



## Should Investors Avoid Canada's Mutual Fund Companies ... Forever?

### Description

At this point, I hope that most investors know that mutual funds are generally a bad place to invest.

In theory, mutual funds are great. They offer instant diversification, an expert manager to make all the investing decisions, and the fund company takes care of just about everything. All investors really need to do is just cut the fund company a cheque and relax.

There are a couple of big problems with mutual funds. The biggest is the fees. Let's face it; it's really hard for a fund manager with hundreds of millions of dollars to beat the index on a regular basis. But fund managers have to do one better. They have to beat the market by at least 2% per year just to justify the management fee. In comparison, investors can own an index fund for a management fee of less than 0.1%.

The other thing bringing down fund managers is what the industry calls window dressing. Managers will often punt companies that have done poorly out of their portfolios, replacing them with stocks that are doing well. Buying high and selling low is the exact opposite of what successful investors do.

While I think investors should avoid costly mutual funds, I'm more than happy to invest in the sector. There's a lot to like about the wealth management business. It takes almost zero physical assets; all you really need to run a fund are some smart managers and an office. The margins are good, even after paying a commission to someone to sell the product. And it's easy to scale up.

Astute investors are switching out of expensive mutual funds and into cheap exchange-traded funds, a trend that doesn't show any signs of slowing down. Will this be the death knell of Canadian mutual fund giants like **IGM Financial Inc.** ([TSX:IGM](#)), **AGF Management Ltd.** ([TSX:AGF.B](#)), and **CI Financial Corp.** ([TSX:CIX](#))?

### The state of the industry

For years, investors have liked IGM Financial for one very simple reason.

Its army of Investors Group salespeople pushed the company's mutual funds over competing products.

CI Financial has a similar business model, but its Assante Wealth Management subsidiary only has 750 agents. Investors Group has closer to 5,000.

Traditionally, Investors Group agents have used funds as a way to get clients in the door, leveraging the opportunity to sell other products like life insurance and mortgages. If investors move on to cheaper fund options, it'll be harder for these advisors to make a living.

Besides, the trend is towards fee-based financial planning, not an asset-based model. It's far easier for a start-up to capture market share as a fee-only planner than it is for a company like Investors Group to adapt. Investors Group has too much invested in the old model.

Things look even bleaker for AGF Financial. AGF has become a smaller player in an increasingly crowded mutual fund world. Without the advantage of a sales force pushing its funds, it's very easy to be bearish on the company.

### **Those dividends**

One thing holding these stocks up are the generous dividends they pay investors. IGM Financial sports a 5.8% yield; CI Financial has a 4.8% payout; and AGF still pays out a 6.1% dividend even after cutting its distribution in early 2015.

But investors should be cautious about these seemingly generous yields. Sure, each company still earns enough to cover the payout, but in today's market, they're automatically viewed as companies with risky dividends.

Besides, there's little reason to pay such generous yields. These companies could start to shift strategies in a number of ways, moves that will likely need capital to succeed. And as the trend towards exchange-traded funds continues, it's likely earnings will go down. Both of those things aren't good for dividends.

Value investors might be intrigued by Canada's mutual fund companies. They seem cheap on a price-to-earnings basis. I just don't see how they're anything but long-term value traps.

### **CATEGORY**

1. Dividend Stocks
2. Investing

### **TICKERS GLOBAL**

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

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