Vanguard

Vanguard's principles for investing success

Minimising costs

While you can't control the markets, the costs you pay are completely controllable. Furthermore, the lower your costs the greater your share of investment returns.

Having a low-cost products advantage will compound results over time.

Most of the time when you're making big decisions about how to spend your money you can rely on past performance.

Whether it's upgrading the family car, eating out or choosing the ideal place to live, the top-rated vehicles, restaurants and suburbs tend to remain at the top — year in, year out.

They also tend to be the most expensive. You get what you pay for.

Minimise costs

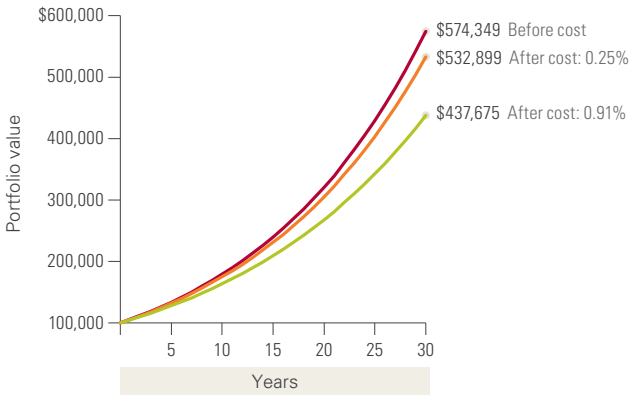
With investing it's different. There's no guarantee that paying more will deliver you a higher return.

In fact, when you're investing, you get what you don't pay for. Every dollar that you don't have to pay in fees and costs is a dollar more in your pocket. The cost of your investments matter.

A few percentage points here or there may not seem much. But over time, thanks to the magic of compounding, this can really add up. Fast forward a few years and you can find it translates into thousands of dollars less in your final investment.

The long-term impact of investment costs on portfolio balances

Assuming a starting balance of $100,000 and a yearly return of 6%, which is reinvested.



Notes: The portfolio balances shown are hypothetical and do not reflect any particular investment. The final balances do not reflect any taxes or penalties due upon distribution.
Source: Vanguard, using data from Morningstar.

There are essentially two ways to increase after-cost returns. The first is to earn higher returns than the average investor by outperforming the market, but unfortunately this is easier said than done.

The second way is to minimise investment costs using low-cost products.

Indexing can help minimise costs

If—all things being equal—low costs are associated with better performance, then costs should play a large role in the choice of investments.

Index funds and indexed exchange traded funds (ETFs) tend to have costs among the lowest in the managed fund industry. As a result, indexed investment strategies can actually give you the opportunity to outperform higher-cost active managers – even though an index fund simply seeks to track a market benchmark, not to exceed it.

Indexed investment strategies can give you the opportunity to outperform higher-cost active managers

Although some actively managed funds have low costs, as a group they tend to have higher expenses. This is because of the research required to select securities for purchase and the generally higher portfolio turnover associated with trying to beat a benchmark.

Using tax management strategies

Taxes are another potentially significant cost. For many investors, it may be possible to reduce the impact of taxes by allocating investments to relatively tax-efficient investments, such as broad-market equity index funds or ETFs. These types of investments are tax-efficient due to the reduced turnover and tax reduction strategies when holdings are sold, which reduces the capital gains tax that maybe payable.

The key take-away

Costs really do matter when it comes to investing, and higher costs do not necessarily translate into higher returns. In fact, in most cases, they have the opposite effect.

That's because the lower your costs, the greater your share of an investment's return, and the greater the potential impact of compounding.

Low-cost indexing products including managed funds and exchange traded funds have generally tended to outperform higher-cost alternatives over time.

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