YAHOO! FINANCE

Print Back to story

Most Profitable Mutual Funds Ever

etfguide

Max Rottersman
Friday February 20, 2009, 10:55 am EST

HANOVER, NH (ETFguide.com) - The highest mutual fund advisory fee, of all time, was collected from the Fidelity Magellan Fund (Nasdaq: FMAGX - News). In 2001 it took in $792 million. Magellan has earned the top three, all-time records, grossing $1.8 billion between 2000 and 2002. Much of that is profit, from future retirees who don't read their statements. Most can't believe such large sums go directly into one manager's pocket. After all, if they did, wouldn't we read about it in the press? No. Mutual fund companies provide a steady stream of advertising dollars. It isn't a conspiracy. It's natural self-interest for all involved, from The New York Times to the Wall Street Journal.

Ironically, American mutual fund regulation is the finest in the world. I'm not joking. There's no secret to the numbers I'm pointing out. They're sent to every shareholder once a year. Sadly, few journalist read fund financial statements either. And any Fidelity shareholder who doesn't like the fees is free to leave.

Mutual funds are corporations run on the behalf of their shareholders, represented by a board of trustees. It's a legal structure that makes for some confusing language; for example, fund fees are often called expenses (which legally they are), rather than fees (which functionally, you pay). For example, Fidelity never charges you, the shareholder, directly. Rather, the fund trust pays a fee, from the fund's assets, to various Fidelity companies (which are separate from the fund corporation) for various services. Your board of trustees enters into contracts, on the shareholder's behalf, with the advisor (like Fidelity) and other service providers. Ironically, mutual funds were born during a 'socialistic' time in American history. Again, I kid you not. Should shareholders revolt, trustees can easily fire the portfolio management companies which serve the funds. Interestingly, that has seldom happened.

If you have any question about the profitability of the fund business, consider this. Last year, these five funds alone earned over $2 billion in advisory fees. Fidelity Contrafund: $522 Million (Nasdaq: FCNTX - News), PIMCO Total Return Fund: $506 Million (Nasdaq: PTTAX - News), Growth Fund Of America: $450 Million (Nasdaq: AGTHX - News), Europacific Growth Fund: $439 Million (Nasdaq: AEPGX - News), Fidelity Diversified International Fund: $374 Million (Nasdaq: FDIVX - News). Again, believe it or not, these are the fees the manager charges for a few people to pick stocks for the fund. The operational costs are separate.

Flying under the radar, because they don't offer shares directly to the public, the CREF Stock Account Fund paid $586 million in advisory and administrative fees, the largest amount of any fund in my database. TIAA-CREF says it's 'at cost'. We have to assume it's true, that the teachers did their own homework and thought for themselves.

Every shareholder should understand that all mutual funds have two basic costs. The first is the cost to manage the portfolio; that is, buy and sell stocks and bonds. A single person with a brokerage account can do this. In mutual funds, the fee for this 'portfolio management' work is called the advisory fee. The second basic cost is operational. This work is often done by hundreds of people: administrators, call center workers, accountants, IT professionals, custodians, printers and lawyers. The operational work is what shareholders 'see and touch' when they deal with their mutual fund. Shareholders seldom, if ever, have any contact with the portfolio manager (advisor).

In 2001 Fidelity charged shareholders $162 million for operational costs (on top of the $792 million). Fidelity probably makes some money on these costs too, since Fidelity subsidiaries handle shareholder servicing, administration and other 'touch' services. Yet most people don't believe me when I say most of the advisory fee is profit. They just can't believe it's legal for Fidelity to collect $792 million for a few people picking stocks (which they pay a handsome salary in the millions, but it's a fraction of what they charge). Here's a list of 58 Fund Managers Who Took in Over $100 Million in Advisory Fees Last Year.

Why is it so unbelievable? In the 1970s no one bought mutual funds. Everyone kept their money in banks and indirectly through pensions. Then all the money moved from bank accounts to mutual funds, to catch the technology revolution. Mutual funds were priced based on low-demand; that is, their margins were very high. As mutual funds grew they were sued to lower their costs (See the 'Gartenberg' case). But the effect was minimal.

