

Robo-Advisors : The Good, The Bad, and The Ugly

Gary Karz, CFA

- Many internet based services have been developed in recent years, some offering sophisticated tools at little or no cost.
- Which robo-advisors are gaining traction and how are the more established providers responding?
- Which tools and what services add value?
- Recent regulatory developments for advisors and brokers and suitability vs. fiduciary standards.
- Common investor mistakes to avoid.

Mountain or Molehill?

"It seems like the year of the robo-advisor"

Within four years, robo-advisors will collectively control \$255 billion in end-client assets, according to research by MyPrivateBanking.com

Andy Klausner

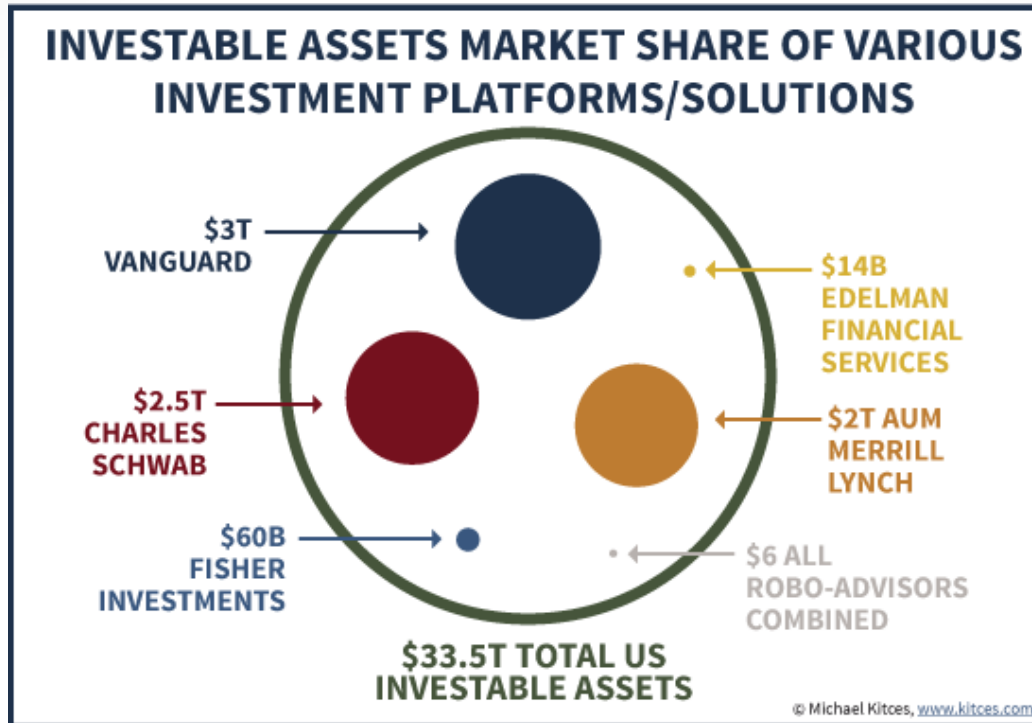
http://financialadvisoriq.com/c/1198833/131673/planning_firms_could_robo_advisor_strategy

"The biggest buzzword in the financial space is robo-advisor. Thousands of articles, interviews, tweets and blog posts have been published speculating about how they will change the advisory landscape ... In the same way that sites like mint.com have tried to take over personal household account tracking, the robo-advisors are trying to win household investment management.

FolioDynamix Whitepaper

http://na-sjf.marketo.com/rs/683-MIW-078/images/Robo-Advisors_Threat%20or%20Opportunity%20-%20A%20FolioDynamix%20Whitepaper%20final%20version.pdf?aiid=303

Mountain or Molehill?



<https://www.kitces.com/blog/why-financial-advisors-using-robo-advisor-technology-still-will-not-close-the-millennial-gap/>

"Merrill Lynch, Morgan Stanley, Schwab and Fidelity each have over \$2 trillion in assets. I understand that the cumulative size of all the robos — put together — is less than \$20 billion. **Saying robos are where the industry has evolved is like saying the oceans have evolved into swimming pools.** Make no mistake: Schwab and Fidelity will never put Merrill and Morgan Stanley out of business, and likewise, these newer models won't put Schwab and Fidelity out of business. But there is a clear place for technology-enabled [brokerage] services."

Steve Wallman @FolioFN (7/27/2015)

http://www.financial-planning.com/news/reinvent_wealth/ex-sec-commissioner-robo-takeover-isnt-imminent-2693646-1.html

What is a Robo Advisor?

This is a very fluid and evolving industry with new developments and firm's morphing and some mergers in recent months. There have been major articles in AAI Journal, WSJ, Barron's, Economist, Kiplingers, NYTimes, etc.

Wikipedia - Robo-advisors are a class of financial adviser that **provides portfolio management online with minimal human intervention**. While their recommendations may vary, they all employ algorithms such as Modern portfolio theory that originally served the traditional advisory community, which has relied on algorithmic templates to conduct portfolio management.

Legally, the term "financial advisor" applies to any entity giving advice about securities. But most robo-advisors limit themselves to providing portfolio management (i.e. allocating investments among asset classes) without addressing issues such as estate and retirement planning and cash-flow management, which are also the domain of financial planning.

Industry Context

The tools they employ to manage client portfolios differ little from the portfolio management software already widely used in the profession. **The main difference is in distribution channel.**

Source: <http://en.wikipedia.org/wiki/Robo-Advisor>

What is a Robo Advisor?

Forty-eight percent of the 134 independent advisors surveyed believe it's a low-cost, technology-based financial advisor for the masses. About a quarter say a robo is an algorithmic-based program used to replace a financial advisor, and about 18 percent define it as technology used to communicate with an investor while providing financial advice. Nearly 9 percent admit to being unclear about what a robo-advisor actually does.

Nearly 97 percent of respondents believe conventional advisors and robo-advisors can “co-exist.” But at the same time, 78 percent of them see robos as a “potentially real” or “significant” threat to their business model.

Source: <http://wealthmanagement.com/technology/what-robo-advisor> (4/23/2015)

There are three main types of robo-advisor per Raef Lee, SEI Advisor Network (4/2/2014)

1. A pure technology website, devoid of advisors, that allows investors to do everything themselves (examples include Motif Investing and Jemstep)
2. Companies that include advisors who use technology only (the internet) to communicate with their clients (such as Personal Capital and Learnvest)
3. Established financial service companies that have recently expanded their online advice offering (such as Vanguard and Edelman Online)

Source: <http://byallaccounts.morningstar.com/blog/399-5-ways-robo-advisors-will-change-the-way-advisors-work.html>

What is a Robo Advisor?

"A Robo is an online financial services firm that has automated the financial planning or investment processes. Computers invest your assets in low cost ETFs and index funds."

There are several types of Robos, based on services, expenses, and your access to humans that use a variety of naming conventions:

- Online Financial Advisors
- Automated Investment Advisors
- Robo Asset Allocators
- Automated Investment Service
- Digital Investment Advisors

Most Robos have automated the investment process. You complete an online questionnaire. A computer program uses your responses to select a model portfolio. You are invested in a diversified portfolio that consists of several ETFs, Index Funds, Mutual Funds, and securities. Most of the Robos also utilize computer programs that rebalance portfolios, harvest tax losses, and produce performance reports. By eliminating the advisor and automating the investment process some Robos have no minimums or very low minimums.

Source: <http://www.paladinregistry.com/> (Jack Waymire)

What is a Robo Advisor?

Primary differences between Robo Advisors and Financial Advisors (FA)

1. Robo questionnaire responses generate a model portfolio, FA personalizes portfolio for your particular situation
2. Robo communication may be limited to online, some hybrids include telephone and/or skype or facetime
3. Robo may limit services to portfolio management, while FA offers financial planning and other services. Some offer insurance (under separate licensing).
4. Robos tend to be passive in terms of security selection and market timing. FA may offer passive or active management
5. Robos tend to offer lower costs.

