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TSP No Longer Low Expense Leader

Michael Wald

Michael Wald is a public affairs consultant and writer based in the Atlanta area. He specializes in topics related to government and labor issues. Prior to his retirement from the U.S. Department of Labor, he served as the agency's Southeast Regional Director of Public Affairs and Southeast Regional Economist.

For decades, one of the selling points of the government's Thrift Savings Plan (TSP) has been its low expenses.

Back in May, I wrote an article for FedSmith.com titled *TSP Should Remain the Investment of Choice for Federal Employees and Retirees* citing the low cost of TSP funds when compared to a several non-government investment funds.

But competition in the fund industry is heating up, and now TSP funds are no longer the low-cost leaders.

Effective August 3, Fidelity created two funds with $0 expense fees along with cutting fees on many of its funds.

Fidelity's ZERO Total Market Index Fund (FZROX) "seeks to provide investment results that correspond to the total return of a broad range of U.S. stocks."

That is a broader mandate than TSP's C Fund that attempts to "fully replicates the Standard and Poor's 500 (S&P 500) Index", but FZROX can be seen as an alternative to the C Fund.

Fidelity ZERO International Index Fund (FZILX) "seeks to provide investment results that correspond to the total return of foreign developed and emerging stock markets", a description that is similar to the TSP's I Fund.

Both funds primarily invest in stocks, so neither offers a direct challenge to the TSP's F, G, or S Funds.

Commission-free funds

While the zero-fee funds at Fidelity limit you to only two choices, Fidelity is offering $0 per trade for commission-free purchases of select Fidelity ETFs, which offer a broader selection of investments. Fidelity is also offering commission-free iShares. BlackRock's iShares is the world's largest provider of exchange-traded funds.

At Vanguard, the world's largest provider of mutual funds, competition is also driving down expenses. The latest news is that Vanguard has now made nearly 1,800 exchange-traded funds (ETFs) commission-free. Excluded from the list are inverse and leveraged ETFs, which the company says they excluded because they say that those funds speculative nature are intentionally designed to be bought and sold within a single trading day and runs counter to Vanguard's belief in a longer-term focus on purchases.

Both Fidelity and Vanguard's ETFs, while commission-free, are not free of expense fees, but provide a wide range of investment options at a low cost. Most funds focus on stocks but there are also bond ETFs on the Vanguard list. The ETFs allow frequent trading, an advantage to some investors who want to trade in and out of the market.

Both Fidelity and Vanguard funds offer no account fees and no minimums to open a retail brokerage account.

Investment Returns

Of course, low or no fees is only one consideration for investors. While minimizing costs helps with investment returns, the performance of the fund remains the primary focus.

Fidelity's ZERO Total Market Index Fund is too new to have a track record, but Fidelity does have Fidelity Total Market Index Fund (FSTMX) that can be used as a substitute.

Over the past year, the FSTMX shows a gain of 16.36%, as of August 22. A similar fund from Vanguard, the Vanguard Total Stock Market ETF (VTI), is showing a 16.45% increase.

As a comparison, the TSPs C Fund shows a 16.21% growth rate.

Where does this leave TSP?

The government's matching contribution makes TSP the default choice for current employees, but without that matching option, the Fidelity and Vanguard funds have become more attractive as they lower or eliminate costs such as commissions and fees.

One advantage for the TSP remains its G Fund, which gives investors rates similar to 10-year Treasury notes without the danger of a loss of principal due to rising interest rates.

As an example, the iShares 7-10 Year Treasury Bond ETF (IEF) seeks to track the investment results of an index composed of U.S. Treasury bonds with remaining maturities between seven and ten years.

Over the past 12 months, the G Fund has shown an investment return of 2.59%, while the IEF is showing a loss of 1.92%.

Unless Congress changes the rules for the G Fund, it will remain an attractive option for investors able to access the TSP.

As for the other TSP Funds, the competition from Fidelity and Vanguard, among other investment management firms, may put added pressure on TSP to change or see an outflow of funds.

Conclusion

If you are a current or retired Federal employee and either are not receiving matching contributions or have maxed out on the match, then you need to reconsider whether TSP is your best choice.

Retired Federal employees, especially those who need to begin making withdrawals from the TSP because of Required Minimum Distribution (RMD) rules, should consider whether investing in low-cost or no-cost funds makes more sense than leaving your money in a TSP account.

As I wrote back in May, "Expenses do make a difference. Unless you find a fund that can outperform the market over several decades, long-term investors are better off with a fund that offers lower expenses."
The effect of costs on investment returns will become even more important if investment returns in the future drop from these historically-high levels.

The other conclusion to draw is that the investment marketplace is changing rapidly and investors must be willing to update their investment decisions as circumstances change.

I am not an investment adviser and cannot provide individualized investment advice or investment products. You need to do your own homework to decide what is best for you.