BROKER VILLAGE

A Division of Black Cat Decisions, LLC

Facts for Advisors

Expense Levels Barely Affect Share Choice

Not a Big Issue

Issue: Investors cannot easily quantify how fund operating expenses affect share class choice.

Background: As expenses change, asset values change, but the best performing share class may not. This result has a curious implication for some investors. They can ignore the level of expenses when choosing a class of a certain fund. Instead, they should consider the *differential* in expenses, along with B-to-A flips and breakpoints.

Suppose ten funds differ only by the level of their A- and B-share expense ratios. Expenses for B's always are 0.75% higher than for A's. That's the difference in 12b-1 fees. Pick a time horizon and hold it constant. After year 10, assume A's beat B's for the fund with a 1% A-share ratio. A's then will beat B's for every fund, even if A-share expenses are 2%, 3%, etc. The 0.75% differential is constant at all expense levels. So, the share that's ahead at any point, stays ahead. Next, change horizon. The best class may change, indicating that horizon affects choice, not expense level.

Result: Investors reap higher returns without more risk. The odds improve that they select the right share class.

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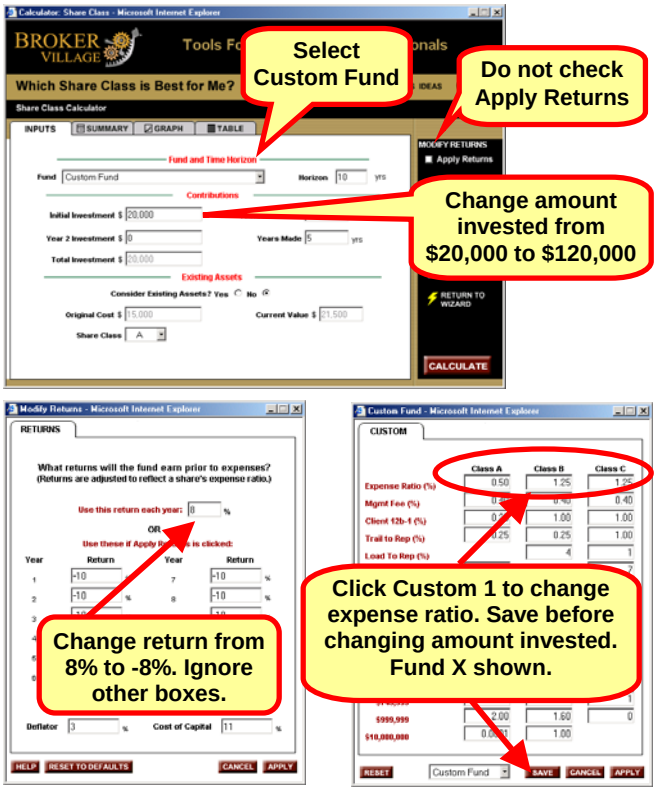
Example. An investor considers funds (X, Y, & Z) with different expense ratios. He'll buy the share class of the fund that generates the highest account value after ten years. He does an analysis at $20,000 and $120,000.

The A-, B-, and C-share expense ratios for the three funds are: (X) 0.5%, 1.25%, 1.25%; (Y) 1.25%, 2%, 2%; (Z) 2%, 2.75%, 2.75%. A-share loads are 5.75% for all funds. CDSCs are ignored given the long horizon. B-shares convert to A's after six years. Annual pre-expense returns of 8% and -8% are tested.



Result. Varying expenses and returns does not affect the outcome. Results to year ten, below, reflect 8% returns for the fund with the lowest (X, 0.5%) and highest (Z, 2%) A-share ratio.

Past year 5, at $20,000, B-shares always are best, totaling $39,286, $36,483, and $33,898 for Funds X,Y, & Z. (1st image.) At $120,000, A's always are best: $237,224, $220,226, and $204,559. (2nd image.) The best class doesn't change even at a –8%/yr return. To year 5, C's always are best, regardless of expense or return.