Source: <http://blog.paladinregistry.com/advisors-2/5-critical-differences-between-financial-advisors-and-robo-advisors-infographic> (Jack Waymire)

Does “Robo” have a negative connotation?

Allan Roth thinks the name “robo advisory” is **derogatory**.

<http://www.ETF.com/sections/features-and-news/4-views-meaning-robo-advisors>

Bill Winterberg says “**Boo hoo**” to the firms complaining about the term - its the “**perfect moniker**” for the firms.

<http://fppad.com/2015/06/09/robo-advisor-is-perfect-moniker>

Does “Robo” have a negative connotation?

-**Wealthfront** opposes the term: They feel that robo-adviser has been “adopted by the traditional financial adviser community and isn’t used by any consumers.”

-**Betterment** also feels that the term robo-advisers doesn’t properly explain their service, but the firm doesn’t oppose it.

-**Hedgeable** doesn’t like the term robo-adviser because “it infers a commoditized, mass-produced, cheapened product. This is what a robot does.”

-**Personal Capital** doesn’t care for the term simply because they’ve built their business around a traditional adviser relationship.

Covestor, not offended by the term and feels that it doesn’t capture a fair representation of their service, which is more of a hybrid model (managed by humans).

TradeKing Advisors “While the term ‘robo’ doesn’t bother us as it has come to be synonymous with high efficiency and accessibility... more in line with the term ‘online advisory’ because we have highly experienced professionals creating and weighting the portfolios.”

Source: <http://www.aaii.com/journal/article/what-exactly-do-online-investment-advisory-services-offer.mobile>

([Jaclyn McClellan](#))

"It’s not a robo adviser, but there are similarities. I view it as more of a hybrid."

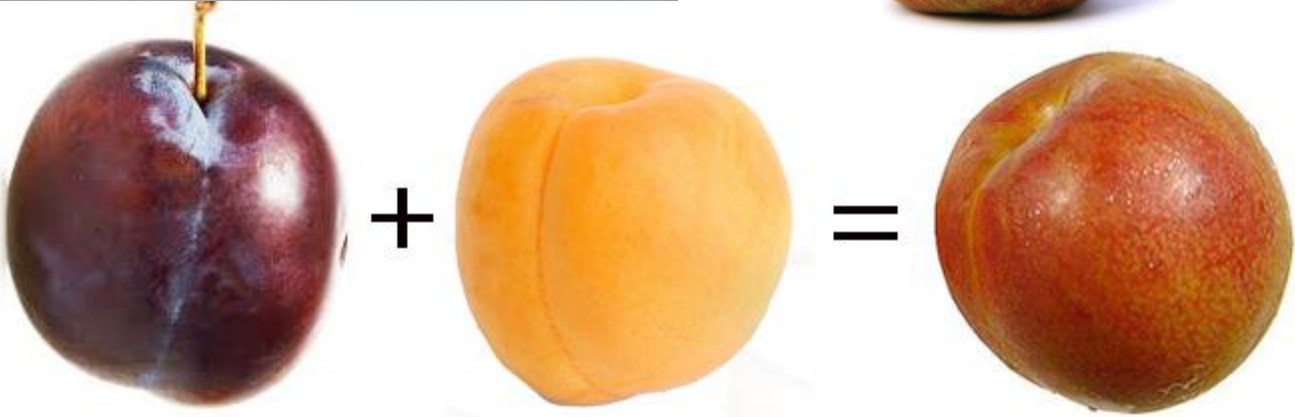
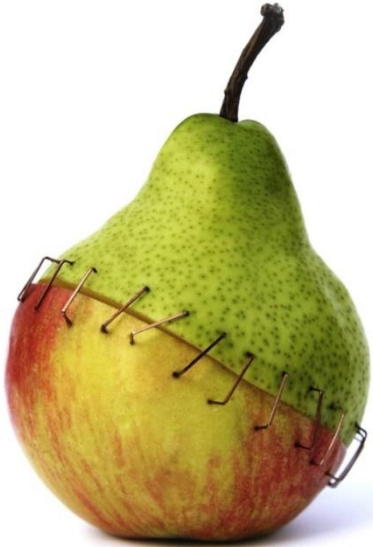
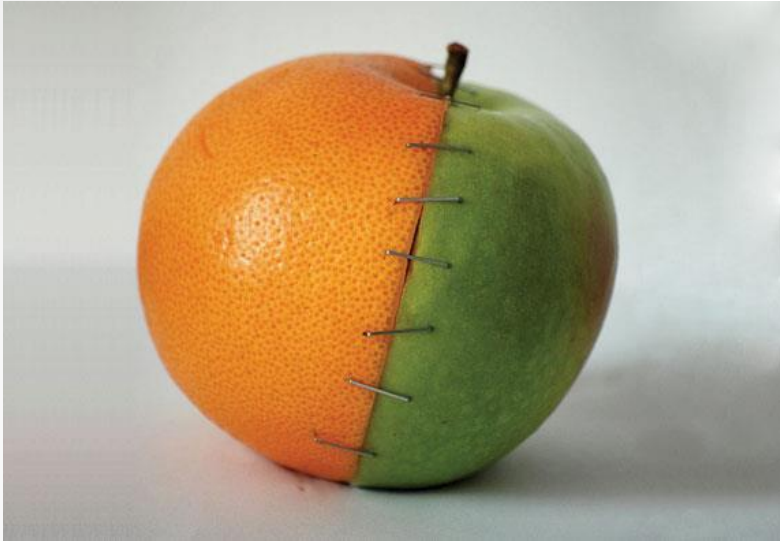
Karin Risi, **Vanguard Personal Advisor Services**

<http://www.wsj.com/articles/vanguards-partly-automated-service-just-dont-call-it-robo-adviser-1428375815>

"**Motif's** co-founder and CEO Hardeep Walia stresses that it is not a robo advisor"

http://www.financial-planning.com/news/reinvent_wealth/online-but-trying-to-more-than-just-a-robo-2692600-1.html

Comparing Apples, Oranges, Plums, Apricots, Pluots



https://blog.etsy.com/en/files/2011/09/noted_hybridfruit_header1.jpg
<https://nomumbo.files.wordpress.com/2012/01/frankenfruit-8x6.jpg>
<https://melonbloggers.files.wordpress.com/2011/07/pluot-synthesis.jpg>

