Load vs. No-Load Funds

Let's first review the different types of mutual fund structures. Load funds charge a commission while no-load funds are commission-free. The structure of load funds can be (1) front-end with the commission varying from 3 to 6.25 percent of the investment, or (2) back-end, also known as redemption, with the commission usually at 3 percent of asset value when sold. In addition, practically all load funds charge annual distribution fees, also referred to as 12b-1 fees, which are used to pay for promotional costs. These costs vary from 0.25 to 0.75 percent of annual asset value. Some no-load funds also charge 12b-1 fees, but no-load funds that *do not* charge 12b-1 fees are known as 100 percent no-load or true no-load.

Is there really that much of a worthwhile difference between load and no-load funds? An analogy to comparing mutual fund structures would be a one-hundred yard race. If the race competitors have equal ability, but one has a five to six yard head start, you obviously know who would win the contest. In fact, the one with the head start would only lose to a competitor with far superior ability. In the mutual fund illustrations below, assume all "competitors" have equal ability in order to accurately demonstrate the differences in performance.

Assuming a $10,000 investment with a conservative nine percent annual net return rate (after annual fund operating expenses) over three years, the following illustrations compare the differences in total return and Return on Investment (ROI) among three different types of mutual fund sales structures:

- 100% no-load (no 12b-1 fees)
- 5% front-end load with 0.5% per year 12b-1 fees
- 3% back-end load with 0.5% per year 12b-1 fees (redemption in year 3)

Total Return Comparison

	Start	Year 1	Year 2	Year 3
100% No-Load	$10,000	$10,900	$11,881	$12,950
5% Front-End Load	$ 9,500	$10,303	$11,174	$12,119
3% Back-End Load	$10,000	$10,845	$11,762	$12,374

Cumulative ROI Comparison

	Year 1	Year 2	Year 3
100% No-Load	9.0%	18.8%	29.5%
5% Front-End Load	3.0%	11.7%	21.2%
3% Back-End Load	8.4%	17.6%	23.7%

In cumulative ROI after three years in this illustration, the 100 percent no-load fund outperforms the five percent front-end load fund by 39.3 percent and the back-end load fund by 24.4 percent -- even though a nine percent annual return rate is identical for all three funds! The ROI advantage of the 100 percent no-load fund in this illustration is due entirely to the absence of both sales load and annual 12b-1 distribution fees. The advantage of the 100 percent no-load fund in these illustrations is very apparent. Comparative ROI differences would be even more dramatic as the annual return rate parameter falls below nine percent, less dramatic as the annual return rate parameter rises above nine percent.

Does this imply that all no-load funds are superior to all load funds? Of course not. Obviously, a five percent front-end load fund with a 15 percent annual return will outperform a no-load fund with a nine percent annual return. However, no-load funds that carry above average rankings (from Morningstar or Lipper) will most likely outperform load funds, *provided that the funds are in the identical fund category (i.e.; growth, growth & income, global, corporate bond) with a time frame of at least three years*.

Finally, you should be aware of custodial fees or managerial fees. Recently, a major brokerage firm announced that it would be offering no-load funds from 28 fund families without charging commissions or 12b-1 fees. However, this firm will compensate salesmen by charging clients up to 1.5 percent of their assets on an annual basis. Over a relatively short time, these fees would be substantially greater than even a five percent front-end load! It is best to avoid these types of fees and maintain the no-load advantage.