Fees Up and Down the Mountain

It costs about $40,000 to climb Mt. Everest. Based on a quick Google search that $40,000 includes the way up and the way down. Would you agree to climb Mt. Everest if no one told you the cost? That sounds a little funny doesn't it?

This paper is about ***Fees*** in/on your investment accounts. I get asked all the time, *why am I being pushed, told and encouraged to "max out" my 401(k), 403(b), or IRA?* Candidly, the answer is ***Fees***. Believe me, it has very little to do with your retirement. The next time you are bored, Google: "average 401(k) fees". Investopedia, Smart Asset, and others will tell you the costs can range from .2% to over 3%. Smart Asset referenced a study that said the average 401(k) participant pays 2.22% in annual ***Fees***/costs. Typically, the smaller your organization the more you pay in ***Fees***. Just to be nice, we are going to show you what 1.5% in annual ***Fees*** can do to your 401(k) going ***Up the Mountain***. We refer to this as the ***Accumulation*** phase, or the time over which your money is supposed to grow.

Let us assume you have 30 years until your retirement goal. Maybe you are 37 looking to retire at 67. We are going to simulate a ***Flat Return*** in this example. ***Flat Returns*** project the same number every single year, synonymous at times, with average returns. Both average returns and ***Flat Returns*** are irrelevant when projecting a realistic future investment balance, but for this paper on ***Fees***, the numbers will work.

For this example, we will assume 30 years until retirement at a ***Flat Return*** rate of 8%. If you invest $10,000 a year into your 401(k), after 30 years your account balance would be $1,132,000. For those with a financial calculator or Excel, the keystrokes look like this: $10,000 payment (PMT), $0 present value (PV), 8 interest (I), 30 number of years (N), solve for future value (FV) . Again, the projected future value before ***Fees*** equals approximately $1,132,000.

Now, let's re-solve the future value subtracting out the ***Fees***. Remember the average 401(k) ***Fee*** is approximately 2.22%. In this example, we are going to use 1.5% in ***Fees***. The re-solve drops the interest rate from 8% to 6.5% because we are going to pay the 401(k) administrator some money. The calculator work: $10,000 payment (PMT), $0 present value (PV) , **6.5 interest** (I) , 30 number of years (N), solve for future value (FV). The future value, less the ***Fees***, comes out to $863,000.

Let's see what we paid the 401(k) company. $1,132,000 was the future value before ***Fees***. Our future value is $863,000 after 1.5% in ***Fees***. The difference equals $269,000. That is a significant number. Did you know that a 401(k) provider can make that much money from your participation in their 401(k) program? Ask yourself, how many people work at my company?

Now, there are several ways to look at this. $269,000 represents 31% of your total future value of $863,000. That is a massive bite. $269,000 also represents 47% of your profits. You contributed $10,000 a year for 30 years or $300,000. Net of ***Fees***, you turned that $300,000 into $863,000. That is a gross profit of $563,000. The 401(k)-provider pocketed $269,000 of profit as well. They made nearly half (47%) of what you made, and they did so by using **your** money….

For the purposes of this paper we are going to say that the proverbial Wall Street made $269,000 from your account as you contributed to your 401(k). Just like getting to the top of Mt. Everest, after discovering this cost, you are probably feeling pretty beat up and exhausted… but remember, you still have to get ***Down the Mountain***.

Let's take a look at the ***Fees*** or costs in getting ***Down The Mountain,*** or the ***Distribution Phase.*** The future value net of the ***Fees*** you paid, equals $863,000. In this example, you have retired from your company and will likely be encouraged, or solicited to "roll over" your 401(k) to an IRA***.*** The next time you are bored, Google: "average fee-based wealth management". There are many links on this; be careful to separate the ads from the real information. Smart Asset has a little chart that suggests typical advisor ***Fees*** range between 1% and 2%. Let's be nice here and say that all in, between the ***Fees*** you pay the advisor and the ***Fees*** you may pay the funds inside your account, your total annual ***Fee*** during retirement (***Distribution)*** is 1.25%.

This next part takes a little more work because your balance will be decreasing by a hypothetical retirement withdrawal. Introducing the ***Safe Withdrawal Rate***, or "SWR". The SWR is a rule of thumb that suggests it is safe to withdrawal 4% of your total *starting* balance annually during retirement. If you do so, you should run out of money right at about the standard mortality age. Here is a quick example. If you are 65 years old with $1,000,000 in your retirement accounts, it is safe to withdrawal $40,000, or 4% of the *starting* balance, per year, for each of your retirement years. In doing so, you will run that $1,000,000 balance down to $0 at let us say age 90 or 25 years later.

