

Bullish on IGM Financial Inc. and AGF Management Ltd.? Then You Have to Read This

Description

For the better part of a century, the mutual fund industry was pretty much the only way the average Canadian could gain access to the capital markets.

Sure, many Canadians did choose to buy and sell their own individual stocks, but education was low and fees were high. Research was limited to either the Bay Street powerhouses of the day, stock quotes in the newspaper, or little tidbits of information gleaned from some other source. The information was out there, but the average investor had no idea where to find it. It's why mutual funds were created in the first place.

But in 2015, the investing world is a very different place. Research on a stock is just a few mouse clicks away. Sites such as Motley Fool Canada help active investors pick out potentially winning stocks. And ETFs have come in and stole a lot of market share from mutual funds. It's hard to justify paying a 2.5% fee on a fund when the equivalent ETF charges a fraction of the price for a better result, at least most of the time.

Then why do mutual funds still exist? There are a few reasons. Some investors are still convinced that they can pick a winning fund, chasing returns of the latest fund to post good results. Others are in funds because of a generous RRSP match from their employer, which instantly gooses their return. But mostly, people are in funds because they're sold funds.

Let me explain that last point a little further.

We've seen it a million times, usually with our friends or family who aren't investment savvy. They know they need to invest, but aren't sure the best way to go about it. So they go to the bank and talk to someone there. Or they see an Investors Group ad on television and buy in, arranging a meeting with one of the company's more than 5,000 investment consultants.

Throughout the years, this has translated into a pretty good business for **IGM Financial Inc.** ([TSX:IGM](#)), the parent company of Investors Group. An investor shows up, buys a couple of funds, and the company can collect fees on that investment for years. It also opens up the opportunity for the advisor to recommend insurance, mortgage, and other financial products to the client.

AGF Management Ltd. ([TSX:AGF.B](#)) has a slightly different business model, although it's still mostly built on selling funds to retail investors. But unlike IGM, AGF doesn't have its own salesforce in the retail channel. It lets other financial advisors sell its funds while focusing on managing them. AGF has also expanded into managing money for pension funds and high net worth clients as well.

Not only are these two companies getting hurt by low-fee ETFs — to the point where AGF has cut its quarterly dividend by 70% — but they're also going to face a new headwind. Although it's not official yet, word is that disclosure to investors will face a major overhaul.

Currently, all an advisor needs to do is disclose the management expense ratio to the client. And even then, it's commonly glossed over. Instead, it looks as though investors will be able to see just how much that fee costs them in dollar terms. Rather than it being just a 2.5% fee, it'll be disclosed as a \$25 fee for every \$1,000 invested.

If investor advocate groups get their way, the upcoming changes might be even worse for the industry. Advocates are calling for a total ban of trailer fees, which are paid to the advisor by the fund company as a reward for keeping the funds under management. Most funds pay advisors a 1% fee on an annual basis.

If the 1% trailer fee is eliminated, many advisors will likely stop selling mutual funds altogether, choosing a model based on ETF sales and a flat fee for financial advice. And most importantly for IGM Financial, it suddenly becomes a lot less lucrative to become an Investors Group consultant.

Changes are coming to the mutual fund industry, and they could be huge. For that reason, I recommend investors avoid both AGF and IGM.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:AGF.B (AGF Management Limited)
2. TSX:IGM (IGM Financial Inc.)

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