We must keep advisory fees in perspective. According to Sports Illustrated, Tiger Woods will collect about $127 million in 2008. Alex Rodriguez is expected to earn half a billion during his career. And to be fair to Fidelity, unlike Tiger Woods, they must funnel money into marketing. Yet the bottom line remains, that some mutual funds are wildly profitable, beyond the imaginings of people who began in the industry decades ago.

Here is the top ten list since 1995. It's doubtful mutual funds will ever be so profitable again.

Top 10 Highest Advisory Fee Grossing Funds

Fund	Year	Advisory Fee $Millions
Fidelity Magellan Fund	2001	710
Fidelity Magellan Fund	2002	556
Fidelity Magellan Fund	2000	554
Fidelity Contrafund	2007	528
Fidelity Contrafund	2006	461
American Funds Growth Fund Of America	2007	455
American Century Ultra Fund	2000	418
Europacific Growth Fund	2007	387
Fidelity Diversified International Fund	2008	382
American Funds Growth Fund Of America	2006	370

Source: FundAnalyze.com

An important issue, overlooked by the media, is that most people are no longer hoping for the growth promised them in the 1980s or 1990s. They're in funds like

Magellan, saving for retirement. Their needs changed, but the fund fees didn't. Economically, it may not be good for society to pay high fees to chase growth for its retirement accounts. Because portfolio managers can't beat indexes on a large scale (it's numerically impossible) most of the fees collected end up as a wealth transfer between savers and portfolio managers. And don't misunderstand me. This isn't a diatribe against Fidelity. Fidelity has also created the lowest fee index mutual funds (the Spartan Funds). This is a public policy issue that only the government can solve.

But don't expect Obama to muddy the mutual fund waters anytime soon. He's already picked a politically savvy bureaucrat (read industry friendly executive) to run the SEC, even though it may not seem that way. Let me clarify. Despite being antiquated, our fund regulation is the best in the world. But that's due to the culture of the 1930s that took our financial market risks very seriously. Today's regulators, on the other hand, have long ago sold out to free-market malarkey. If we enter a real depression, it might change.

In the past 10 years stock funds have taken in $21.4 billion in stock picking (advisory) fees. Imagine reading that social security had squandered that amount playing the stock market with social security money? A couple of years ago Republicans tried to push through private savings plans to replace social security. Fortunately, the public seems to recognize its own laziness and poor understanding of investment fees.

The following is a list of the largest funds in 2003 and how much in advisory fees they collected in the most recent 10-year period. Keep in mind, these are just the fees for a few people to pick stocks. The money to do the shareholder work was part of additional fees.

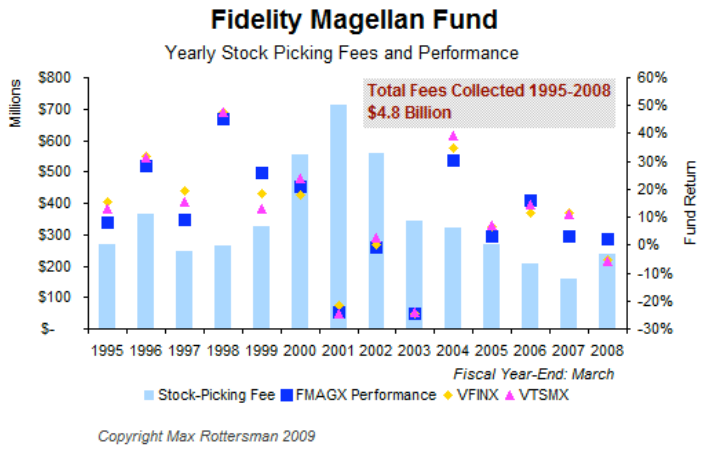
Stock Funds With Largest Advisory Fees	**10-Year Period**	**Stock Picking Fees $ Billions**
Fidelity Magellan	1999-2008	$ 3.70
Fidelity Contrafund	1998-2007	$ 3.00
American Century Ultra	1999-2008	$ 2.30
PIMCO Total Return	1999-2008	$ 3.00
American Funds Inv Co Amer	1998-2007	$ 1.54
Fidelity Growth and Income	1999-2008	$ 1.56
American Funds Growth Fnd Amer	1999-2008	$ 2.10
Fidelity Low-Priced Stock Fund	1999-2008	$ 1.66
American Funds Europacific	1998-2007	$ 1.74
Fidelity Dividend Growth	1999-2008	$ 0.80
	TOTAL:	**$ 21.40**