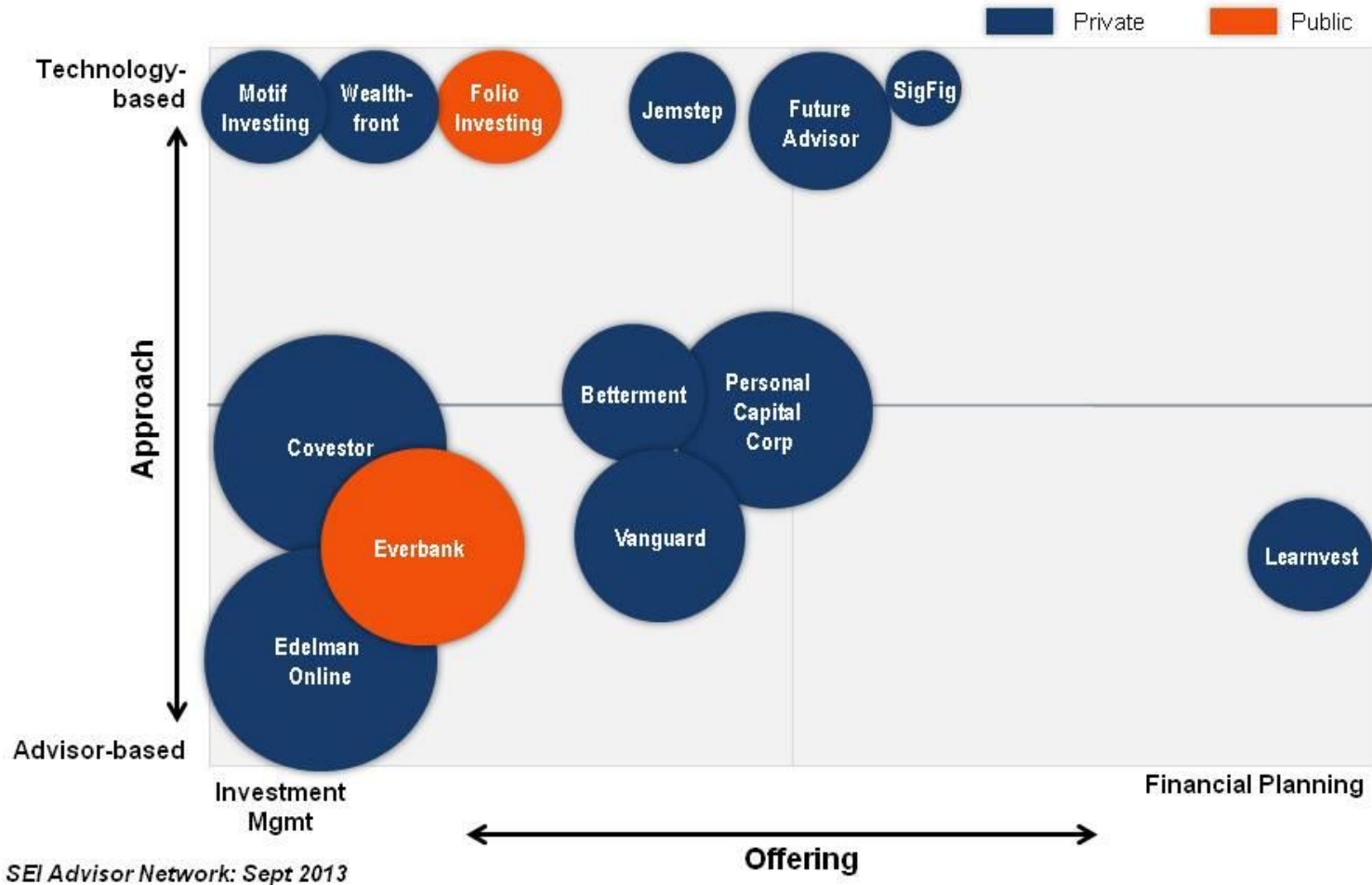
Some Robos include human interaction and some traditional advisory firms are adding Robo functions



<http://www.economist.com/news/special-report/21650292-human-wealth-advisers-are-going-out-fashion-ask-algorithm>

Robo-advisor Landscape

Size of bubble correlates to fees: Higher fees = larger; Lower fees = smaller



<http://byallaccounts.morningstar.com/blog/399-5-ways-robot-advisors-will-change-the-way-advisors-work.html>

Notable Firms

More than 60 firms can loosely be included in the Robo-advisor space (RIAs, Robos, custodians, software providers).

Some take discretion, others (like newsletter providers) do not.

The more established firms tend to be associated with retirement plans in various forms.

AAA (rumored), Acorns, Advizr, Amerivest Portfolios, AssetBuilder, Autopilot, Betterment, Bloom, Blueleaf, CircleBlack, CapitalOneInvesting, Covestor, Edelman Online, Ellevest, E*Trade, Fidelity, Financial Engines, FinanceLogix, FlexScore, FolioDynamix, FolioInvesting, FTJ Fundchoice, FutureAdvisor, GuidedChoice, Hedgeable, IFA, Invescence, iQuantifi, Jemstep, Kivalia, LearnVest, LPL, Marketriders, Marstone, Morningstar, MotifInvesting, MyMoneyGuide, MyPlanIQ.com, NestEgg Wealth, Nextcapital, PersonalCapital, Plan and Act, ProManage, Quovo, RebalanceIRA, RiXtrema, Robinhood, Schwab Intelligent Portfolios, SciVantage, SigFig, Smart401k, SmartPlanner, TradeKing Advisors, Trizic, Upside Advisor, Vanguard Personal Advisor Services, WealthAccess, Wealthbot.io, Wealthfront, Wealthminder, Wells Fargo?, WiseBanyan

See <http://www.investorhome.com/robos.htm> for ranks by AUM and costs.

History and Notable Firms

Where were you in 1996?

As the internet was developing, the seeds of the robo-industry were planted.

Financial Engines (ticker symbol FNGN) was started by Professor Bill Sharpe to provide sophisticated tools (previously available only to institutions) to individual investors. FNGN completed its IPO in 2010, manages over \$100 Billion (60%) of the market, and has a market capitalization north of \$1.5 Billion. Nine million people have access through the online tool through 650 plan sponsor plans. Last month they announced plans to offer about half of those people access to advisors via telephone, webcam, or chat.

<http://wsj.com/articles/financial-engines-to-offer-free-access-to-advisers-1443006001>

“They’re the only survivor of that big push 10 or more years ago to get in and do this online advice. What Financial Engines is doing now and the reason they’ve survived is because they switched the focus to asset management. They’ve got online advice that people can take advantage of, but it’s the professional management product that is really growing for them.”

Rick Meigs of 401khelpcenter.com LLC

<http://www.riabiz.com/a/25271003/financial-engines-more-than-doubles-its-share-price-by-defining-a-niche-in-the-401k-market-between-target-date-funds-and-riabiz>

History and Notable Firms

Other established competitors include **Morningstar, GuidedChoice, & Promanage.** Morningstar Associates acquired **mPower** in 2003, which was one of the initial players (with FNGN, while **directadvice.com** did not survive despite \$16M VC) Morningstar unit had more than 900,000 participants in its managed-accounts program at the end of June 2013, up from about 820,000 at the end of 2012,

<http://www.riabiz.com/a/25271003/financial-engines-more-than-doubles-its-share-price-by-defining-a-niche-in-the-401k-market-between-target-date-funds-and-rias>

BusinessInsider researched the derivation of the term Robo Advisor and found published a **March 2002** article in "Financial Planning" magazine, titled "Robo-Adviser" a Richard Koreto which discussed the use of software and the Internet in the management of 401(k) plans (citing mPower and Financial Engines)

<http://www.businessinsider.com/where-robo-advisor-started-2014-9>

Bill Winterberg started using the term regularly in **2012**

<http://fppad.com/2012/01/31/robo-advisers-are-here-what-you-need-to-do-to-adapt>

Notable Firms

There are many firms sometimes classified along with Robos that are using different approaches.

Foliofn (started in 2000 as FolioInvesting.com) is a brokerage firm that allows you to build portfolios.

Motif Investing allows you to build thematic portfolios of up to 30 stocks based on a style or theme.

Robinhood is a zero commission broker.

Acorns is an app that allows you to round up purchases and invest the small amounts in diversified portfolios. They have raised over \$30 million in venture capital funding (\$23m in April). They have over 650,000 members.

Links at <http://www.investorhome.com/robos.htm>
(including an increasing number outside the US)

Notable Firms

Wealthfront and Betterment both have over \$2.6 billion in assets under management and both have each raised over \$100 million in venture capital funding. (Wealthfront was valued at \$700 million in October 2014, and Betterment at \$400-\$500 million in February 2015) according to MFWire.

<http://www.mfwire.com/article.asp?storyID=52266&bhcp=1>

FutureAdvisor was recently acquired by Blackrock. It had approximately \$600,00,000 in assets under management bat the time, and apparently sold for approximately \$152 million.

Betterment offers a service to advisors through various venues, but **Wealthfront** says it has no plans to diversify into a business-to-business model and does not an intermediary between clients.

http://www.financial-planning.com/news/reinvent_wealth/wealthfront-commits-to-millennials-passes-on-401ks-2694277-1.html

Desperation, Misinformation, etc.

