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Should You Be Using Index Tracking ETFs or Unit Trusts for Cost Effective Investment?

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An article appeared in the City Press newspaper on 11th November 2012, which appears to indicate that index tracking (passive) unit trust funds are cheaper to invest in than ETFs.

Please find attached the article in question (click here).

I wrote to the editor of the City Press pointing out some inaccuracies in the article, which he did not print in his paper. In order to clear up any misunderstandings or misleading impressions, please see my reply to this Cost Effective Investment article below. The evidence indicates that ETFs still offer significant cost advantages to unit trusts tracking similar indices.

Attention:	**THE EDITOR**
Company:	**CITY PRESS**
Date:	**14 November 2012**
Re:	**Cost Effective Investing**

Dear Sirs

The information provided by your columnist Maya Fisher-French in an article entitled "Cost-Effective Investing" dated 11/11/2012 can be misleading for investors.

She states that the cost of access to ETFs, together with the management fee of the ETF funds, makes them more expensive than unit trusts passive index tracker funds. This conclusion is incorrect.

There are two costs that are paid by retail investors for unit trusts or ETFs. They are: the management fees taken by the issuer of the product – the Total Expense Ratio (TER); and the costs of purchasing this product through an investment platform, from the issuer itself, or through stockbrokers and other intermediaries. This cost is normally known as the access cost.

The first cost of an investment for the retail investor is the charge made by the issuer of the unit trust/ETF to run the fund, which is known as a Total Expense Ratio. This is an audited figure calculated on an annualised basis. This TER fee is embedded in the price of the unit trust/ETF and is paid by every single investor in the Fund, no matter how they access the fund.

Total Expense Ratios of index tracking unit trusts, are typically much higher than for ETF index trackers. Some examples for comparative products:

Current Total Expense Ratios (TERs) (per annum)				
Unit Trust		**ETF**		**Comment**
SIM Index Fund	1,14%	RMB Top 40	0,21%	Both track FTSE/JSE Top 40 Index
Old Mutual RAFI 40 Tracker	0,88%	NewFunds eRAFI Overall	0,36%	Both track FTSE/JSE RAFI Index
SIM Dividend Plus Index fund	0,56%	Satrix DIVI Plus	0,45%	Both track FTSE/JSE Dividend Plus Index
Prudential Property Tracker Fund	0,76%	Proptrax TEN	0,51%	Both track JSE Property Indices
Source: ASIA Quarterly Unit Trust Survey (September 2012).				

As can be seen, ETFs that track the equivalent indices are significantly cheaper than unit trusts doing the same thing. These TERs are an unavoidable cost paid by all investors, big or small.

The second cost borne by the investor is the cost to access the product, which is not included in the TER figures above, as access costs differ from investor to investor, depending on the LISP, stockbroker, investment platform, etc, used to access unit trusts and ETFs. Comparative figures are as follows:

Investment Platform Fees	
Unit Trusts	**Annual Admin Fees**
Sanlam	0,45% to 0,58%
Old Mutual	0,86%
ETFs	
Satrix Investment Plan	0,35% to 0,75% (depending on size of investment)
etfSA Investor Scheme®	0,45% to 0,8% (depending on size of investment)

If you add the TERs and the access fees together to provide a total cost to the investor, the results are shown below:

Top 40 Funds	TER	Platform Fee	Total
SIM Index Funds (unit trust)	1,14%	0,45% - 0,58%	1,59% - 1,72%
RMB Top 40 (ETF)	0,21%	0,45% - 0,8%	0,66% - 1,01%
RAFI Funds			
Old Mutual RAFI 40 (unit trust)	0,88%	0,86%	1.74%
NewFunds eRAFI 40 (ETF)	0,36%	0,45% - 0,8%*	0,81% - 1,16%
** etfSA Investor Scheme® - fees are scaled on size of investment.*			

Clearly, when you take all costs into account, both management costs and access fees, ETFs still have a clear advantage – they can be 50% or more cheaper than equivalent passive unit trusts.

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