

From Physician's Financial News

## Vote with Your Feet

By Shirley M. Mueller, MD Published on March 4, [[Email](#)] - [[Print](#)]

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### *Stamp Out Expenses*

Last summer Eric Smith and his wife took a special anniversary trip to New York City. One item on his wife's agenda was to go shopping; Eric agreed to go along. After stopping in several stores, he got bored. To alleviate his monotony, he decided to wait outside the store while his wife shopped.

Much to his surprise, when he did this, his wife's shopping pattern was different. Although she would usually browse leisurely when he was with her, if he waited outside, she hurried through the store, bought little or nothing and quickly joined her husband.

Through this experience, Eric learned something important. He could vote with his feet. By not going into the store with his wife, he effectively gave her a message, "I'm not having fun." In response, she cut down on her shopping time (along with the money spent). Eric voted with his feet. His wife understood the message. Eric thought his wife wasn't paying attention, but she was.

Voting with your feet is one of the most persuasive ways to get another party to change behavior. New information indicates that it is also convincing to the investment industry. According to the June 2007 issue of *Research Fundamentals* published by the [Investment Company Institute](#), investors are buying mutual funds with lower expense fees in increasing numbers. As a result funds are lowering their cost to accommodate and hopefully attract more clients. The change can be attributed in large part to index fund investors, who are especially sensitive to expenses.

Between 1997 and 2006, stock funds with below market averages expense ratios received 90% of new cash coming into funds. This included both actively managed and index funds. In response, stock funds consistently lowered their fees. For example, in 2001, the average fees and expenses for stock funds was 1.24%. This figure includes both managed and unmanaged (index) mutual funds. That is why it is so low. The managed fund figure would be higher by itself and the unmanaged would be lower by itself. By 2006, this figure was 1.07%. Investors voted with their feet and the funds responded.

### **This tells us two things:**

- 1) Many investors are getting smarter and making lower fees a priority--congratulations;
- 2) Other investors aren't paying attention to fees. They are paying higher expenses and very likely have lower returns. This is because funds that have higher fees are rarely able to outperform their relevant indexes sufficiently to make up for the higher costs. This means that there is less money going into the client's pocket and more into their managers.

Of course fees and expenses aren't the only concern for fund investors. Turnover\* of the fund costs the investor money too and the client has no control over this except to choose an index fund, which has lower turnover than a managed fund. Taxes are another consideration. The investor can control them by preferentially investing in a tax-free account, such as a 401(k).

The message is this: don't be left behind. Vote with your feet by taking the following action steps:

- 1) Choose broad-based low-cost, low-turnover index funds, preferentially in tax-free accounts.
- 2) Use the Nobel Prize winning concept of [asset allocation](#).
- 3) Reallocate periodically.

*\* Turnover: Active money managers try to beat their relevant index by selecting stocks that they think are more likely to beat the market than the ones they already have in their portfolio. This can result in 100% or more turnover a year in a portfolio. That means every stock is replaced once. The cost to the investor over time is enormous. If \$100,000 is invested for 40 years at 10% return with no expense or taxes, but 75% turnover, it ultimately gleans \$2,518,670. On the other hand, if turnover is less, as it is in an index fund (because the mangers are not trying to beat the market, but only to mirror it), the return is much more. If turnover were 15%, for example, under the same conditions as in the earlier scenario, the final return to the investor would be \$4,028,076.*

#### About Shirley M. Mueller, MD

Dr. Shirley Mueller is a physician turned financial consultant and investment educator. She teaches others how to invest their own money using a Noble Prize-winning financial strategy. Her fee is hourly, not a percentage of assets. She welcomes comments at [ShirleyMMueller@MyMoneyMD.com](mailto:ShirleyMMueller@MyMoneyMD.com). For more information, visit her website at [MyMoneyMd.com](http://MyMoneyMd.com)