Things are continuing to heat up, with tempers flaring and giants entering, causing the celebrity venture-capital funded upstarts of Wealthfront and Betterment to start feuding. Such fallout could cost them their remaining goodwill as pioneers and industry disruptors. **Here we have Wealthfront on the attack, a PR gambit that smacks of desperation. And when given a chance to take a higher road, Betterment also chooses to roll in the mud.** Wealthfront used to be called KaChing, of all things.

http://financialadvisoriq.com/c/1177153/128283/betterfront_proposal_more_competitive_robo_advisor

A recent article written by a LinkedIn employee (published on LinkedIn, of course) claimed Wealthfront is the only robo advisor worthy of an investor's money. He called Betterment's service "horrendous" and concludes, "there is absolutely no reason to utilize Betterment." The article made waves on social media and ignited debates between fans of both companies. Jackson Moses, the executive recruiting associate at LinkedIn who authored the anti-Betterment rant, eventually deleted the article from the "professional social network."

<http://wealthmanagement.com/blog/robo-fanboy-wars-are-here>

I spit up my coffee reading this. So much misinformation about @Betterment in here.

Bill WinterbergCFP®

<https://twitter.com/economix101/status/649242769458749440>

Notable Firms

SigFig claims to “oversee” \$350 billion, but assets under management are only \$70 million.

<http://www.riabiz.com/a/4993216319324160/an-insider-reveals-turbo-contents-of-the-invest-conference-in-new-york-a-summit-of-vcs-robo-founders-and-big-banks>

Hedgeable claims \$474 billion in “assets under advisement” (7/31/14), but only manages \$35 million (7/31/2015)

<https://www.hedgeable.com/legal/formadv.pdf>

Marketriders claims thousands of subscribers have used their online portfolio management service to build over 15,000 portfolios valued at over \$5 billion, but only has \$6 million in discretionary assets under management.

<http://www.marketriders.com/pricing>

Notable Firms

Charles Schwab launched their “free” Intelligent Portfolios on 3/9/2015 and reportedly has over \$3 billion in assets and more than 39,000 accounts. Some have criticized the offering for its arguably high cash allocations in the portfolios.

http://financialadvisoriq.com/c/1159843/125543/vanguard_robosurge_threat_others

“The notion of a fully automated advisory service with no human interaction or support might work for “a very small percentage of people ... Think of what a quality investment advisor or counselor does for someone,” he says. “It’s a whole pyramid of services. They might start with trust development or credibility development, and then they go to goal planning for that individual, risk evaluation. Then they get into portfolio construction. Then they do rebalancing. Then they do ongoing goal planning and risk adjusting. And maybe the most important thing they do is they play psychiatrist when the market’s going down.”

<http://www.financial-planning.com/news/technology/robos-no-substitute-for-the-genuine-article-schwab-ceo-2692824-1.html>

Robos No Substitute for the Genuine Article: Schwab CEO (Walter Bettinger)

Man and Machines: New Charles Schwab Study Examines How Different Generations Approach the Use of Technology: Study finds no link between age and affinity for technology; People still need people, across the generations (5/12/2015) (>1,800 affluent consumers across four generations)

When asked to choose between relying on a financial advisor and a computer algorithm for managing their portfolios, two-thirds (66%) of all respondents say they still prefer the human touch, and Gen-Xers are just as likely as Millennials to prefer a portfolio based on a computer algorithm (40% versus only 30% of Boomers and 24% of Matures).

Technology is the preferred mode for transactions like booking a flight (96%), getting directions (95%), researching a new car (91%), and planning a vacation (90%), respondents feel differently when it comes to more private matters. Across the generations, the vast majority say they prefer to interact in person when dealing with a health issue (80%) or finding a date (68%).

<http://pressroom.aboutschwab.com/press-release/schwab-investor-services-news/man-and-machines-new-charles-schwab-study-examines-how-d>

Notable Firms

Fidelity is rumored to be thinking about their own direct robo service, but they have partnerships with Betterment and Learnvest and manage a huge amount in a comparable product line.

TD Ameritrade is working with Jemstep, NestEgg Wealth, Trizic, and Upside Advisor, but plans on launching their own robo offering.

<http://www.financial-planning.com/blogs/td-ameritrade-to-join-robo-race-2693181-1.html>

“We don’t want to pick a single horse in this race ... We want to be the stable.”

Tom Nally, President of TD Ameritrade Institutional

<http://www.technologytoolsfortoday.com/blog/td-ameritrade-s-tom-nally-discusses-robo-tech-t3-s-joel-bruckenstein>

LPL (acquired Nestwise, previously Veritat) then killed it in 2013. Recently they announced new robo plans?

http://www.financial-planning.com/news/reinvent_wealth/strategic-shift-for-lpl-robo-program-plus-price-cuts-2693654-1.html

<http://thetrustadvisor.com/news/the-independent-empire-strikes-back-giant-lpl-moves-800-lb-gorilla-into-the-robo-advisor-sphere>

Firms to keep an eye on

Merrill Lynch One was released two years ago to replace five aging Merrill Lynch brokerage platforms with disparate fees and enrollment processes, has attracted \$400 billion to date ... gaining nearly \$7 billion a week in new and existing accounts, and 98% of Merrill's own advisors have some money on the platform

Merrill Lynch to Clients: Join "One" or Pay Commissions: Memo (6/19/2015)

http://financialadvisoriq.com/c/1141493/122703/merrill_lynch_clients_join_commissions_memo

Wells Fargo's executives said the firm was considering developing robo advisor technology and may work with FNGN.

http://www.financial-planning.com/news/reinvent_wealth/robos-could-see-a-new-player-wells-fargo-2693521-1.html

<http://www.riabiz.com/a/5033842482085888/what-exactly-to-make-of-the-big-robo-advice-deal-that-according-to-reuters-financial-engines-and-wells-fargo-are-nearing>

Only about one in five affluent clients say they are familiar with the new technology, according to a recent Wells Fargo survey of clients who had \$250,000 or more in investable assets. Of those who have heard of robo advisors, one-third has already used one. And, not surprisingly, there is a big generational gap in attitudes toward the new technology, with 71% of clients in their 30s saying they would use a robo in the next five years compared with 27% of clients over age 60 who said the same.

"Your Clients Haven't Even Heard of Robo Advisors... Yet"

<http://www.financial-planning.com/news/technology/your-clients-havent-even-heard-of-robo-advisors226128166-yet-2693523-1.html>

Notable Firms

Vanguard offers what it calls a hybrid “**Personal Advisor Services**” starting at a cost of .30% per year, including access to an advisor. It reportedly already has over \$21 billion in assets. They raised \$4 billion in the second quarter, \$7 billion was new assets raised during the two year pilot phase, and they also transitioned clients from their existing wealth management, trust and estate planning services, Asset Management Services, over to Personal Advisor.