For this paper, we used the same premise, and calculated the ***Fees*** for each of those years during retirement. The Excel spreadsheet is shown. Starting with $863,000, it should be safe to withdrawal 4% or $34,500 per year for about 25 years. According to Safe Withdrawal Rate philosophy, as you withdraw money, the market will go up and down a little, but ultimately, you will run the balance down to zero. While doing so, let us not forget about that 1.25% in ***Fees***. As you can see from the chart, the total in ***Fees*** to get ***Down the Mountain*** is another $140,000.

Age	Balance	SWD (4%)	Fees
65	$863,000.00	$34,520.00	$ 10,787.50
66	$828,480.00	$34,520.00	$ 10,356.00
67	$793,960.00	$34,520.00	$ 9,924.50
68	$759,440.00	$34,520.00	$ 9,493.00
69	$724,920.00	$34,520.00	$ 9,061.50
70	$690,400.00	$34,520.00	$ 8,630.00
71	$655,880.00	$34,520.00	$ 8,198.50
72	$621,360.00	$34,520.00	$ 7,767.00
73	$586,840.00	$34,520.00	$ 7,335.50
74	$552,320.00	$34,520.00	$ 6,904.00
75	$517,800.00	$34,520.00	$ 6,472.50
76	$483,280.00	$34,520.00	$ 6,041.00
77	$448,760.00	$34,520.00	$ 5,609.50
78	$414,240.00	$34,520.00	$ 5,178.00
79	$379,720.00	$34,520.00	$ 4,746.50
80	$345,200.00	$34,520.00	$ 4,315.00
81	$310,680.00	$34,520.00	$ 3,883.50
82	$276,160.00	$34,520.00	$ 3,452.00
83	$241,640.00	$34,520.00	$ 3,020.50
84	$207,120.00	$34,520.00	$ 2,589.00
85	$172,600.00	$34,520.00	$ 2,157.50
86	$138,080.00	$34,520.00	$ 1,726.00
87	$103,560.00	$34,520.00	$ 1,294.50
88	$ 69,040.00	$34,520.00	$ 863.00
89	$ 34,520.00	$34,520.00	$ 431.50
90	$ -	$34,520.00	$ -
Total Fees			**$140,237.50**

Now, just as before, there are a few ways to look at this number. $140,000 is a lot to pay someone. Are you getting your money's worth? Over 25 years, that could be an additional $5,600 per year in your pocket ($140,000 divided by 25 years). That is another vacation per year. You could also say, that if this was a 401(k) "rolled" into an IRA, your $34,000 will be a gross number and that after taxes you may pocket only $28,000 per year, give or take your belief on future taxes. $28,000 ***net after tax***, multiplied by 25 years of retirement, equals $700,000 in real, post tax, spendable dollars. Therefore, $140,000 in ***Fees*** is 20% of your retirement. *Do yourself a favor and remember that $700,000 real, after tax, number...*

To sum this up, we can suggest that Wall Street will pocket another $140,000 in ***Fees*** on your way ***Down the Mountain***. Do you remember what Wall Street, or your 401(k)-plan administrator, took in ***Fees*** and costs on your way ***Up the Mountain***? The amount was $269,000. So ***Up and Down the Mountain***, you paid $269,000 plus $140,000 for a total of $409,000. That is one heck of a guide. For $409,000 are you getting what you expected?

The $409,000 in ***Fees*** is more than half (58%) of your total, net after tax, spendable retirement. Remember $700,000 was the approximate, net after tax total, of all your retirement withdrawals. Furthermore, you contributed $10,000 for 30 years, or $300,000 into your 401(k) and received an additional $400,000 of net spendable retirement. You gained a net

$400,000 on your $300,000 and by comparison, Wall Street gained $409,000 on your $300,000. Remember, Wall Street did not contribute to your 401(k).

We started this paper by asking if you would climb Mt. Everest without knowing the cost. I believe most would say no to that question. I imagine some "thrill seekers" may climb the most dangerous mountain on earth regardless of their safety or cost, but I must believe most of us would have a lot of questions. Along those lines, would you contribute to an investment without knowing the risks or costs? With Mt. Everest your life is on the line, with your 401(k) and/or IRAs, your retirement is on the line. Are you a "thrill seeker" when it comes to your financial planning? If at the bottom of Mt. Everest, you got a bill for $409,000 how would you feel…?

To summarize, there are many ways to look at, understand, and evaluate, your 401(k), IRA, or any investment account. The balance, or worse yet, the projected balance, is just one of those ways. Fees and the costs associated with your accounts should play a role in your evaluation of your investment and its performance.

Is there a better way? You better believe it.