Dr. Mom Rants on Active Management

[Editor's Note: This is a guest post from Dr. Mom, who has guest posted here previously. Her posts, comments, and forum posts have always been well-received and I always appreciate them as they require very little editing. She submitted this in response to my post a few months ago about what to do when you have [a crummy 401(k)](). She titled this, "I am no man: Slaying Active Management in My Portfolio." We have no financial relationship.]

It's been a while since I invoked Tolkien for you guys. So, now you get to hear my favorite quote instead of my kids' and husband's, which was "[Not All Who Wander Are Lost]()." Mine is "I am no man." For those of you unfamiliar with the Lord of the Rings movies, this quote is what the warrior princess, Eowyn, cries as she slays the Nazgul, an evil beast who believes himself immortal because no man can slay him. Of course, that means it takes a woman to do it.

I am not going to review all the evils of active management. The purpose of this post is to explain how I am slaying it in my own portfolio. I hope to help you understand why not to choose it if you can help it and how to argue to change it if you have a retirement plan that doesn't offer you low cost options. Your employer has a responsibility to you to offer you a plan that does not take advantage of you. When I took over our retirement management from my husband, we had a hodge-podge of active funds and individual stocks. Remember, we are older than many of you readers. We learned finance when indexing was in its infancy and were slow to jump onto the bandwagon because we really didn't have the time to learn about it. Active management allowed diversification from individual stock picking. The marketing then encouraged you to find "The Great Man" who would manage your money for you. Of course, once I got involved in our finances, finding the great man did not seem like the path for me, so I started my financial education. You are all so lucky to have WCI to help educate you! Let's get started…

 # 1 PIMCO Total Return Fund (PTTDX)

I fired Bill Gross over this fund years ago because of a 12b1 fee of 0.25%. For those of you unaware of this fee, it is something active funds charge you so they can go advertise to get more investors. The more investors they have, the more funds they manage, and the more fees they earn. For you, the bigger they are, the more they perform like a closet index fund, and the less you earn after fees. In bond funds in particular, you want to keep your fees as low as possible since the fund basically gives you the yield of the bonds it holds. In this low yield environment, it is particularly criminal to me to have high fees in a bond fund. PIMCO has an expense ratio of 0.75% with a 12b1 fee of 0.25%. Wow, 1% fee on a plain vanilla bond fund – makes me understand Ken's argument of holding individual bonds. I use BND which is Vanguard's ETF equivalent of its Total Bond Market Fund (VBMFX) which has an expense ratio of 0.06%. Plot PTTDX vs. BND in your favorite online comparison chart to see the performance for yourself. Enough said. *[Editor's Note: The PIMCO fund has had pretty good returns over the years, but over the last five years has trailed the Vanguard ETF by about 0.25% per year.]*

 # 2 Royce Small-Cap Value Service Fund (RYVFX)

This fund was easy for me to kick out. My husband started us with a tilt to small cap without really knowing why he did it. I agreed with it, but switched us to Schwab's US Small Cap ETF (SchA). I left a fund that was being led by a committee of men with a fee of 1.45% and a 12b1 fee of 0.25%. SchA has an ER of 0.08%. RYVFX has to beat it by 1.62% annually just to match it. That price difference is just too big a hurdle for me to pay for small cap active management. *[Editor's Note: Over the past five years the passive Schwab fund has outperformed the active Royce fund by 6% a year.]*

 # 3 Oakmark Equity and Income (OAKBX)

I actually placed this fund in our portfolio myself. The idea was that we could dollar cost average into it monthly, which I could not do with ETF’s. It is a fund that allocates between stocks, bonds, and cash. It served as part of my small bond allocation in the early years before I became more comfortable with better choices. Its fee was “only” 0.75% with no 12b1 fee, so it didn’t get my attention as a high fee choice while I was making the changes above. The “great man” here was Clyde McGregor who did serve the fund well until he brought in a team of male underlings to oversee. Once this happened, the return was not as good, probably due to allocation choices. The fund started holding more cash. At the time I left, its cash position was about 20%. I am not going to pay them 0.75% to manage cash for me. I now use my own combination of VTI for stocks, BND for bonds, and allocate my own cash to serve my liquidity needs. *[Editor’s Note: Over the last five years, the passive Vanguard balanced index fund has outperformed the active Oakmark fund by about 2% per year.]*

 # 4 Fidelity Contrafund (FCNTX)

So, now we come to Will Danoff. His fund did serve us well for many years likely due to his recognizing momentum before others joined in. As his fund grew, it became a closet index fund as well. Much of his out-performance comes from his early years. The performance lately really just mimics the S&P 500, but he charges me 0.70% to do it. Then in late 2013, I noticed an aberration in the chart. His fund dropped about 8% when the S&P 500 did not. Then, this pattern repeated in 2014 and in 2015. Why? I may not have the answer, but really did not like what I found as I searched for one. At some point in the last few years, Fidelity and some other companies have moved from a purely mutual fund model to a partly collective investment trust model. The move is most likely to be able to compete with the low cost fee providers like Vanguard and Schwab.

What is a collective investment trust or CIT? It is an investment vehicle that operates like mutual fund but is only available to qualified retirement plans. Ominously, it traces its roots back to the late 1920's. It is not regulated by the SEC. It is regulated by the Office of the Comptroller of Currency, a part of the U.S. Treasury. They are not required to give statistics, investment details, or prospectuses like mutual funds. Thus, they cost less to run and have a lower management fee. I personally take issue with the use of opacity to lower fees. And, by the way, they access their money differently, which can make rollovers problematic.

As it turns out, Fidelity Contrafund is moving some of its assets from a mutual fund model to a CIT model. It will then be able to offer the CIT participants in the plan a lower fee than the mutual fund participants. Being the leftover higher fee-paying participant in Contrafund while they can potentially play me against an opaque entity to their benefit is not for me. *[Editor's Note: Over the last 5 years, the passive Vanguard 500 Index Fund outperformed the active Contrafund by 0.23% per year.]*

In conclusion, I have hopefully given you some food for thought about active management from the perspective of one woman who has had enough of it. Coming full circle, let's go back to Eowyn. Ladies, we are all part warrior and part princess. Use the warrior when it comes to financial management. Gentlemen, if you have a female partner who is not particularly into finance, help awaken her inner warrior. She can serve you well.

As always, best wishes from Dr. Mom.

While all these popular mutual funds are all actively-managed by men, the issue wasn't so much the men as the active management. What disappointments (or successes) have you seen from the active managers in your life? Do you invest in CITs? Why or why not? Comment below!