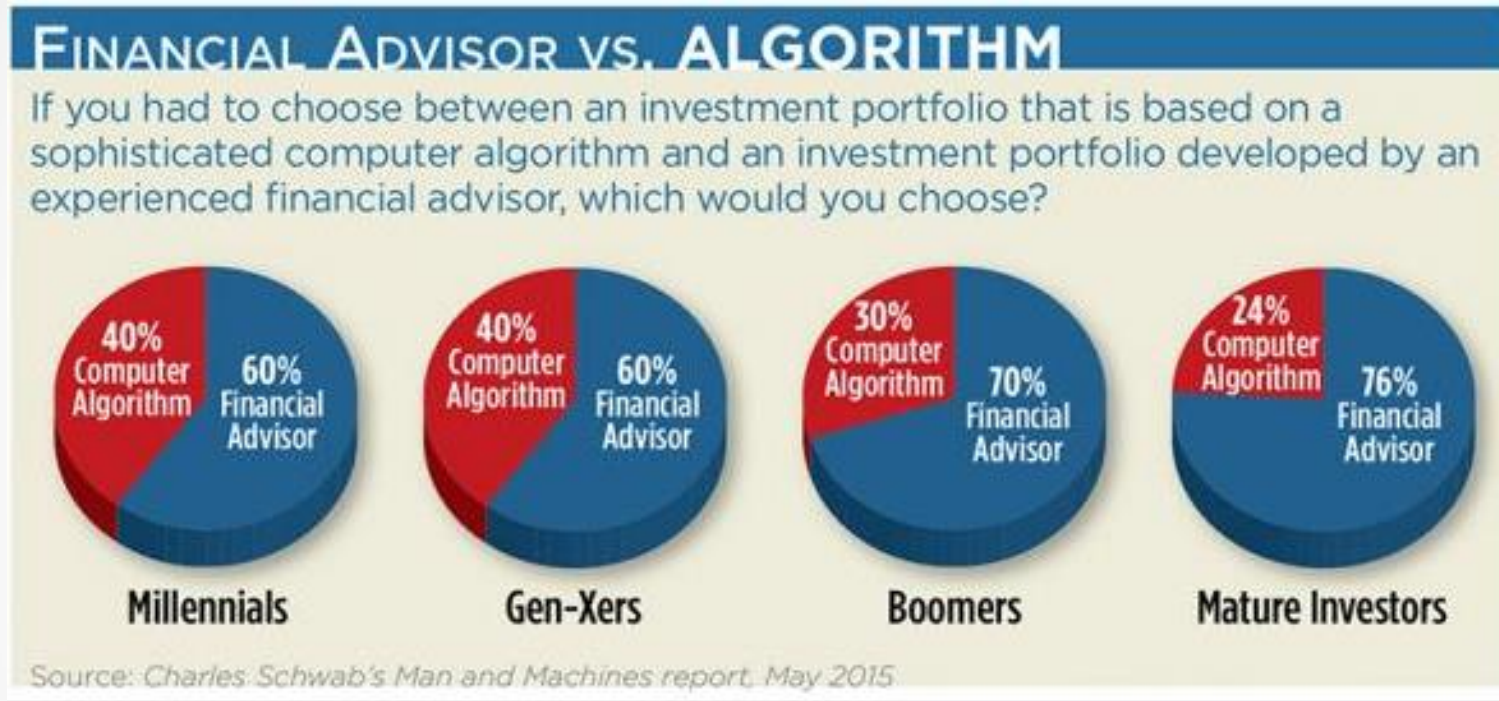
<http://www.riabiz.com/a/4933584188080128/vanguards-white-hot-hybrid-robo-just-added-4-billion-in-three-months---a-heat-that-may-cast-a-chill-on-pure-robos>

They formally launched the service in May and they lowered the minimum investment to \$50,000.

See <http://wealthmanagement.com/technology/vanguard-cuts-account-minimums-robo-service-half>
Vanguard Cuts Account Minimums For Robo Service In Half (5/5/2015)

Target date mutual funds (and some balanced and global asset allocation funds) are comparable to some Robo services, but in a different format.

Human vs. Robot



<http://wealthmanagement.com/blog/investors-still-prefer-human-advisors-over-computers>

Investors Still Prefer Human Advisors Over Computers (5/12/2015)

In the next five year robo-advisors are projected to manage \$255 billion worldwide ... Traditional advisors still control around \$5 trillion in the US alone.

<http://www.businessinsider.com/robo-advisors-manage-billions-2014-9>

Robo influence on Traditional Advisors

Betterment and Personal Capital and Wealthfront, they're all going to become like Vanguard. And traditional advisors like us who are human-based, are going to have to become like Vanguard. And everyone's going to meet in the middle, in this bionic, hybrid solution which is humans and computers, working together. It's inescapable.

I really think [BlackRock's acquisition of San Francisco-based robo FutureAdvisor] was a questionable one.

If all you're doing is wrapping a set of mutual funds and charging 1%, you do not have a business five years from now. You simply won't. But that's the overwhelming majority of the industry. I welcome this, because it ensures that consumers will actually get what they pay for. The reality is most consumers are paying 1% for absolute garbage, for something that they could do for free with Schwab, right now, with something at least as good, which is passive index investing.

This is what happens unfortunately in most of the industry. They are marketing like Nordstrom, but they are selling Wal-Mart.

Joe Duran United Capital

http://www.financial-planning.com/news/reinvent_wealth/robos-wont-uberize-wealth-management-says-united-capital-ceo-2694234-1.html

Do Robos threaten brokers and RIAs?

Of 650 U.S. and Canadian practitioners recently surveyed by consulting firm Accenture, just 19% said robos pose a serious threat, and more than 40% perceive no threat at all. To the contrary, some advisors plan to integrate robo-advisors into their own businesses, in part as an inexpensive way to serve the Henrys who might later become full-service clients.

"Robo-advisors can't hold a client's hand during turbulent markets, after all, and they can't help with many of the complex needs of greater wealth."

"I believe robo-advisors will set a benchmark for the value of commoditized services in the investment business," [Steve] Lockshin says. Translation: Advisors who charge three times more than robos for essentially the same services will be forced to lower prices or deliver more services.

<http://online.barrons.com/articles/financial-advisors-now-face-robo-rivals-but-the-humans-arent-fretting-1429318843>
When Financial Advisors Meet Their Robo-Rivals (4/18/2015)

As online advice firms mimic each other, they will come under pressure to differentiate themselves with more services and lower costs

"Eventually the products will all be free and all offer the same thing," said Mike Kane, chief executive of Hedgeable, also a robo-adviser offering.

<http://www.investmentnews.com/article/20150406/FREE/150409948/the-commoditization-of-the-robo-adviser>
The commoditization of the robo adviser (4/6/2015)

Human vs. Robot

“Depending on which article you read, if you are a financial advisor either the robots will crush you — like a Bradley fighting vehicle rolling over a walnut — or you have no more to fear from them than a five-star restaurant has to fear from McDonalds. Both views are wrong. “

Scott MacKillop "No, Robo-Advisors Won't Crush You Like a Bug" (5/28/2015)
http://financialadvisoriq.com/c/1126573/120523/robo_advisors_crush_like

The truth is that the convergence of these robo- and non-robo groups is well underway. Classic RIAs, with the help of their RIA custodians and technology vendors, are rapidly automating their practices in ways unthinkable 10 years ago.

<http://www.riabiz.com/a/4939998704959488/why-i-find-the-term-robo-advisor-objectionable-and-unhelpful>

Clients Lost to Robo Advisors	Length of Service		
	<5	5 to 14	15+
Yes, larger client(s)	2.5%	0.6%	0.4%
Yes, smaller client(s)	5.0%	3.2%	3.1%
No	78.8%	87.2%	88.8%
Unsure	13.8%	9.0%	7.8%

***Oechsli Institute Q1 2015 Elite Advisor Research**

<http://wealthmanagement.com/elite-advisor/fact-new-advisors-lose-more-clients-robo-advisors>

Human vs. Robot

Nearly two in three investors say they prefer to get financial advice from both sources, including 39% who want advice to come mostly from advisers and 26% who want it to come mostly from digital tools. A combined 62% prefer getting financial advice exclusively (23%) or mostly (39%) from a personal financial adviser, whereas a combined 35% prefer mostly (26%) or exclusively (9%) digital advice. Also, when asked to choose between three sources of advice, 50% opt for a strong relationship with a financial adviser, 24% for access to state-of-the-art online or digital investing tools, and 19% for access to on-call financial advisers.

