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Save £200,000 by going it alone

By using self-select Isas and execution-only stockbrokers, it's possible to beat the fees and charges that eat into investments

Nina Montagu-Smith - Published: 20 March 2011

Investment fund charges could knock £243,400 off the value of your Isa portfolio over 30 years of investing, according to figures produced for The Sunday Times by Vanguard, the American fund manager.

The figures, which assume the Isa allowance rises in line with 2% inflation each year for the next three decades and that investment returns are 6% a year, show that if you invest in funds costing the industry average of 1.65% a year, you would be left with a pot worth £900,478, compared with £1,143,847 for funds costing 0.25% a year.

A growing realisation about the effects investment charges have on your savings over the long term is one reason many Isa investors are taking charge of their portfolios by using self-select Isas and execution-only stockbrokers this year.

According to Interactive Investor, the online stockbroker, the number of people using self-select Isas has risen by more than 50% this tax year to nearly one in three.

While Isa wrappers offered by most fund managers provide access to only that manager's range of unit trusts, with sometimes a limited selection of unit trusts from other managers, self-select Isas usually provide access to a much larger range of investments and allow you to hold other lower-cost equity-based assets such as investment trusts and shares.

Most actively-managed unit trusts levy an initial charge of about 5% — though this can be discounted if you invest via most advisers or discount fund brokers instead of going direct to the manager — as well as an annual management charge of about 1.5%.

Of this, however, only about half goes to the manager, while the rest is paid as "trail commission" to the financial adviser or investment platform through which you buy the fund.

Tim Cockerill at Ashcourt Rowan, the adviser, said: "All fees eat into the return an investor can make and the bigger the fee, the more the damage they do to the return."

Shares, investment trusts and exchange traded funds (ETFs), however, pay no commission so cost less to invest in.

We look at the alternatives and identify the best self-select and execution-only Isas.

Investment trusts

These are listed fund companies that generally cost less than other investment funds. Investment trusts do not levy initial charges and often boast annual management charges as low as 0.35%. However, some do use performance fees.

Unlike open-ended investment companies (Oeics) and unit trusts, investment trusts issue a finite number of shares, the price of which moves in response to demand.

The shares of many investment trusts are now trading at a discount to their underlying value (net asset value). They can also borrow to magnify returns, which can boost performance relative to unit trusts — although it also increases the risks.

Over the past five years, the average emerging markets unit trust has returned 65% to investors after charges, while the average investment trust has returned nearly 90%.

The Templeton Emerging Markets investment trust has produced returns of 122% over five years, compared with 108% from Aberdeen Emerging Markets, the best open-ended fund.

Shares in the Templeton trust are trading at an 8% discount to its net asset value, and the annual charge is 1%.

However, investment trusts do not always outperform. Over five years the average UK growth investment trust has returned 9.8%, against 10.6% from open-ended funds.

Some fund managers offer both Oeic/unit trust and investment trust versions of their funds, which can show the difference between the potential performances even where performance fees are used by the investment trusts.

For example, the Standard Life UK Smaller Companies trust has produced returns of 152% over two years, while its open-ended counterpart has returned 119%.

Cockerill said: “The funds have the same managers and teams behind them. The flip side is that when markets fall, the investment trusts will fall further and faster but in the long term investment trusts have the greater potential.

“There’s no doubt that investment trusts can provide growth potential over and above a lot of open-ended funds but they will be more volatile.”

You can buy investment trust shares via a stockbroker, or choose a self-select Isa from a fund manager that offers access to investment trusts, such as Alliance.

Exchange traded funds

ETFs, which track the price of an index, individual shares and commodities, have become popular in recent years, partly because they are cheap. Indeed, ETFs are now among the top 10 holders of physical gold.

There are no initial fees and the annual management charge is usually about 0.5%. Unlike ordinary shares, there is no stamp duty. You can buy them from fund managers, such as iShares or ETF Securities, or through a stockbroker.

However, you must check that you understand what you are investing in. Some commodity-based ETFs — known as exchange traded commodities — track the price of futures rather than hard commodities. The performance for each will differ. The ETF Securities futures-based one-year oil fund, for example, has risen 35% since 2007, but the price of Brent crude has surged 60%.

Low-cost funds

JP Morgan and Schroders have recently launched low-cost "actively-managed" tracker funds. The Schroder UK Core fund has total costs capped at 0.4%, while the JP Morgan UK Active Index Plus costs up to 0.55%. Barclays has also launched a multi-asset Isa fund with no initial charge.

Danny Cox at Hargreaves Lansdown, the adviser, said initial charges on the majority of active funds can be discounted or waived via a discount broker or investment platform.

There are also plenty of tracker funds that cost as little as 0.1% to 0.5% a year and which do not levy initial charges. The higher the charge, the further their performance will fall below that of the index they are following.

Philippa Gee, a financial adviser, recommends the Fidelity Moneybuilder UK Index fund, which costs 0.1% a year; the Vanguard FTSE UK Equity Index fund, which costs 0.25% a year; and the HSBC FTSE 250 tracker fund, also 0.25% a year.

Cox recommends the HSBC FTSE All Share tracker, which has a 0.25% annual management charge, and the HSBC FTSE 100 tracker, which also costs 0.25% a year.

Justin Modray of Candid Money said: "The key question is whether good fund management can compensate for the higher charges. While some managers do more than justify their fees, history suggests there are plenty who don't."

Shares

There are no management charges for investing in shares. However, you will have to pay a share dealing charge and there is also 0.5% stamp duty.

