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Portfolio Manager Winnie Go at the ScotiaMcLeod offices in Toronto.

Tim Fraser for The Globe and Mail

Funds

Mutual funds have their place in a portfolio

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With sometimes-hefty annual fees, relatively weak returns and growing competition from index investment vehicles, mutual funds in Canada are facing a barrage of criticism.

Yet they remain a popular option for hands-off or smaller investors, as well as those looking for diversity and exposure to foreign holdings and emerging markets. They also can provide a degree of comfort in today's volatile market.

Finding the right mutual funds, with active management and solid positions that complement and balance your financial portfolio, is critical.

Winnie Go, a portfolio manager and senior wealth adviser with fee-based ScotiaMcLeod, says that while mutual fund fees in Canada are high, some companies have competitive fees and good managers at the helm to temper the free-market risk inherent, for example, in exchange-traded funds (ETFs), which passively track an index such as the Toronto Stock Exchange.

"In this type of marketplace, I would say that there's value in active management and suggest considering some mutual funds where you get value paying the fee," Ms. Go says. "There are worthy mutual funds out there, for sure."

Canadians pay the highest mutual fund fees in the world. Known as a management expense ratio (MER), the fee is based on the total amount invested and pays for expenses such as portfolio management, administration, marketing and a commission for the dealer who originally sold the fund. The average MER is about 2.5 per cent, meaning that if you have $100,000 invested you pay $2,500 a year. The amount is deducted from the assets of the fund, which can make it difficult to determine the rate and its compounded impact.

“Read the prospectus,” Ms. Go says. Indeed, beyond a company’s own literature investors will find myriad investment research databases and services, from Morningstar Canada to Globefund.com, that track mutual fund fees, performance data and more. “You have to do your homework.”

Finding the right mutual fund means determining the right fit for your portfolio, especially based on your risk tolerance and investment time horizon, says Tina Tehranchian, a certified financial planner and the branch manager at Assante Capital Management Ltd. in Richmond Hill, Ont.

“Mutual funds are long-term investments,” she cautions, adding that fees can be an irritant especially when markets are volatile, expectations are not met and emotions rise. “You can’t judge a long-term investment with short-term yardsticks.”

Look at a fund’s annualized returns, which show consistency, and make sure its manager has been there for some time – “usually three to five years is a good indicator,” Ms. Tehranchian says. Compare the fund with peers in its category as well as its performance against the index. MERs can be lower in some cases, but “you have to look at the fees in relation to performance, not in isolation,” she says. “You’re paying for management expertise.”

Watch out for funds that are too large, losing their nimbleness. And do not hold too many funds in your portfolio and make it “over-diversified,” so that your holdings end up overlapping and cancelling each other out.

“Look at the underlying assets,” Ms. Tehranchian adds. “Do a portfolio X-ray.”

Philip Lee, a senior fund analyst at Morningstar Canada, says his team analyzes funds based on their people, processes, performance, parent company and price. The factors are linked; for example, the fund should be run by “seasoned and accomplished” managers implementing tested investment strategies. “You’re trying to find the funds that have the best people and most robust processes, with a combination of the two that translates to performance.”

Some vendors such as RBC Direct Investing offer breaks on fees with higher minimums, usually $10,000 and up, Mr. Lee says. Firms such as Mawer Investment Management, Beutel Goodman & Co., Jarislowsky Fraser Ltd., Leith Wheeler Investment Counsel, McLean Budden Ltd., Steadyhand Investment Funds and Phillips, Hager & North keep their fees at half of typical MERs because they don't pay investment advisers for their services.

Investors should ask mutual fund companies “how much am I paying and what am I getting,” Mr. Lee says. “There shouldn’t be any mystery to it.” There should be transparency and responsibility in the parent company making the business decisions.

When judging a fund’s performance, look at returns over a 10-year period, broken down into 12-month rolling increments.

“To look at one number can be misleading,” Mr. Lee says, adding that it’s important to “kick the tires” to gauge a fund’s value. “Are you really getting active management?” he asks, especially as market exposure is so cheap through index funds and ETFs. But a fund manager with foresight and insight can act if the market heads south, for example, moving money to the sidelines or rotating into another sector.

Dave Salloum, a certified financial planner with RBC Dominion Securities in Edmonton, calls mutual funds another tool in the financial planning toolbox. He says it’s important for investors to follow a plan and deal with a financial adviser licensed to help you invest in a full range of products, not just mutual funds. “If the only tool you have is a hammer, then pretty soon everything starts to look like a nail."

Too much information can be confusing. Fund companies are starting to produce "fund fact' sheets, simplified yet informative three-page summaries of key facts about each of their products.

Mr. Lee says the fund facts can be helpful in increasing awareness and to assist investors in staying on top of the management team.

"Buying a mutual fund is no different than anything else," Mr. Lee adds. "You have to be comfortable with what you're paying for."
