New Investors: Here’s How to Avoid Paying Over $2,000 in Investment Fees Per Year

Description

Last month, Morningstar released some shocking news: compared with other countries, Canada received a “below average” rating in terms of the cost for investment funds and investing advice.

Of course, for those familiar with Morningstar’s Global Investor reports, this isn’t truly “new.” For years now, Canada has had some of the highest MERs and investment costs in the world. In fact, it wasn’t that long ago that Canadian mutual funds were the most expensive in the world, and, by good estimates, many Canadian investor could still pay upward to $2,000 in fees in 2022 for these funds.

For new investors, this poses an enormous challenge: how can you maximize your returns while also minimizing fees? Here is how you can avoid paying high fees.

Avoid mutual funds

Perhaps the easiest way to avoid high fees is to steer clear of mutual funds altogether.

Recall that mutual funds are baskets of investments, like stocks, that are actively managed by a fund manager. When you buy shares of a mutual fund, you spread your money across numerous companies. This is different than, say, buying an individual stock: instead of investing your money in one company, a mutual fund spreads your money across numerous companies.

What makes mutual funds different from other funds, however, is the active management. Most mutual funds have fund managers who are actively trying to beat the market. They’ll often trade stocks within the mutual fund, as they try to pick ones that will outperform the broader market, and those trades could incur fees — fees that are then passed on to investors.

Because mutual funds are actively managed, they’re typically more expensive than other funds, such as index funds and ETFs. But in Canada, they are noticeably expensive: the average MER (management expense ratio) in Canada hovers around 1.98%.

That means for every $100,000 that you invest in mutual funds, you will pay around $2,000 in MER fees every year.

So, yes, perhaps the best way to avoid paying high fees is to avoid investing in mutual funds. And, truthfully, you’re not missing out if you do. Though mutual funds are actively managed, they rarely, if ever, outperform passively managed funds, such as ETFs, over long periods of time. And considering that the MERs on ETFs are significantly lower, you would save yourself money by investing in them.

Double-check MERs

Of course, if you’re set on investing in mutual funds, I’m not going to dissuade you. But I will say this: mutual funds are not created equal. Before you buy shares in a mutual fund, be sure you compare the MER with the fund’s performance. If the fund has performed exceptionally well over the last five or 10 years, then it might be worth your investment.

You might also want to look for low-cost mutual funds, too. Not all mutual fees have MERs as high as 1.98%. Some may have MERs that are comparable to those on ETFs.

Again, if you’re looking for a low-cost investment, I would recommend ETFs. Like mutual funds, ETFs are baskets of investments. The difference, however, is that ETFs are passively managed, meaning they follow a certain market index. They’ll never beat the market. At best, they follow it.

But the MERs on ETFs are low, and the investment gains can be high over long periods of time. For new investors, investing in ETFs can be a smart choice — especially if you don’t have time to pick individual stocks.

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