Keeping Portfolio Costs Low

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January 2020

The importance of keeping portfolio costs should be self-evident. Costs come directly out of the investor's pocket. The two primary portfolio costs consist of the expense ratio of the mutual funds and/or ETFs being used in the portfolio and the advisory fee being charged (if there is a financial advisor involved). Therefore, both costs have to be kept as low as possible.

The first place to start is the cost of the funds being used in the portfolio. The average expense ratio among all mutual funds is roughly 100 bps. Assuming an annual advisory fee of 100 bps, the total annual portfolio cost is **200 bps** (or 2%). At that cost level, the average annual withdrawal for a retiree invested in a diversified 7-asset portfolio is approximately **$120,214** over the 25-year period between the ages of 72 to 97 (assuming only the amount specified by the Required Minimum Distribution was withdrawn from the portfolio and assuming a starting balance of $1,000,000).

This average annual withdrawal of $120,214 was calculated by analyzing the performance of an equally-weighted 7-index portfolio over the 26 rolling 25-year periods between 1970 and 2019. The 7 indexes in the portfolio covered the following asset classes: large cap US stock, small cap US stock, non-US stock, real estate, commodities, US bonds, and cash. To purchase the spreadsheet tool to do this analysis yourself click on this link: http://www.7twelveportfolio.com/Downloads/Web7TwelveReport.pdf

If the cost of funds in the portfolio is cut in half (from 100 bps to 50 bps) by utilizing mutual funds (or ETFs) with lower expense ratios, the overall portfolio cost can be reduced from 200 bps to 150 bps. By doing so, the average annual withdrawal for the retiree increases to **$129,461**, or roughly $9,200 more income each year. That works out to a "raise" of about **$770 per month** during retirement.

But, we can do even better. It's possible, using low-cost ETFs, to build a diversified retirement portfolio for as low as 10 bps. If the advisory fee were reduced by a mere 10% from 100 bps down to 90 bps, combined with funds costing 10 bps, the overall portfolio cost could be lowered to a total of 100 bps. At that cost level, the retiree withdrew an average of **$139,503** each year—or an additional **$1,607 per month** compared to a portfolio costing 200 bps each year.

The Impact of Reducing Portfolio Cost

Combinations of fund expenses and advisory fee	**Total Portfolio Cost** (aggregate expense ratio of funds and advisory fee)	**Average Annual Withdrawal from a Retirement Portfolio between the ages of 72 to 97* (using RMD guidelines)**	**Additional Monthly Income for Retiree**
Total fund expenses of 100 bps Advisory Fee of 100 bps	**200 bps**	**$120,214**	**---**
Total fund expenses of 50 bps Advisory Fee of 100 bps	**150 bps**	**$129,461**	**$770**
Total fund expenses of 10 bps Advisory Fee of 90 bps	**100 bps**	**$139,503**	**$1,607**

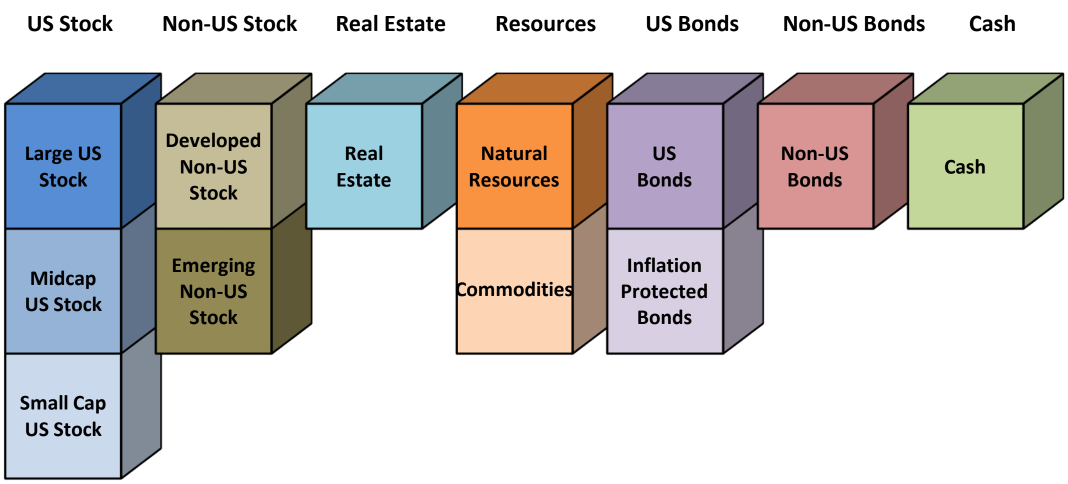
** Assuming a $1,000,000 starting balance at the age of 72. Multi-asset portfolio including large cap US stock, small cap US stock, non-US developed stock, US real estate, commodities, US bonds, US cash. Analysis of 26 rolling 25-year periods from 1970-2019.*
Past performance is not a guarantee of future performance.

A Modern Diversified Portfolio

A modern diversified portfolio is the ***7Twelve***® portfolio. It is an investment model that can be built very easily and at very low cost. For example, if actively managed funds from various fund families are used to build the 7Twelve portfolio the overall fund expense can be as low as 70 bps. If the 7Twelve model is built using ETFs from Vanguard, for example, the total cost of funds can drop to 9 bps.

The *7Twelve*® Model

All 12 funds in the "core" model are equally-weighted



There are several 7Twelve models, all built with 12 mutual funds and/or ETFs covering the same 7 core asset classes. As shown below, there is an Active 7Twelve model, a Passive model, two Vanguard models, a Fidelity model, and a Schwab model. The results are consistently good. To purchase 7Twelve research reports that provide guidance in building one of the 7Twelve models shown in the table below click on this link: http://www.7twelveportfolio.com/Downloads/Web7TwelveReport.pdf

Table 2. Low-Cost *7Twelve* Models

7Twelve® **Model**	***Active 7Twelve*** *12 actively managed funds*	***Passive 7Twelve*** *12 ETFs from various families*	***Vanguard Mutual Fund 7Twelve*** *12 Vanguard mutual funds*	***Vanguard ETF 7Twelve*** *12 Vanguard ETFs*	***Fidelity 7Twelve*** *12 Fidelity* mutual funds	***Schwab 7Twelve*** *12 Schwab ETFs*
Portfolio Aggregate Annual Expense Ratio (bps = basis points)	**0.70% or 70 bps**	**0.14% or 14 bps**	**0.15% or 15 bps**	**0.09% or 9 bps**	**0.22% or 22 bps**	**0.11% or 11 bps**
20-Year Average Annualized Return (2000-2019)	**7.50%**	**6.82%**	**7.18%**	**7.26%**	**7.45%**	**6.90%**

Craig L. Israelsen, Ph.D. is the developer of the 7Twelve® Portfolio. He teaches in the Personal Financial Planning program at Utah Valley University. He has previously taught at Brigham Young University and the University of Missouri-Columbia. Craig writes monthly for New York-based *Financial Planning Magazine.* He can be reached at craig@7TwelvePortfolio.com