U.S. Investors Prefer Mix of Human, Digital Financial Advice (Gallup 6/29/2015)

<http://www.gallup.com/poll/183815/investors-prefer-mix-human-digital-financial-advice.aspx>

As for robo advisors, aka automated investment management, Beatty said the phenomenon was more of an opportunity than a threat. Some advisors will employ robo technology to gather new clients with smaller assets and be able to service them profitably, he says. Other firms will use the new technology to open up their practice to mass affluent clients who may start with mostly automated investment management and light human advice, but hopefully graduate to a more full service offering. Most advisors, Beatty maintains, "don't feel threatened" by robo advisors as competition.

<http://www.financial-planning.com/news/ria/ria-profits-revenues-hit-record-highs-schwab-study-2693573-1.html>

Kitces made it clear that he thinks a robo-advisor can basically be defined as **rebalancing and on-boarding software.**

Michael Kitces Trades Jobs With Leading Robo-Advisor

<http://www.fa-mag.com/news/the-great-robo-advisor-debate-23238.html> (9/28/2015)

The Good

“There will be a lot of casualties of both advisory firms and robo-adviser platforms in the next few years, but **the ultimate winner in this contest is clear: It is the consumer**, who will wind up with improved access to superior financial advice at a lower cost, and who is likely to start planning and managing his or her finances earlier in life as a result.“ Financial planning is all about the people — the emotions they feel, the desires they have, the fears they face, and the situations in life that are, mostly, unique to them.

Chuck Jaffe (4/22/2015) in Here’s who wins the battle between human and ‘robo’ advisers

<http://www.marketwatch.com/story/heres-who-wins-the-battle-between-human-and-robo-advisers-2015-04-21>

Meb Faber back testing (from 1972) Schwab, Wealthfront, and Betterment and found nearly identical returns

<http://mebfaber.com/2015/04/24/schwab-vs-wealthfront-vs-betterment/> Schwab vs. WealthFront vs. Betterment" (4/24/2015)

"The emergence of the roboadvisors and low cost cyberadvisors (advisor powered automated solutions like Vanguard) are a huge positive for investors and advisors alike.“

Meb Faber in What a Great Time To Be An Investor! (3/25/2015)

<http://mebfaber.com/2015/03/10/what-a-great-time-to-be-an-investor/>

Are the stand-alone Robos long-term threats? The (UGLY?) long-term profitability projections

We Believe Wealth Management Moats Can Repel the Fiber-Clad Legions. **We believe robo-advisory firms will have to eat through all of the capital they raised in order to reach a profitable scale.** Additionally, our view is that the cost advantage, intangible asset, and switching cost moat sources of the full-service wealth managers and investment service firms will protect their assets and clients from hungry robo-advisors. In fact, we find it highly unlikely that standalone robo-advisors will ever be able to match Schwab's industry-leading scale efficiencies, and that Schwab Intelligent Portfolios is best-positioned to capture any economic rents from robo-advisory.

Hungry Robo-Advisors Are Eyeing Wealth Management Assets

<http://fsc.org.nz/site/fsc/files/FAAR%202015/Morningstar%20%20Hungry%20Robo-Advisors%20Are%20Eyeing%20Wealth%20Management%20Assets%20We....pdf>

"We see the economics of the stand-alone robo-advisors such as Betterment and Wealthfront as challenging, and believe that few will be materially profitable and still standing several years down the road."

Brad Matthews is CEO of Trizic

<http://www.financial-planning.com/blogs/todays-robo-advisors-will-be-tomorrows-failures-2693614-1.html>

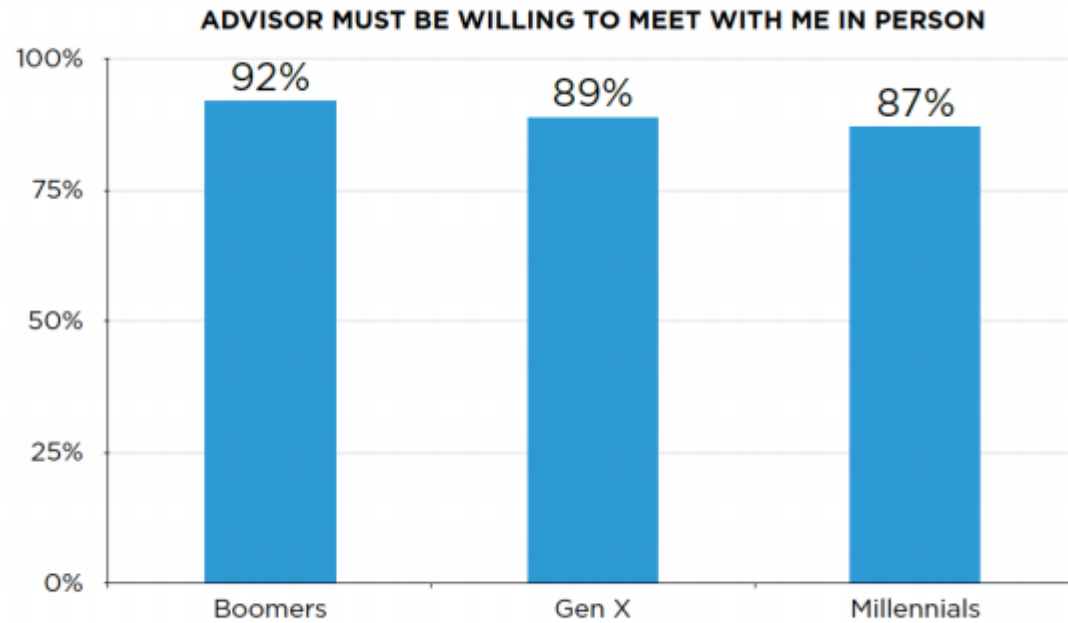
Cerulli estimates the robo-advisors (which it calls eRIAs in the study) need to grow 50 to 60 percent annually for six years in order to satisfy their investors. In the most optimistic scenarios, it would be 40 percent annually for seven years, while the most pessimistic scenarios require them to grow as much as 85 percent per year over the next five years. And these estimates are only for a strong market. Cerulli said a bear market would threaten a robo's ability to retain clients and increase the possibility of missing investor expectations. Cerulli suggests that in order to survive, robos need to focus on a business-to-business model, like Betterment has done with Betterment Institutional, a partnership with Fidelity's RIA business, and the recently announced 401(k) business. Two areas that would be a natural fit for robos are banks, which have access to thousands of mass affluent customers, and RIAs looking for a technology solution to service their established client bases.

"Ultimately, the eRIA services need to prove themselves as a business model and not a technology offering," Pickering said. "By collaborating with banks and small RIA firms, eRIAs should be able to tap the third-party vendors marketplace and become contenders."

Sep 16, 2015 Ryan W. Neal Robos Need Extended, Explosive Growth to Survive

<http://wealthmanagement.com/technology/robos-need-extended-explosive-growth-survive>

Are the stand-alone Robos long-term threats?



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<http://myirionline.org/docs/default-source/research/iri-cgk-study---millennial-retirement-research---digital.pdf>

September 2015

Despite millennials love for all things digital, a new study reports that they want to meet face-to-face with their financial advisor. The study, by the Insured Retirement Institute (IRI) and the Center for Generational Kinetics, **Conversely, only 19 percent of millennials said they were willing to use a robo-advisor.**

<http://insurancenewsnet.com/inarticle/2015/09/28/millennials-crave-face-to-face-financial-advice.html>

Are Robos right for you?

What kinds of investors might benefit most from a robo-adviser. You might if:

- You don't have complicated finances.
- You're comfortable banking online.
- You don't like to meddle.
- You got through 2008-09 without panicking.
- Other advisers don't want you.

A secret-shopper study of 300 financial professionals by the National Bureau of Economic Research found that when shoppers walked in with efficient, low-cost, passively managed portfolios, 85 percent of the time the financial adviser tried to talk them out of it, often recommending higher-cost investments instead. Your human adviser is supposedly obligated to be a fiduciary who puts your financial interests first.

Target-date or age-based funds effectively do the same thing, albeit at varying degrees of success and cost. They're available in retirement plans and in IRAs through discount brokerages.

