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Checking the Math as Expenses Rise on Many Vanguard Funds
Vanguard's reputation as the mutual fund industry's low-cost leader is well deserved, and we're often reporting on reductions in fund fees as the firm finds ways to save investors money and stay ahead of competitors trying to keep pace. But fees don't always go down.

The fund giant is quick to tout news when its expense ratios decline, even if it's also a matter of how and when it chooses to measure them. As we learned from Vanguard's 2015 annual reports released in March, 52 Vanguard funds (counting separate Investor, Admiral, ETF and Institutional share classes) saw their expenses increase rather than fall over the past six months.

Since expenses went down overall in 2015, it means costs dropped during the first half of the year before reversing course and retracing a bit over the following six months.

Let's look closer. The largest increase was a 33% rise in the cost of Intermediate-Term Bond Index Institutional Plus, although it was but a mere basis point, from 0.03% to 0.04%, between June 30, 2015 and December 31, 2015. But Vanguard often uses percentages to emphasize its expense reductions, since those minuscule basis-point declines look a lot bigger when expressed this way. For example, a recent press release cited expense ratio reductions ranging from 7% to 27%.

Using that same percentage translation, over the last six months of 2015, operating expenses increased from 5% to 33%, though just about every change was an increase of just one basis point. Inflation-Protected Securities' Admiral shares saw a 2-basis-point increase (up 29%) between June and December, from 0.07% to 0.09%.

You'll never hear us complain about expenses falling fees, but one to two basis points on already low expense ratios makes it harder and harder to make any real news out of it, try though Vanguard might. And it's no surprise that the fund titan would rather promote expenses falling over 12 months than rising over six.

There's another important issue here for investors to know. When Vanguard mentions lower expense ratios, it's really talking about lower fees claimed in its prospectuses. Here's the gist: Vanguard will issue a new fund prospectus, report a lower expense ratio and claim it as a decrease. That's not wholly accurate.

When Vanguard reports a new expense ratio in a prospectus, it's an *estimate*, not hard and fast data. Twice a year, Vanguard reports actual, audited expense ratios rather than educated guesses in its semiannual and

annual reports. Reading the letters to shareholders in those reports, you'll always see Vanguard comparing its funds' expense ratios with those of its peers. But the ones they use for comparison aren't accurate, since they're taken from the estimates used in prospectuses.

For example, take Vanguard's Precious Metals & Mining, a fund whose fiscal year ended in January and just released its annual report. That report referred to prospectus expenses of 0.29%, but acknowledged in the footnotes that the actual expense ratio was 0.35%. Vanguard explained the difference as due to performance fee adjustments—the manager was docked less money in the current year than the previous one. As you can see, prospectus numbers are simply estimates.

In fact, when we looked at all of the numbers for the 34 funds that reported at the end of January, 29 of those 34 saw expenses rise over the six months ending January 31 (by anywhere from 4% to 17%), further proof that Vanguard's costs were going up in the latter part of 2015 and into 2016.

Expense Ratio Seesaw

Fund	Exp. Ratio 12/31/2014	Exp. Ratio 6/30/2015	Change from Dec. 2014	Exp. Ratio 12/31/2015	Change from June 2015
Intermediate-Term Bond Index Inst. Plus	0.05%	0.03%	-40%	0.04%	33%
Admiral 500 Index	0.05%	0.04%	-20%	0.05%	25%
Admiral Total Stock Market Index	0.05%	0.04%	-20%	0.05%	25%
S&P 500 ETF	0.05%	0.04%	-20%	0.05%	25%
Total Stock Market ETF	0.05%	0.04%	-20%	0.05%	25%
MidCap Index Inst. Plus	0.06%	0.04%	-33%	0.05%	25%
SmallCap Index Inst. Plus	0.06%	0.04%	-33%	0.05%	25%
Intermediate-Term Bond Index Inst.	0.07%	0.05%	-29%	0.06%	20%
Short-Term Bond Index Inst.	0.07%	0.05%	-29%	0.06%	20%
Balanced Index Inst.	0.08%	0.06%	-25%	0.07%	17%
Extended Market Inst.	0.08%	0.06%	-25%	0.07%	17%
Growth Index Inst.	0.08%	0.06%	-25%	0.07%	17%
LargeCap Index Inst.	0.08%	0.06%	-25%	0.07%	17%

