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Economies of scale allow Vanguard to further reduce fund fees

By Editorial Staff *Wed, Jan 4, 2017*

Vanguard CEO Bill McNabb said the reductions were not “another volley fired in the fee war” but rather “business as usual” for the Malvern, Pa., firm.

Vanguard, the $3.6 trillion direct-sold fund supermarket whose founder, Jack Bogle, believed in sharing its economies of scale to its customers in the form of ever-falling prices, has further reduced the already ultra-low expense ratios on 35 individual mutual fund shares, including 11 exchange-traded fund shares (ETFs).

In a press release, Vanguard CEO Bill McNabb said the reductions were not “another volley fired in the fee war” but rather “business as usual” for the Malvern, Pa., firm, which has a mutual-like ownership structure. The cost reductions reflected growth of the funds via market appreciation, as well as strong cash inflows, according to the release.

According to one Bogle biographer, his commitment to low costs arose from a strategy to attract disaffected investors back to mutual funds after the deep 1974 bear market, and was enabled by the firm’s use of indexing, its low distribution costs and its ownership structure.)

Since 1975, when Vanguard managed just $1.8 billion in U.S. fund assets, the average expense ratio of its funds has fallen to 0.18% from 0.89%. On an asset-weighted basis, the average expense ratio is 0.12%. The fund industry average is 1.01%.

The low-cost strategy has paid off in positive fund flows. With 2016 net inflows of $253.5 billion through mid-December, Vanguard gathered more assets than the next nine largest fund companies combined. Investors have also favored ETF specialists like iShares and SPDR State Street Global Advisors and low-cost provider Dimensional Fund Advisors. Since 2004, Vanguard U.S. ETF assets have risen to $593 billion from $6 billion.

Expense ratio reductions for the 12 months ended August 2016 for a range of fund share classes (Investor, Admiral, ETF, Institutional, and Institutional Plus) in five fund categories included:

Bond index funds. Twenty-four Vanguard bond index fund shares reported lower expense ratios. The $18.7 billion Vanguard Short-Term Corporate Bond Index Fund reported the following reductions: Admiral Shares, three basis points to 0.07%; ETF Shares, three basis points to 0.07%; and Institutional Shares, three basis points to 0.05%. A basis point is one-hundredth of 1%.

Size/style equity index funds. Four size/style index fund shares that seek to track CRSP benchmarks reported lower expense ratios. The largest of these funds, the $2.3 billion Vanguard Mega Cap Growth Index Fund, reported that the expense ratios of its Institutional Shares and ETF Shares declined by 2 basis points, to 0.06% and 0.07%, respectively.

Social index. Two social index fund shares reported lower expense ratios. The $2.4 billion Vanguard FTSE Social Index Fund reported that the expense ratio of its Investor Shares fell three basis points, to 0.22%, while that of its Institutional Shares fell three basis points, to 0.12%.

Actively managed domestic equity. Three actively managed domestic fund shares reported lower expense ratios. The largest of these funds, the $6.6 billion Vanguard U.S. Growth Fund, reported that the expense ratios of its Investor and Admiral shares declined by one basis point to 0.46% and 0.32%, respectively.

Actively managed international equity. Two actively managed international fund shares reported a lower expense ratio. The $21.5 billion Vanguard International Growth Fund, reported that the expense ratios of its Investor Shares and Admiral Shares declined by one basis point to 0.46% and 0.33%, respectively.

Two Vanguard funds reported fee increases:
Admiral Shares of the $2.1 billion Vanguard Consumer Discretionary Index Fund and ETF Shares of the $6.2 billion Vanguard Health Care Index Fund each reported increases of 1 basis point, from 0.09% to 0.10%, for the fiscal year ended August, 2016.

The expense ratio changes were reported on Vanguard funds with a fiscal-year-end date in 2016 (in this instance, funds with a fiscal year that ends in August), according to a Vanguard release.

The Malvern, Pa.-based firm said it would announce any additional expense ratio changes as funds update their prospectuses in the coming months. Expense ratios are reported on an annual basis and are based on actual operating expenses for the prior fiscal year.