Robo-advisers might cut down on some mistakes. They might enhance risk-adjusted return. But they can't, so far, identify the mistakes you make outside of your investments. You still need family, friends, a fiduciary adviser or a personal robot for that.

Five things to consider before hiring a robo-adviser By Brent Hunsberger
http://www.oregonlive.com/finance/index.ssf/2015/04/five_things_to_consider_before.html

Are Robos right for you?

The upside of robo-advisors:

They're convenient. Changes can be made 24/7, and no appointment is necessary.

They're economical. Robo-advisors are less expensive than human advisors, and they generally don't require a minimum value of investments.

They're efficient.

But

They don't offer personalized advice.

They don't talk through options and scenarios with investors with questions.

They don't take into account life changes.

<https://www.hartfordfunds.com/blog/2015/2015-march/the-pros-and-cons-of-online-financial-services.html>

The Pros of Robo-Advisors

Professional investment advice at a much lower cost

More diversification

Protection from emotional investing mistakes

The Cons of Robo-Advisors

The might not consider your outside accounts

You can't choose or edit particular investment suggestions

They don't offer financial advice other than investing

<http://lifehacker.com/should-i-let-a-robo-advisor-manage-my-investments-or-do-1701366242>

Are Robos right for you?

Who should use a robo advisor?

If you are in the wealth accumulation phase of your life, are focused on other personal endeavors, and just want to buy a basket of stocks and bonds.

Who should not use a robo advisor?

If you are concerned about managing downside risk in your portfolio through active asset allocation changes or stop losses, then you should not use a robo advisor.

If you require regular servicing of your account through cash management needs, investment questions, financial planning, or other general updates, then you should not use a robo advisor.

If you want to customize your investment objectives to meet your goals with respect to growth or income, then you should not use a robo advisor.

If you want to comingle multiple security styles such as mutual funds, ETFs, individual stocks, or closed-end funds, then you should not use a robo advisor.

If you enjoy a hands on approach that allows you flexibility to suggest changes or work together with your advisor, then you should not use a robo advisor.

The Bottom Line

Robo advisors are fantastic solutions for investors that desire a passive portfolio approach with proven tools for very little (if any) cost. I think they definitely bridge the gap between overpriced “buy-and-hold advisors” and the throw caution to the wind “do-it-yourself” crowd.

<http://fmdcapital.com/when-you-should-and-shouldnt-use-a-robo-advisor/>

Are Robos right for you?

Most People in the World Have No Idea How to Manage Their Money

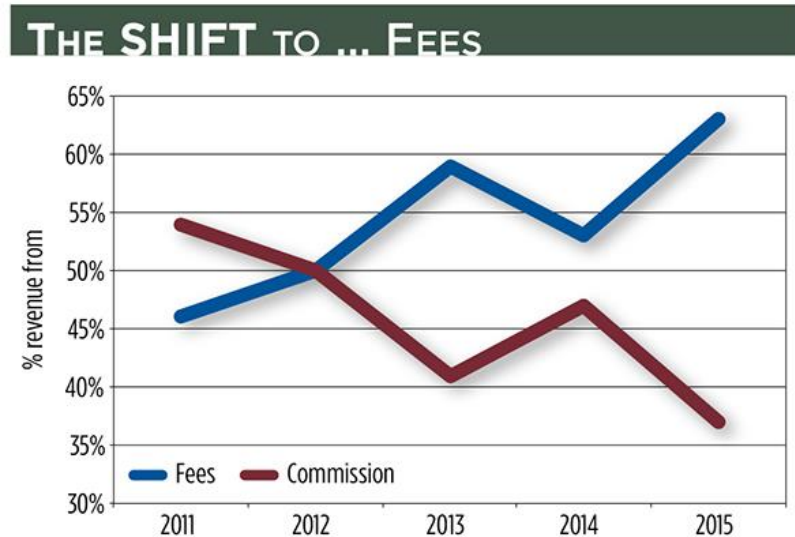
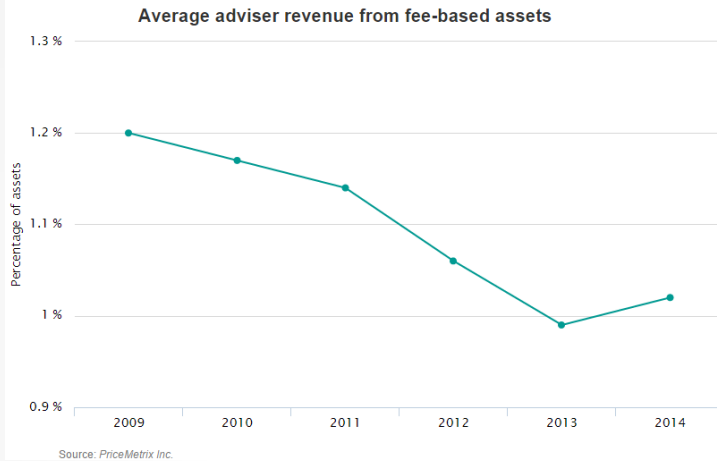
Asked to rank their financial knowledge on a scale of 1 (very low) to 7 (very high), 70 percent of the Americans surveyed by Lusardi and Mitchell ranked themselves at level 4 or higher. Yet only 30 percent of them got all three questions in the finance quiz right. The same pattern was apparent in Germany and the Netherlands. The research also found that women, the poor, and the elderly are the groups with the lowest levels of financial literacy.

1. Suppose you had \$100 in a savings account and the interest rate was 2 percent per year. After five years, how much do you think you would have in the account if you left the money to grow? A) more than \$102; B) exactly \$102; C) less than \$102; D) do not know; refuse to answer.
2. Imagine that the interest rate on your savings account is 1 percent per year and inflation is 2 percent per year. After one year, would you be able to buy A) more than, B) exactly the same as, or C) less than today with the money in this account?; D) do not know; refuse to answer.
3. Do you think that the following statement is true or false? "Buying a single company stock usually provides a safer return than a stock mutual fund." A) true; B) false; C) do not know; refuse to answer.

Answers at

<http://www.theatlantic.com/international/archive/2014/05/the-danger-of-financial-ignorance-do-you-understand-money/361851/>

Are Robos right for you?



<http://www.investmentnews.com/article/20150330/FREE/150339996/advisory-fees-rise-above-1-after-bottoming-in-2013>
Advisory fees rise above 1% after bottoming in 2013 (left graphic)

<http://wealthmanagement.com/2015-compensation-survey/compensation-survey-2015-slowly-disappearing-commission?page=2>
Compensation Survey 2015: The Slowly Disappearing Commission (right graphic)

Report shows reversal of long downward trend in conjunction with increasing asset levels (3/30/2015)
Advisers charged an average of 1.02% on client assets in 2014, compared with 0.99% the previous year.

The Fiduciary Standard Debate

On January 22, 2010 the SEC issued its report in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The SEC's mandate was to resolve differences between the suitability standard that Stockbrokers (aka Registered Representatives) are held to and the fiduciary standard that Registered Investment Advisors (RIAs) are held to.

[Investor Knowledge and Experience with Investment Advisers and Broker-Dealers](#)

Hung (RAND), Clancy (RAND), and Jeff Dominitz (Carnegie Mellon) (11/11/2010)

The financial services industry has been changing so fast and growing so complex that broker-dealers and investment advisers, which are subject to different regulations, are no longer easy to distinguish from one another.

Typical investors are confused about what services different financial professionals offer.

Many investors do not understand the key distinctions between advisers and brokers (titles, fees, services).

Many respondents did not understand the term fiduciary and whether fiduciary was a higher standard than suitability.

Even though they sought to explain fiduciary duty and suitability in plain language, respondents struggled to understand the differences between the standards of care. Even after explaining that a fiduciary duty is generally a higher standard of care, focus-group participants expressed doubt that the standards are different in practice.

