the tax cost on the total cost of the fund. The net tax cost of 0.1 pps adds to the 2.27% expense ratio to produce a total cost of 2.37%. The total cost of the index fund is 0.16% (0.06% expense ratio plus 0.1 pps tax cost). The total cost of the actively managed fund is 2.53% (2.37% net tax cost plus 0.16% tax cost). The total cost of the actively managed fund is 2.53% (2.37% net tax cost plus 0.16% tax cost).

Finally, the author describes the impact of the tax cost on the total cost of the fund. The net tax cost of 0.1 pps adds to the 2.27% expense ratio to produce a total cost of 2.37%. The total cost of the index fund is 0.16% (0.06% expense ratio plus 0.1 pps tax cost). The total cost of the actively managed fund is 2.53% (2.37% net tax cost plus 0.16% tax cost). The total cost of the actively managed fund is 2.53% (2.37% net tax cost plus 0.16% tax cost).



with some consistency, fund (asset-weighted) returns, representing yet another source of diminished returns for investors in actively managed funds.

The author argues that Sharpe was correct in his analysis of mutual fund expense ratios and the damaging impact they have on the long-term returns earned by investors. The author takes the analysis one step further by estimating the other significant costs incurred by actively managed funds and their investors, which, although much more challenging to quantify than expense ratios, add to the damage done to investors' returns. The author's advice to investors is (1) to take into account all the costs of fund investing, (2) to invest for a lifetime, and (3) do not allow the tyranny of compounding costs to overwhelm the magic of compounding returns.

#### Related Research Data

[Mechanism by which active funds make market efficient investigated with agent-based model](#)

Source: Springer Science and Business Media LLC

Linkin



Relate



The

William  
Financia  
Publishe

The Ari

### Information for

- Authors
- R&D professionals
- Editors
- Librarians
- Societies

### Opportunities

- Reprints and e-prints
- Advertising solutions
- Accelerated publication
- Corporate access solutions

### Open access

- Overview
- Open journals
- Open Select
- Dove Medical Press
- F1000Research

### Help and information

- Help and contact
- Newsroom
- All journals
- Books

### Keep up to date

Register to receive personalized research and resources by email

 Sign up

Copyright

Access

Register  
5 Howick Pl

Wiley & Francis Group  
Wiley Online Business

