To Load Or Not To Load

One of the common questions when purchasing mutual funds is whether it is better to choose a fund with a front end load, rear end load or no load.

Loads, or sales fees, are the way the industry covers the cost of selling funds. Regardless of the fund, its selling costs must be covered. With no load funds there is no direct sales charge, so the costs must be covered by the fund's management fees. On funds with a front end load, there is a direct fee or commission charged when the fund is purchased. Funds with deferred charges, usually trailer fees, charge a fee when the fund is sold. The amount of the trailer fee usually decreases over time. For example, if you sell the fund within a year of purchase, the fee might be six percent, reducing by one percent for every year that you hold the fund, and if you hold the fund for six years there is no fee. The exact terms and rates will depend on the fund.

Many people choose no load funds just to avoid the fees. However, in the long run, one way or another, you are going to cover the sales costs. Therefore, our first piece of advice is to determine the level of service and number of choices you want, then find a professional with whom you are

comfortable. At the low end of the scale, you can make your own decisions and purchase directly from the companies, or use a discount broker. At the top end there are full service financial planners, who will help you with all your financial decisions. The more service you want, the more you should expect to pay, but it may be worth it.

Once you have established who you are going to for advice, you should start picking your funds. At this stage you should ignore the sales fees. A five percent front end load will ultimately reduce the size of your investment by five percent. However, over the long haul, a one percent reduction in annual return can cost a lot more. So, look at the risks, expected returns and quality of management first. In the long run, these factors will have a much greater impact on your portfolio.

Once you have chosen a fund or narrowed the choice to one or two funds, you can consider the sales charges. At this stage the fees may become relevant, especially if the fund company offers a choice of fee structures for the fund, or it offers two similar funds with different fee structures.

We ran an analysis of a $10,000 investment that earned ten percent per year for twenty years. At the end of the period, it was worth $67,275. If we applied a 2% front end load, which reduced the initial investment to $9,800, it was worth $65,929, or 2% less. Similarly, a 5% load reduced it by 5% to 63,911. However, if we did not charge a load, but decreased the return by 1%, (the same effect as increasing the management expense ratio by 1%) at the end of the period the investment was worth $56,044 or 17% less than in the original scenario. Even a decrease in return of 1/2% had a significant impact. With the 1/2% decrease in return, at the end of the period, the investment was worth $61,416, or 9% less than the original $67,275.

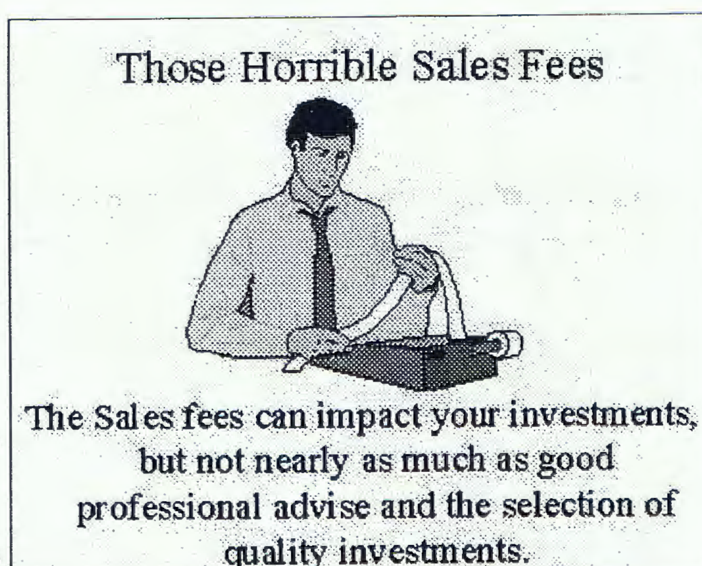
As you can see, over the long haul, a small reduction in return has a much greater impact than a large sales fee. So, assuming that you are planning to hold your investment for a long period of time, when making a decision between two similar funds, where the only comparable difference is type of fee, you should look at the management expense ratio. If one choice has a lower ratio, it will probably be the better choice. If the ratios are similar or almost similar, then choose the no load option.

If the choice is between a front end load and a trailer fee, it gets more difficult. If the rates are the same, and they are both based on the purchase price, take the trailer fee, as it will be the same amount but deferred. However, the choice is usually between a trailer fee that reduces over time and a fixed front end fee. If this is the case, and there is not much difference between the front end fee and the highest trailer fee, choose the trailer fee as it will decline over time. However, more than likely the choice is between a low front end fee of 2 or 3% and a trailer fee that starts around 6% and reduces to nothing over about 6 years. In this case you have to ask yourself, how long you plan to hold the investment. If you might make a change in the next two or three years, you will probably be more comfortable with a small front end load. At this point, you should compare options and choose the one that you feel most comfortable with. Only time will tell which would have been better.

Comments

In our opinion, most people place far too much emphasis on which load is better. Probably because they are fairly visible, and lets face it, no one likes to pay. We think your emphasis should be on choosing the most suitable investments and advisors. In the long run these will have a much greater impact on your financial well being.

The above assumes that you are buying funds with the intent of holding them for long periods of time. If not, all fees should be avoided, as their impact will be much greater.



If you are making your own decisions, you may prefer to use a discount broker to lower the fees. However, before you do, you might want to check the rates with a full service broker, often they will provide rates equal or nearly equal to those of the discount brokers, and you may get better service.

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