After this, you can shelter any gains from tax by holding them in an Isa, while dividend income tax is capped at 10% within an Isa. Held outside an Isa, there is an additional income tax charge for higher-rate taxpayers.

Many investors are opting to choose shares themselves, and Barclays Stockbrokers — an execution-only broker — says that shares now account for 96% of its clients' holdings. Funds and ETFs make up the remainder.

Low-cost option: Spread's the word

Angus Farr, 39, from London, spreads his Isa allowance across eight investment trusts, which he holds in an Alliance Trust wrapper. Farr, who runs a management training company, chose them because he wanted a cheaper and more adventurous way to invest for the long term.

He holds about 20% in global technology and healthcare trusts. He said: "When I was doing my research, I found that investment trusts were a bit riskier but could offer a better return. Alliance is low cost, an advantage over the long term."

The best self-select Isas

Choosing the best self-select or execution-only Isa will depend on what you want to invest in, as some are better for funds and others for shares and investment trusts. For example, if you want a broad selection of shares, open-ended funds, ETFs and investment trusts, the Alliance Trust Savings self-select Isa is likely to be cheapest, said Justin Modray at Candid Money.

Alliance rebates all commissions but there is a £12.50 dealing fee for all investments and an annual £25 Isa fee, which includes two free deals.

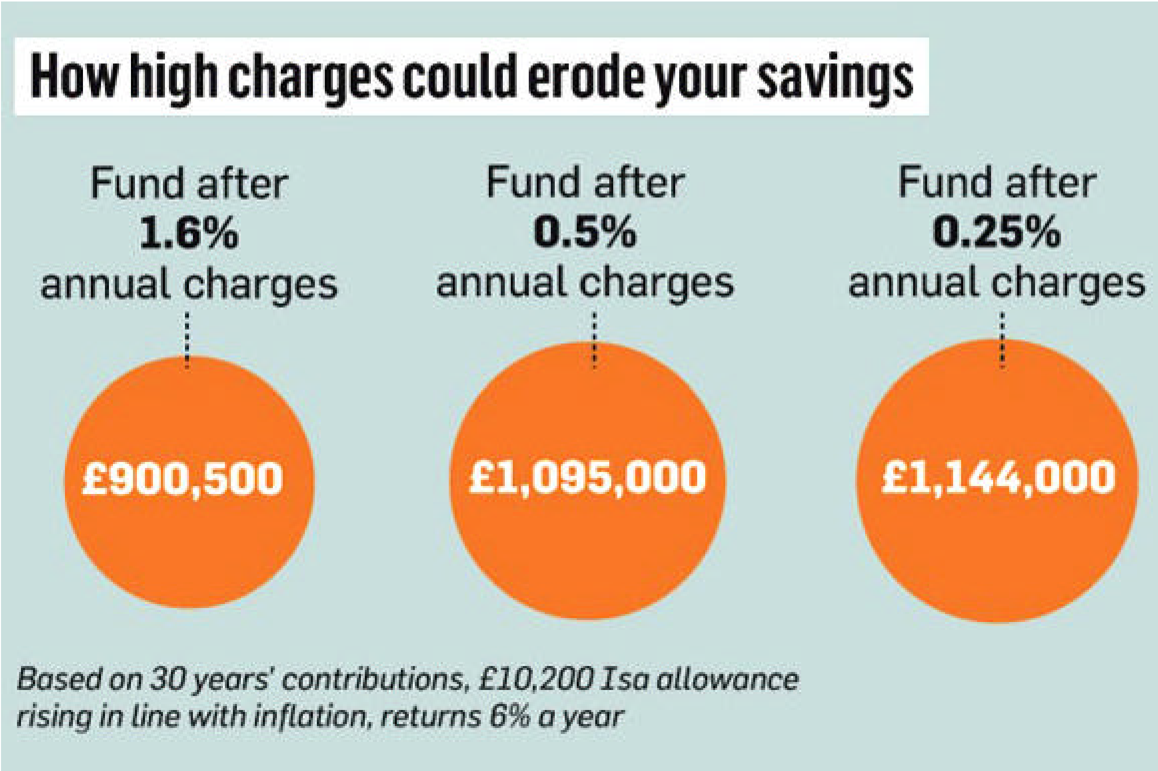
Interactive Investor and X-o.co.uk offer fee-free Isas but Interactive Investor does not rebate trail commission and X-o does not offer any access to investment funds.

Cavendish Online is the cheapest for open-ended funds as it rebates all initial and trail commissions in exchange for a one-off £25 fee. Hargreaves Lansdown's Vantage Isa rebates initial charges and about half the annual commission but charges 0.5% plus Vat on any investments that do not pay trail commission, making them more expensive for tracker funds, ETFs, investment trusts and shares.

Modray said: "If you don't need advice, then buying funds via discount brokers rather than financial advisers or fund managers could save you thousands of pounds over time.

"When looking at fund charges, pay attention to the total expense ratio (TER), as this gives a better idea of overall annual costs including the management charge."

Active funds might have TERs of about 1.6%, increasing to more than 2% for funds of funds. Tracker funds, including ETFs, generally have TERs below 0.5%.


How high charges could erode your savings
Fund after 1.6% annual charges
£900,500
Fund after 0.5% annual charges
£1,095,000
Fund after 0.25% annual charges
£1,144,000
Based on 30 years' contributions, £10,200 Isa allowance rising in line with inflation, returns 6% a year