

# Why the Rich Get Richer

by Robert Kiyosaki



## Why Mutual Funds Are Lousy Long-Term Investments

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Posted on Monday, June 26, 2006, 12:00AM

This past Christmas, I was at a party, and a man who's about 10 years older than I am asked me what mutual funds I invested in. My reply was "None. I rarely invest in mutual funds because of the lack of transparency. I don't know their fees. And I know there are hidden expenses they don't need to disclose to investors."

Hearing that, he nearly choked on his spiked eggnog. "What do you mean there's no transparency? My mutual-fund companies send me a report every year." Getting into an argument over mutual funds at a holiday party is not a way to enjoy the season. Rather than offer my information where it wasn't wanted, I thought it better to explain further to readers why I don't invest for the long term in mutual funds.

### Fee Problem

A vast number of people think that investing for the long term in a diversified portfolio of mutual funds is the smart thing to do. In my opinion, this ranks among the worst possible investments.

The problem with funds is fees. The longer you invest in a mutual fund, the more you pay in fees. I've pointed out before that when I buy a piece of real estate or a stock, I pay the sales commission once, but when I purchase a mutual fund, I pay a sales commission for as long as I own the fund (see "[So Long Pensions, Hello Fees](#)").

That's why the return on investment is much lower on mutual funds -- and why gains get lower the longer you own them. The reason most financial planners recommend you invest for the long term is simply because the longer you hold on to the fund, the more money they make.

### How Much Do Fund Companies Make?

Just how much does a fund company make from investors who hang in there for the long term? John Bogle, the founder of the very successful Vanguard Group, shed some light on that.

He was asked by an interviewer with the TV program "Frontline," "What percentage of my net growth is going to fees in a 401(k) plan?" Bogle replied, "Well it's awesome. Let me give you a little longer-term example. An individual who's 20-years old today [is] starting to accumulate for retirement.... That person has about 45 years to go before retirement -- 20 to 65 -- and then, if you believe the actuarial tables, another 20 years to go before death mercifully brings his or her life to a close. So that's 65 years of investing. If you invest \$1,000 at the beginning of that time and earn 8 percent, that \$1,000 will grow...to around \$140,000."

He continued: "Now the financial system -- the mutual-fund system in this case -- will take about 2.5 percentage points out of that return, so you'll have a net return of 5.5 percent, and your \$1,000 will grow to approximately \$30,000 to you the investor."

"Think about that. That means the financial system put up zero percent of the capital and took zero percent of the risk and got almost 80 percent of the return. And you, the investor in this long time period, an investment lifetime, put up 100 percent of the capital, took 100 percent of the risk, and got only a little bit over 20 percent of the return. That's a financial system that's failing investors because of those costs of financial advice and brokerage, some hidden, some out in plain sight, that investors face today. So the system has to be fixed," said Bogle.

In other words, the longer you invest, the more the investment house makes. That's why the financial institutions recommend you invest for the long term.

Occasionally, I will buy a mutual fund. But I'll never hold it for a long period of time.

### So What Should You Invest In?

The next time you hear a financial expert recommend that you "invest for the long term in mutual funds," take a moment to ask them to explain how their fees work over the long run. I suspect you'll hear some interesting answers -- if they can answer the question.

The reason they'll probably not be able to give you a definitive answer is because most financial experts don't know how much a mutual fund's fees and expenses are as most funds aren't required to disclose all such charges. In other words, there's no transparency.

If you're a passive investor, you may want to consider investing in index funds, which Mr. Bogle's fund company, Vanguard, specializes in (though not exclusively). Simply put, index funds have lower fees so the investor has a chance of making more money. After all, isn't that why we invest?

While index funds have the potential of generating greater returns via lower fees, I would still prefer to be an active investor. Most index funds think a 10 percent to 25 percent return is a good rate. Active investors can regularly beat those gains, especially if they stay away from traditional investments such as savings, stocks, bonds, and index and mutual funds (for more on being an active investor and not a passive one, see "[To Diversify or Not to Diversify](#)").

Summarizing what Bogle is saying, if you invest in mutual funds for a long period of time, this is a simplified picture of how the return is split over the long term -- and who takes the risk.

<b>Mutual-Fund Company</b>	<b>Investor</b>
80 percent of the return	20 percent of the return
0 percent of the capital	100 percent of the capital
0 percent of the risk	100 percent of the risk

If you don't like the above distribution of returns, I suggest you contact John Bogle or try index funds.