MidCap Index Inst.	0.08%	0.06%	-25%	0.07%	17%
SmallCap Index Inst.	0.08%	0.06%	-25%	0.07%	17%
Tax-Managed Cap. Apprec. Inst.	0.08%	0.06%	-25%	0.07%	17%
Value Index Inst.	0.08%	0.06%	-25%	0.07%	17%
Tax-Managed SmallCap Index Inst.	0.08%	0.06%	-21%	0.07%	16%
Admiral SmallCap Index	0.09%	0.07%	-22%	0.08%	14%
Admiral Growth Index	0.09%	0.07%	-22%	0.08%	14%
Admiral MidCap Growth Index	0.09%	0.07%	-22%	0.08%	14%
Admiral MidCap Value Index	0.09%	0.07%	-22%	0.08%	14%
Admiral LargeCap Index	0.09%	0.07%	-22%	0.08%	14%
Admiral Value Index	0.09%	0.07%	-22%	0.08%	14%
Admiral Balanced Index	0.09%	0.07%	-22%	0.08%	14%
SmallCap ETF	0.09%	0.07%	-22%	0.08%	14%
Growth ETF	0.09%	0.07%	-22%	0.08%	14%
MidCap Growth ETF	0.09%	0.07%	-22%	0.08%	14%
MidCap ETF	0.09%	0.07%	-22%	0.08%	14%
MidCap Value ETF	0.09%	0.07%	-22%	0.08%	14%
LargeCap ETF	0.09%	0.07%	-22%	0.08%	14%
Value ETF	0.09%	0.07%	-22%	0.08%	14%
Admiral Extended Mkt. Index	0.10%	0.08%	-20%	0.09%	13%
Admiral Short-Term Bond Index	0.10%	0.08%	-20%	0.09%	13%
Admiral Intermed.-Term Bond Index	0.10%	0.08%	-20%	0.09%	13%
Extended Market ETF	0.10%	0.08%	-20%	0.09%	13%

Short-Term Bond ETF	0.10%	0.08%	-20%	0.09%	13%
Intermediate-Term Bond ETF	0.10%	0.08%	-20%	0.09%	13%
Long-Term Bond ETF	0.10%	0.08%	-20%	0.09%	13%
Admiral Inflation Protected Sec.	0.10%	0.09%	-10%	0.10%	11%
Tax-Managed Balanced	0.12%	0.10%	-17%	0.11%	10%
Tax-Managed SmallCap	0.12%	0.10%	-17%	0.11%	10%
Tax-Managed Capital Appreciation	0.12%	0.10%	-17%	0.11%	10%
500 Index	0.17%	0.15%	-12%	0.16%	7%
Total Stock Market Index	0.17%	0.15%	-12%	0.16%	7%
SmallCap Growth Index	0.23%	0.19%	-17%	0.20%	5%
Inflation-Protected Securities	0.20%	0.19%	-5%	0.20%	5%
Extended Market Index	0.23%	0.21%	-9%	0.22%	5%
Growth Index	0.23%	0.21%	-9%	0.22%	5%
Value Index	0.23%	0.21%	-9%	0.22%	5%
Balanced Index	0.23%	0.21%	-9%	0.22%	5%

Source: The Vanguard Group.

Again, while Vanguard can lower expense ratios in its prospectuses, that doesn't mean funds will actually charge the prospectus amount over the ensuing 12 months. Those estimates are not actual, real-world numbers that investors can rely on.

So, what's the takeaway? We are certainly not looking at some nefarious scheme to swindle shareholders here. However, as an investor, it pays to be informed so at the least you can set the proper expectations (or if you detect funny business, you can head for the exit). While Vanguard's reporting method for expense ratios may leave something to be desired, the funds affected are still a bargain compared to peers, even if fees did rise by a few basis points over the last six months of 2015.

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