

Racing on a Sinking Boat



Imagine setting out for a boat race. You have a shiny new Skater Powerboat, a powerful Mercury Racing 450R engine, an advanced Weather Alert System, and even a special racing suit with a superior aerodynamic design. You will certainly win, right? But wait, were you too busy to check if there are any cracks on the bottom?

Just like in boat racing, where neglecting a crucial check can lead to disaster, in investing it is up to the ultimate beneficiary owner to ensure everything is in perfect condition. Overlooking hidden costs or failing to properly manage fees can significantly impact your financial performance. Smart investors know that this task should not be delegated to the wealth manager; they must take an active role in overseeing and optimizing the cost of investment.

Industry Practices: Geometric vs. Arithmetic Returns

There are two ways to race for top returns: boosting the arithmetic average rate of return or maximizing the geometric average rate of return. The wealth management industry focuses solely on arithmetic averages, driven by short-term incentives like annual bonuses, quarterly reviews, and the classic three-year cycle in one role. However, intelligent investors should prioritize geometric returns, which emphasize long-term compounding and protecting the capital base.

Yet in reality, investors may find it hard to resist the marketing efforts that promote the industry’s perspective: always looking for a new star manager, trying to get access to unique opportunities, preempting market moves – all of that is part of the playbook. However, there is one powerful force that consistently plays by investors’ side, helping to boost geometrical return regardless of market cycles, asset types, or managers. It is consistently low investment costs.

The wealth managers would object saying, "My strategy generates 10-15% return—why do you even care about meaningless savings?" Let us pause here and consider that compounding at 11% after savings is drastically better than 10% before savings. Take an example of compounding an initial \$10M with different return expectations. It is surely hard to disregard an additional increase of 25% in the initial wealth in 10 years.

Impact of Compounding on Investment Returns Over Time			
Year	10% Return	11% Return	Delta (% of initial wealth)
1	\$11 M	\$11.1 M	\$0.1 M (1%)
5	\$16.1 M	\$16.9 M	\$0.8 M (8%)
10	\$25.9 M	\$28.4 M	\$2.5 M (25%)

Unmasking hidden investment cost

Every percentage of cost savings is crucial due to compounding. However, why does it attract so little attention? The answer lies in the complexity of costs, often made convoluted by financial intermediaries.

A non-vigilant investor only observes visible costs that appear in quarterly bank statements, such as custody or advisory fees. It may come as a surprise that hidden costs make up a significant share of the total cost of investment. Examples include forex bid/ask spreads, retrocessions, brokerage fees, and mutual fund manager charges, which are deducted directly from instrument prices or NAV. In some cases, hidden expenses can double the total investment costs, complicating the understanding of true investment costs.

The fees as a percentage of Assets under Management (AuM) depend on many factors: the size of AuM, allocation to asset classes (from cheap ETFs to expensive private assets), transaction frequency, and ability to control

intermediaries along the investment value chain. That is why it is challenging to benchmark cost against peers accurately, as this can only be done effectively at a very granular level, not at an 'all-in' level.

The wealth industry is ready to negotiate, but few investors are interested

There are two main strategies to reduce investment costs: simple and complex. The simple approach involves growing your AuM and boldly asking for discounts in return. The complex approach requires breaking down your investment value chain into key components and conducting a detailed benchmark of different types of fees.

It is important to know what to ask for to maximize cost reduction by focusing on essential elements of the fee structure: if you are a long-term investor, request reductions in custody fees; if you are pursuing a high-turnover strategy, focus on negotiating brokerage fees.

Below, we provide insights collected from real-life cases (negotiated terms) and compare it to official pricing (non-negotiated terms). It's a myth that formal pricing is set in stone. The industry almost expects negotiation, but few investors take advantage of this. Investors' minds are lured away by how to get to the finish line faster.

Negotiated vs. Non-Negotiated Fee Structures Across Different AuM Tiers						
	\$5-10M AuM		\$30-50M AuM		\$100M+ AuM	
	Non-negotiated	Negotiated	Non-negotiated	Negotiated	Non-negotiated	Negotiated
Custody fee	0.25%	0.15%	0.15%	0.10%	0.10%	0.05% (or fixed)
Forex fee	1.50%	0.10%	0.5-1%	0.05%	0.10%	0.02%
Brokerage fee	0.5-1%	0.25%	0.25%	fixed	0.10%	fixed
Advisory fee	0.5-0.7%	0.30%	0.35%	0.20%	0.20%	0.10%
Global Equity strategy	1.20%	1%	1%	0.80%	0.80%	0.4% - 0.6%
Fixed Income strategy	1%	0.80%	0.90%	0.55%	0.65%	0.45%
PE strategy	3.5% + 20%	3.5% + 20%	3% + 20%	2% + 20%	2.5% + 20%	1.75% + 20%
Margin loans fees	0.75%	0.75%	0.50%	0.35%	0.35%	0.20%
Deposit / money market fees	0.20%	fixed	0.15%	fixed	0.10%	fixed

Source: Greenlock Proprietary Fee Benchmark Database, 2024. The dataset is based on a 100+ real-life cases representing top-tier private banks across North America, Europe, and the Middle East. "Fixed" term refers to a pre-agreed fixed price, either annually or per transaction

Performance comes and goes, but fees stay with you forever

In the competitive world of investment, the focus is often on finding the fastest racing boat to reach the finish line (i.e., year-to-date performance). Providers offer advanced equipment and electronics to help achieve this, but a true captain knows it is his ultimate responsibility to ensure the boat is solid before reaching maximum speed.

Similarly, before chasing high returns, it's crucial to address the hidden and visible costs that can drain your wealth. The enduring advantage of a fee reduction is that it only needs to be done once.

Unlike annual returns, your savings are guaranteed for a lifetime and compound over time.

About the author

Danil Knyazev is the CEO and co-founder of Greenlock (greenlock.io), a wealth tech startup that helps institutional investors reduce investment costs. With a background in management consulting, and investment strategy, Danil leverages his diverse expertise to automate the auditing of investment fees, helping large entities like college endowments and multi-family offices save 20-30% on costs.