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$300 Billion is on the line. Where Are The Mutual Fund Boards?

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Mutual Fund Research

Fees and Expenses Analyzed

As a head of Thrift Financial, I find it disappointing that mutual fund boards tolerate substandard performance and fail to manage (or force) change in the mutual funds they have a legal fiduciary duty to oversee.

> ...nearly $300 billion was significantly underperforming their peer group or benchmark across 3, 5, and 10 years.

My firm recently analyzed large-cap mutual funds (value, growth, and blend subcategories) and found that nearly $300 billion was significantly underperforming their peer group or benchmark across 3, 5, and 10 years. Moreover, the board of directors (or trustees) overseeing those assets have shown few tangible results to investors in those strategies.

As some understand, mutual fund boards have a fiduciary duty to place the interest of investors ahead of the mutual fund companies, often called the advisor, that oversees the day-to-day management of the mutual fund. In addition, the fund boards have a legal responsibility to place the interest of the shareholders they serve ahead of the mutual fund companies.

Typically, the boards meet quarterly and are charged with reviewing the activities and results of the investment activities in the mutual fund. Among some of their weightier responsibilities, the boards are responsible for examining fund performance, agreeing to an advisory contract, and assessing the appropriateness of the fees and expenses charged to the mutual fund.

When performance suffers or fees charged to shareholders become excessive, it is the mutual fund board of directors' responsibility, as fiduciaries, to push back on the mutual fund company to encourage and possibly demand change.

> ...the Clipper Fund Board voted to move $6.3 billion managed Pacific Financial Research to Davis Select Advisors.

Unfortunately, few instances of mutual fund boards that fully discharge their fiduciary duty exist. For example, in late 2005, the Clipper Fund Board voted to move $6.3 billion managed Pacific Financial Research to Davis Select Advisors. Before that, the fund board of Selected Funds rejected Kemper Financial's interest in managing the $2 billion pool of assets and moved the money to Davis Select Advisors. The fund boards of these organizations should have been honored for their independence in acting on their fiduciary duties. Instead, these mutual fund boards gained little recognition in the industry trade journals and popular press.

Shareholders in many mutual funds would benefit from more independence and a fiduciary commitment by mutual fund boards. For example, one of the most competitive universes in mutual funds is the large cap space. Being an excellent large-cap manager is often measured by consistently beating your benchmark by a few basis points (.001), which is exceedingly challenging; however, the rewards are enormous, with hundreds of billions of dollars at play. Yet, despite this highly competitive space, where great firms often charge clients 1/2 a percent (50 bps) per year or less, there are still over 100 large-cap mutual funds operating with expense ratios at 1% per year or more. Equally disappointing but not surprising, many of these same companies manage some of the worst-performing mutual funds when measured against various dimensions, including total return across 3-5 and 10 years.

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It's the responsibility of the mutual fund board to identify performance shortcomings and encourage the mutual fund companies to make changes in the management of the product to enhance returns, efficiencies, or protections to shareholders' capital. In addition, the mutual fund board must review and approve the investment advisory contract with the management company and negotiate other improvements to enhance shareholders' returns and protect shareholders' investments. This responsibility is always present but heightened by poor performance and high expenses.

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Thrift research shows that over $165 billion of shareholder capital is being charged at nearly twice the 47 basis points average expense ratio for equity mutual funds, reported by the Investment Company Institute in 2021. More disappointing is that almost $50 billion of mutual fund investor money is being charged at two or more times the industry averages and among the worst-performing funds across multiple performance measures.

> expense ratios are running exceptionally hot at a simple average of 1.12%, and their 3-5-10 simple average competitive ranking is in the 83rd percentage....17 points off the bottom

High Expense and low Return Mutual Funds with $1+ billion in Assets September 2022

- Alger Spectra
- Allspring Growth
- Allspring Premier Large Co Growth
- Calamos Growth
- ClearBridge Aggressive Growth
- ClearBridge All Cap Value
- Gabelli Asset Fund
- Hartford Capital Appreciation
- Invesco Charter
- Invesco Main Street All Cap
- MainStay Epoch US Equity Yield
- Sequoia
- Voya large cap Growth Port

Disclosures: Compared to Mutual Funds with assets of at least $250 million in assets and a 10-year track record. Large cap categorization is based on Morningstar data as of 9/30/22 and inclusive of growth, value and blend subcategories. Performance calculations are a weighted average across 3-5-10 years. The share class with the largest assets base is used in the analysis.

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Diagram A

Diagram A, on the preceding page, captures 13 of the worst offenders, each with assets over $1 billion invested in their large-cap mutual fund, expense ratios over 1%, and investor returns among the lowest in absolute and relative terms. The boards of these mutual funds represent over $35 billion of investor money, owned by hundreds of thousands of individuals and institutions. These 13 mutual fund boards should advocate for improvements to the investment management process and reductions in the expense ratios. Instead, their expense ratios are running exceptionally hot at a simple average of 1.12%, and their 3-5-10 simple average competitive ranking is in the 83rd percentage....17 points off the bottom. Given the poor extended performance and exceptionally high fees, Thrift Financial questions how effectively these mutual fund boards are discharging their fiduciary responsibilities.

“When is.. charging nearly twice the industry average fees and having some of the worst industry returns focused on the interests of the shareholders?

Why do mutual fund boards seemingly remain silent? Why do they not demand improvements to the investment process and waivers of some or all fees until performance improves? Might some of these boards make the bold decision, like Clipper and Selected Funds' boards, and temporarily or permanently move shareholder capital to another investment firm better positioned to improve returns and reduce costs more quickly? The fund boards have a fiduciary duty to act in their shareholder's best interest. So how are boards concluding that charging nearly twice the industry average fees and having some of the worst industry returns focused on the interests of the shareholders?

Where are the mutual fund boards of directors?

About the Author

After two decades in investment and wealth management, George founded Thrift Financial, working with institutions and individuals across the United States and Canada. Before founding Thrift Financial, he held senior executive roles with four multi-billion-dollar financial services organizations, overseeing individual and institution client assets and investment portfolios.

George has worked closely with individuals and families, helping build their investment portfolios through investments across public and private equities and fixed-income investments. He has extensive professional experience working with institutional clients creating investment policies, assessing asset allocation, risk analysis, investment selection, and cost analysis. In addition, George has worked closely with large and middle-market plans covering health companies, insurance, state and local government, Taft Hartley, endowments, and foundations in both their retirement and operating funds.

George received a Master's of Business Administration from Cornell's Johnson Graduate School of Management and graduated with a Bachelor of Business Administration with honors from the University of Michigan, Ross School of Business. George holds a series 65, 24, and 7 licenses and is a member of the CFA Institute and a member of the CFA Society Chicago.

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