3 Ways to Cut Common Trading Fees

Mutual fund trading costs are part-and-parcel of the investing experience, but many of these fees can be avoided or minimized. Below, we highlight three common trading fees that fund and ETF investors face, and we share some ways that investors can avoid paying excessive fees.

While we generally think it's worth trying to avoid paying excess fees, we don't believe in avoiding fees at the expense of pursuing your strategy or maximizing returns on your portfolio.

1 TRANSACTION FEES

Transaction fees are fees that a brokerage firm or custodian may charge investors to buy or sell a fund. Most brokers charge a flat dollar amount per transaction, but some, like Vanguard, charge a percent of the trade amount with certain minimum and maximum charges.

> **Transaction fees vs. Loads**
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> Transaction fees aren't the same as loads, which are commissions paid to brokers or financial advisors, although fees and loads are frequently confused.
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> Transaction fees are relatively modest: most brokers charge $75 or less. Loads can be quite high – they may run from 1% to more than 5% of the money being invested. Loads may be paid up front at the time of purchase (a front-end load), when shares are sold (a back-end load), or for the entire time the fund is held by the investor (a level load).

Brokers typically have a selection of funds that are available to investors for a fee and funds that are available without transaction fees (these funds are called NTF funds, or no-transaction fee funds).

At most brokers, you're charged a transaction fee on each time you trade a fee fund: buying a fund, for example, is considered one transaction and selling a fund is another transaction. Fidelity and Schwab are two notable exceptions: at both brokers, you're only charged a transaction fee when you buy a fee-fund; you don't pay a fee to sell a fund. (This policy can change over time so remember to check with your broker).

Transaction fees have a significant impact on smaller positions. At Fidelity, for example, a transaction-fee fund costs $75. If you invest $50,000, this fee represents only 0.15% of your position. But if you invest just $2,500 – the minimum investment for most mutual funds – the transaction fee represents 3% of your investment. We think that's a steep price to pay for just one position.

We suggest paying no more than 1% of your investment in trading fees. That means that if you are placing trades through Fidelity, you'd want to be investing at least $7,500 in a transaction-fee fund.

Managing Transaction Fees

To avoid transaction fees, check funds at your broker before you invest and seek out NTF funds. You may need to learn how your broker identifies NTF funds and fee funds. At Fidelity, you'll see a note for NTF or Fee under a fund's name and ticker. But TD Ameritrade only notes whether a fund is NTF; fee funds are simply marked as 'noload'. In NoLoad FundX, we show which top-ranked core funds are fee funds or NTF funds at five major brokers.

Subscribers to NoLoad FundX may find that are times when there aren't enough highly ranked funds that are available NTF at your broker. If your portfolio size allows, it's OK to pay an occasional transaction fee.

2 REDEMPTION FEES

Redemption fees are fees that a brokerage firm or fund company charges investors if they sell a fund within a certain time frame. These fees are designed to discourage investors from selling shares soon after purchasing them. Most brokers charge a flat redemption fee (usually $75 or less), while most fund redemption fees are a percentage of the investment, often 1% or 2%. Investors can be charged a redemption fee from both their broker and their fund, and this can get expensive.

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Managing Redemption Fees

To avoid getting hit with an unexpected redemption fee, make sure you know your broker's required holding period. We've listed the redemption fees policies at common brokers, below, but remember that this information is subject to change.

Broker	Redemption Fee Holding Period	Redemption Fee
ETrade	90 days	$49.99
Fidelity	60 days	$75.00
Schwab	90 days	$49.95
Scottrade	90 days	$17.00
TD Ameritrade	180 days	$49.95
Vanguard	60 days	$50.00

You should also check to see if the mutual fund you are buying has a redemption fee. We publish fund redemption-fee information in NoLoad FundX, but you can also find redemption-fee information in a fund's prospectus.

Holding funds a minimum of 90 days helps avoid redemption fees at most brokers and many funds. To avoid having to keep track of both fund and broker redemption fees, we suggest you invest in funds that have the same holding period as your broker. For example, since Schwab has a 90-day redemption fee period, you might opt to only invest in funds that have a redemption-fee period of 90 days or less. This way, you'll know that as long as you hold funds at least 90 days, you'll avoid both fund and broker redemption fees.

③ ETF TRADING COSTS

Investors pay a commission to buy and sell most ETFs, and this commission tends to be fairly low (usually $10 or less). Many brokers now offer commission-free ETFs, but these ETFs are not always the best performers. At most brokers, the trading commissions for ETF trades are usually relatively small – usually around $7-15 for market orders — but the difference in return between two ETFs can be huge.

Commissions are just part of the cost of trading an ETF. Other ETFs costs include the spread between the bid price and the ask price. In other words, the difference between the lowest price a seller is willing to accept and the highest price a buyer is willing to pay as of the last trade. When the spread is wide, you could end up paying more for the ETF than it is actually worth – and this can easily add up to more than a broker's transaction fee. Spreads tend to widen dramatically when the market is more volatile.

ETF trading costs can include:

(1) trading cost or commission;

(2) bid/ask spread;

(3) discounts or premiums to net asset value (NAV).

Unlike open-end mutual funds which are bought and sold at net asset value (NAV), ETFs are traded throughout the day at whatever price clears the market, and at times, an ETF's price may deviate from its NAV.   When an ETF's price is more than its NAV, the ETF is trading at a premium. When an ETF's price is less than its NAV, the ETF is said to be trading at a discount. If you buy an ETF at a premium, you'll be paying more than you need to and putting yourself at an immediate disadvantage. Likewise, if you sell an ETF at a significant discount to NAV, you'll essentially short-change yourself on some of the gains.

Managing ETF Trading Costs

We believe it is more important to focus on an ETF's assets, trading history and bid-ask spread than on whether or not you'll pay a commission to trade an ETF. We think the best way to reduce the costs of trading ETFs is to focus on ETFs that are well-traded and highly liquid, like the ETFs we include in NoLoad FundX.

When we screen ETFs for NoLoad FundX, we look for those that have a consistent trading history. This indicates that there is an active market for this ETF, and that there are generally enough investors trading for smaller investors to still get a true market price.

ETFs that haven't attracted sufficient assets and aren't widely traded often lack liquidity. This can lead to wider bid-ask spreads, larger and more frequent discrepancies between net asset value (NAV) and the value of the underlying securities, and a decreased ability to trade profitably. In periods of market upheaval, a small, poorly-traded ETF may not be easy to sell, and during such times, it may be quite difficult to obtain reasonable pricing.