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YOUR MONEY

Give Fees an Inch, and They’ll Take a Mile

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Strategies

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Watch out for investment expenses. They will cut down your return, shrink your nest egg and may well prevent you from achieving your financial goals.

This common wisdom may seem so obvious that it’s not worth thinking about.

But in a bulletin for investors titled “How Fees and Expenses Affect Your Investment Portfolio,” the Securities and Exchange Commission puts a particularly fine point on it.

Even for market veterans, the bulletin bears close attention. What’s startling is how many fees and expenses lurk in your investments — and how big a bite even modest expenses can take out of an investing dollar.

Fees may seem inconsequential at first. “But over time they can have a very profound impact on investment returns,” said Owen Donley, chief counsel in the S.E.C.’s office of investor education and advocacy.

Consider the pernicious effect of even a seemingly small annual fee over time. To illustrate the point, the S.E.C. used very conservative and simple assumptions: a 1 percent annual fee on a $100,000 portfolio that grew 4 percent annually over 20 years.

Without any fees whatsoever, the portfolio would have grown to almost $220,000 in two decades, thanks to compounding. That’s the good news.

The bad is that you would never see a considerable part of that money. A 1 percent annual fee would subtract almost $28,000 from the portfolio. What’s more, the S.E.C. included opportunity cost in its calculations — the lost return on the $28,000 devoured by fees. If you had been able to invest that $28,000 at the same rate as the rest of your portfolio, you would have earned an additional $12,000. All told, then, 1 percent in annual expenses would have eaten up roughly $40,000 — or about one-third of the total $120,000 return on your investment. Ouch.

(And now that tax season is upon us, it is worth noting that unless that portfolio were tax-sheltered, the I.R.S. would also take a bite out of your gains.)

It’s true, of course, that if you earned more on your money over 20 years, that investment expense might seem less onerous. But there have been many years in which investment returns have been less than 4 percent, which would increase the proportionate impact of the fees.

Such effects are well worth pondering, because a 1 percent drain on your money is, in fact, a very moderate estimate: For example, it is less than the average fee for an actively managed mutual fund. That average annual fee, known as the expense ratio, is 1.26 percent, according to the most recent figure from Morningstar. That compares with 0.76 percent for the average index fund; some funds are cheaper than that.

You may not know what the expense ratio of your own mutual fund is; it's worth finding out early in the game, before the expense leakage does too much damage. As the S.E.C. bulletin points out, the expense ratio must be listed by mutual funds; it is "identified in the fund's prospectus as the total annual fund operating expenses."

Alas, this is just the start of it. There are many different types of fees and expenses, and the S.E.C. broke them down into two broad categories: transaction fees, like those paid to a brokerage firm when a stock is bought, and continuing fees or expenses, like those expense ratios charged by mutual funds or exchange-traded funds.

Additional transaction fees listed by the S.E.C. include these:

MARKUPS That is the term used when a brokerage firm — strictly speaking, a "broker-dealer" — sells you securities that it is holding in inventory and charges you a price higher than the market price.

SALES LOADS These are charged by some mutual funds, and they come in many varieties. Front-end loads are assessed when you make an investment; back-end loads are charged when you sell it.

SURRENDER CHARGES These are imposed when you withdraw early from an investment in a variable annuity, which is another big subject in itself. The S.E.C. put out a separate bulletin on variable annuities recently, highlighting the complexity and the multilayered fee structure that are common for them.

Then there are additional, continuing fees and expenses. Here are just a couple of them:

INVESTMENT ADVISORY FEES These are often charged by advisers and may be based on the amount of assets in a portfolio.

401(K) FEES Remember those annual operating expenses for mutual funds and E.T.F.s? Fees for 401(k)'s are additional expenses for operating and administering retirement plans, and they may be passed on to employees, on top of the mutual fund and E.T.F. fees.

These fees aren't simple. And the agency also warns that its list is not all-inclusive. You may be charged additional brokerage fees for not maintaining a minimum balance, as well as for account maintenance, account transfer, account inactivity, etc. "These fees may not always be obvious to you from your account statement or confirmation statement," the S.E.C. warned. "You should obtain information about all the fees you are charged and why they are charged."

It's nearly impossible to avoid fees entirely, but you do have some control. Even if you don't have much leverage to negotiate fees, you can often shop around. For help researching brokers, the agency says, you may visit Finra's BrokerCheck service. For advisers registered with the S.E.C., you may use the agency's Investment Adviser Public Disclosure website.

Individual mutual fund and E.T.F. annual fees may be researched at a website operated by Finra, the brokerage industry's self-regulatory organization. Finra's Fund Analyzer summarizes the various fees and expenses for more than 18,000 mutual funds and E.T.F.s.

Of course, you may be willing to pay higher fees in exchange for a higher return. The reality, however, is that higher fees may merely result in less money for you.

As John C. Bogle, the founder of Vanguard, likes to say, “In investing you get what you don’t pay for.” But first you need to ask questions and understand what you’re being charged.