These Funds Are Cheap, But Are They Right for You?

Description

An interesting article appeared recently in *The Globe and Mail* looking at the increasing offerings of D-series mutual funds. What are these funds, and how do they work? Are they right for you? And what do these funds mean for the banks themselves?

The purpose of these funds

Under normal circumstances, if an investor buys a mutual fund through an advisor, he or she must pay what's called a "trailing commission", which goes to the advisor. This commission is invisible to the investor, but is included in the total price of the fund. This is what compensates the advisor for his or her services.

But what about those who buy the funds themselves? They certainly shouldn't have to pay any trailing commissions. Two banks — **Royal Bank of Canada** (TSX: RY)(NYSE: RY) and **Bank of Montreal** (TSX: BMO)(NYSE: BMO) — have taken the lead in providing cheaper alternatives to those who don't use an advisor.

These so-called D-series funds have fees of around 1.2%, well below the 2%+ fees seen for most equity mutual funds.

Are they right for you?

Astute investors will ask: Why should I buy these funds when I can own an index fund instead? Aren't those even cheaper? The short answer is yes, but these index funds trade like stocks, meaning you'll have to pay a small fee (typically $10) to buy or sell them. The D-series funds have no fees, making them ideal for very small accounts.

Secondly, the banks do have small support services — yours truly used to work on one of these teams — dedicated to helping individual investors who hold mutual funds. If you're looking for some basic advice, but don't have enough money for an advisor, then these funds could be right for your portfolio.

Finally, it should be noted that Royal Bank offers some funds from outside companies like **Mackenzie**

(TSX: MKZ.UN), **Invesco** (NYSE: IVZ), and Beutel Goodman. These companies offer some funds with very strong track records, some of which may be more attractive than an index.

What does this mean for the banks?

The Canadian banks are facing a serious problem in their wealth management departments: Many investors are tired of paying fees that are among the world's highest for funds that rarely outperform their benchmarks. As lower-cost options rise, this puts pressure on the banks' profits from wealth management.

Shareholders of Royal Bank and Bank of Montreal should be happy about what these banks have done — these funds will likely divert some money away from ETFs. Likewise, we should expect the other large banks to follow suit. This is also a reminder that wealth managers have been making too much money for years, and eventually this has to change. Bank shareholders should follow this closely.

CATEGORY

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