Source: FundAnalyze.com
That's right. In the past ten years, for the largest 10 funds, our society has spent $21 billion to watch stocks go up and down.

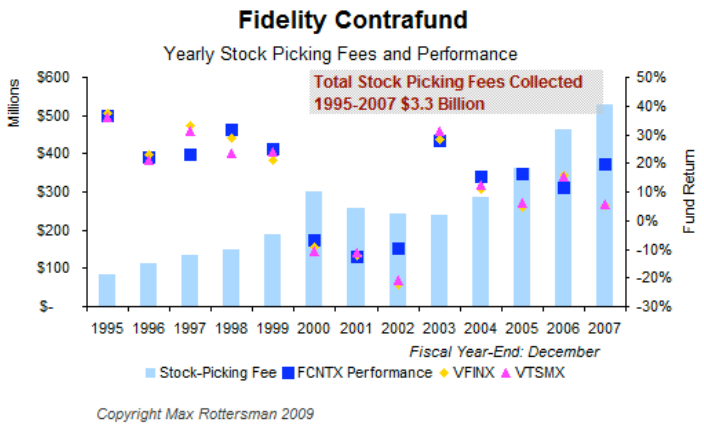
If you're not convinced that advisory fees are immensely profitable for large funds let's look at another fund similar in size to the Magellan Fund.

In 2001 the Magellan fund had $99 billion in assets. The Vanguard 500 Index Fund (Nasdaq: VFINX - News) had $89 billion. Because operational costs are generally a function of the number of shareholders, the Vanguard fund had similar operational expenses of $153 million (compared to Magellan's $162 million). The only difference is that the Vanguard fund didn't charge its shareholders to 'beat the market.' Therefore, the Vanguard advisory fee was only in the thousands, $181,000 (though administrative fees were $12 million). It only takes one person to buy and sell the stocks listed in the S&P 500 index, no matter how many shareholders are in the fund.

Vanguard could easily have told its shareholders that it would pick and choose from the S&P 500, with the idea of beating it, and charge an additional $780 million. The shareholders would never know if one person did the work, or one hundred. But Vanguard shareholders expected, over time, to save more than the Magellan shareholders because they were getting, essentially, a $780 million rebate every year, compared to the Magellan fund. History has proven their assumption correct.



A shareholder who had $10,000 in Magellan in 1995 would have watched it grow to $70,057. The Vanguard shareholder's account grew to $93, 597. This experience is not the same for all actively managed funds however. A few funds have collected large fees and beat the market.



Although the Fidelity Contrafund (Nasdaq: FCNTX - News) took in $3.3 billion, its shareholder have ended up with $56,592 and Vanguard's shareholders, $39,646.

But keep in mind, the asset-weighted, long-term average of all shareholders in actively managed fund do not beat low-cost funds. Over time Fidelity's Spartan funds will probably beat most of Fidelity's own actively managed funds. I am showing the Contrafund for the sake of fairness.

Again, everyone should be free to invest in smart people (at Fidelity for instance). But retirement is a numbers game and over the long-term a low-fee and diversified portfolio is the proven winner. The government isn't going to save you from yourself. Indeed, they can barely keep the fund industry off your social security assets. If you'd like to discover the fees of your fund you can check this Mutual Fund Costs Database.

Max Rottersman is a principal of Hanover Technology Group, LLC. His opinions don't necessarily represent the views of ETFguide.com or Yahoo Finance.