[A 2006 study](#) by [TD Ameritrade](#) revealed that 74% of investors did not understand the different obligations required of RIAs and stockbrokers. Unlike stockbrokers, RIAs have an obligation to act in the investor's best interests in all aspects of the financial relationship. After learning about the differences between a brokerage account and an advisory account, 79% of investors said they would be less likely to go to a brokerage firm for financial advice.

Fiduciary Debate

"while brokerage firms advertise as though they are trusted guardians of their clients' best interests, they arbitrate any resulting disputes as though they are used care salesmen. A review by the Public Investors Arbitration Bar Association (PIABA) of the advertising and arbitration stances of nine major brokerage firms – Merrill Lynch, Fidelity Investments, Ameriprise, Wells Fargo, Morgan Stanley, Allstate Financial, UBS, Berthel Fisher, and Charles Schwab – finds **that all nine advertise in a fashion that is designed to lull investors into the belief that they are being offered the services of a fiduciary.**"

BROKERAGE INDUSTRY ADVERTISING CREATES THE ILLUSION OF A FIDUCIARY DUTY
Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard

By: Joseph C. Peiffer and Christine Lazaro (3/25/2015)

<https://piaba.org/system/files/pdfs/PIABA%20Conflicted%20Advice%20Report.pdf>

"purpose of self-regulation is not to determine, 'What can I get away with under the law?'"

Marianne M. Jennings in "Investment Professionals and Fiduciary Duties" (9/1/2014)

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2571406

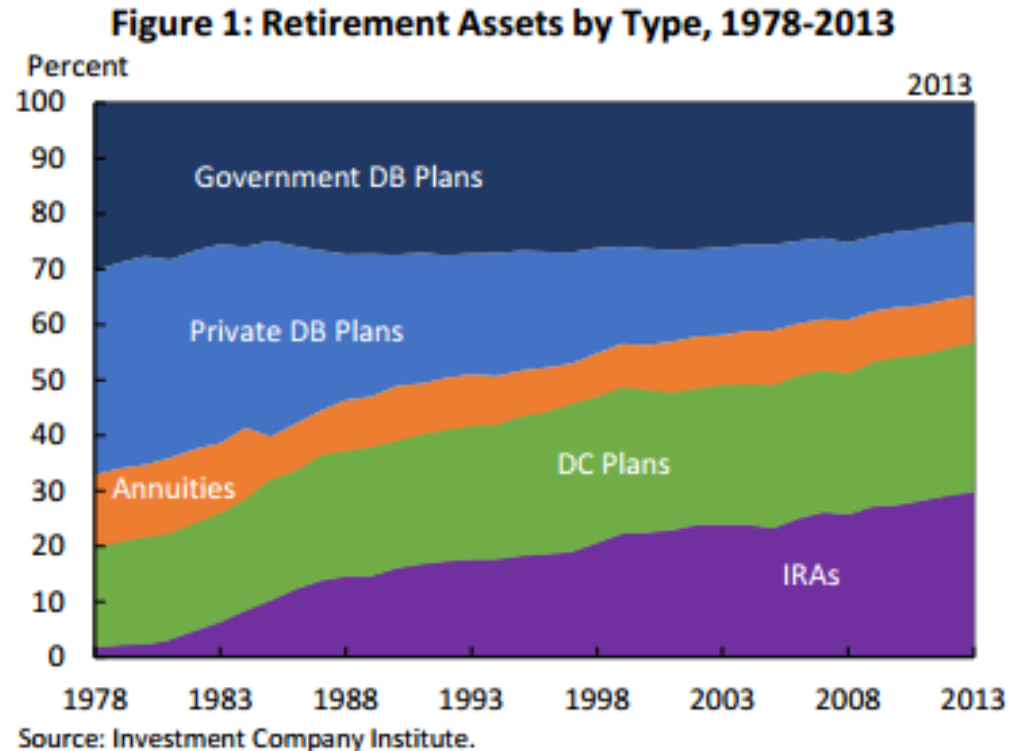
The Department of Labor's new proposed fiduciary rule for advisors to retirement accounts could impact LPL Financial's gross profit by 2 percent ... The firm began the shift to fees two decades ago, and launched its hybrid RIA platform in 2008. Now, 90 percent of the firm's advisors are licensed to provide advisory and brokerage services to their clients. In 2014, 62 percent of gross asset sales were advisory, up from 45 percent five years ago.

<http://wealthmanagement.com/legal/lpl-dol-rule-could-cut-gross-profit-2-percent> ;

LPL: DOL Rule Could Cut Gross Profit by 2 Percent 4/30/2015

Fiduciary Debate

The Labor Department has been holding hearings after it unveiled details of its own proposed rule that would impose a fiduciary standard on thousands of brokers and advisors providing retirement investment advice. See <http://www.dol.gov/ebsa/regs/conflictsofinterest.html>



This followed a White House report in February 2015 titled THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf

Fiduciary Debate

Some argue against a harmonized fiduciary standard because it could be costly to smaller investors. Some like Doug Black have argued that robo-advisors take the air out of that argument

<http://www.wsj.com/video/big-players-impact-on-the-robo-advisory-arena/DCF4B40-1CD6-4FD8-AA29-77D12DB32678.html>

Others disagree and Melanie Fein has even argued this week, that Robo-Advisors do not provide personalized investment advice because their questionnaires do not elicit all relevant information and may ignore key facts. She points out that Robo Advisor agreements provide that the client is responsible for ensuring that the robo advisor's recommendations are in the client's best interests.

<http://www.financial-planning.com/blogs/idea-exchange/how-robos-fall-short-of-fiduciary-law-2694407-1.html>

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2658701

Robo concerns

Investor Alert: Automated Investment Tools (May 8, 2015)

The SEC's Office of Investor Education and Advocacy (OIEA) and the Financial Industry Regulatory Authority, Inc. (FINRA) are issuing this alert to provide investors with a general overview of automated investment tools.

While automated investment tools may offer clear benefits—including low cost, ease of use, and broad access—it is important to understand their risks and limitations before using them. Investors should be wary of tools that promise better portfolio performance.

1. Understand any terms and conditions.

2. Consider the tool's limitations, including any key assumptions.

Be aware that an automated tool may rely on assumptions that could be incorrect or do not apply to your individual situation. ... In addition, an automated investment tool, like other investment programs, may be programmed to consider limited options. For example, an automated investment tool may only consider investments offered by an affiliated firm.

3. Recognize that the automated tool's output directly depends on what information it seeks from you and what information you provide.

Which questions the tool asks and how they are framed may limit or influence the information you provide, which in turn directly impacts the output that an automated investment tool generates. ... Be aware that a tool may ask questions that are over-generalized, ambiguous, misleading, or designed to fit you into the tool's predetermined options. In addition, be very careful when inputting your answers or information. If you make a mistake, the resulting output may not be right for you.

4. Be aware that an automated tool's output may not be right for your financial needs or goals.

An automated investment tool may not assess all of your particular circumstances, such as your age, financial situation and needs, investment experience, other holdings, tax situation, willingness to risk losing your investment money for potentially higher investment returns, time horizon for investing, need for cash, and investment goals. Consequently, some tools may suggest investments (including asset-allocation models) that may not be right for you. For example, an automated investment tool may estimate a time horizon for your investments based only on your age, but not take into account that you need some of your investment money back in a few years to buy a new home. In addition, automated tools typically do not take into account that your financial goals may change. **If the automated investment tool does not allow you to interact with an actual person, consider that you may lose the value that human judgment and oversight, or more personalized service, may add to the process.**

5. Safeguard your personal information.

<http://www.sec.gov/oiea/investor-alerts-bulletins/autolistingtoolshtm.html>

Robo concerns

SOME QUESTIONS THE ROBOS ASK

Robo-adviser services typically use online questionnaires to gauge users' risk tolerance. Here's a sampling of their questions.

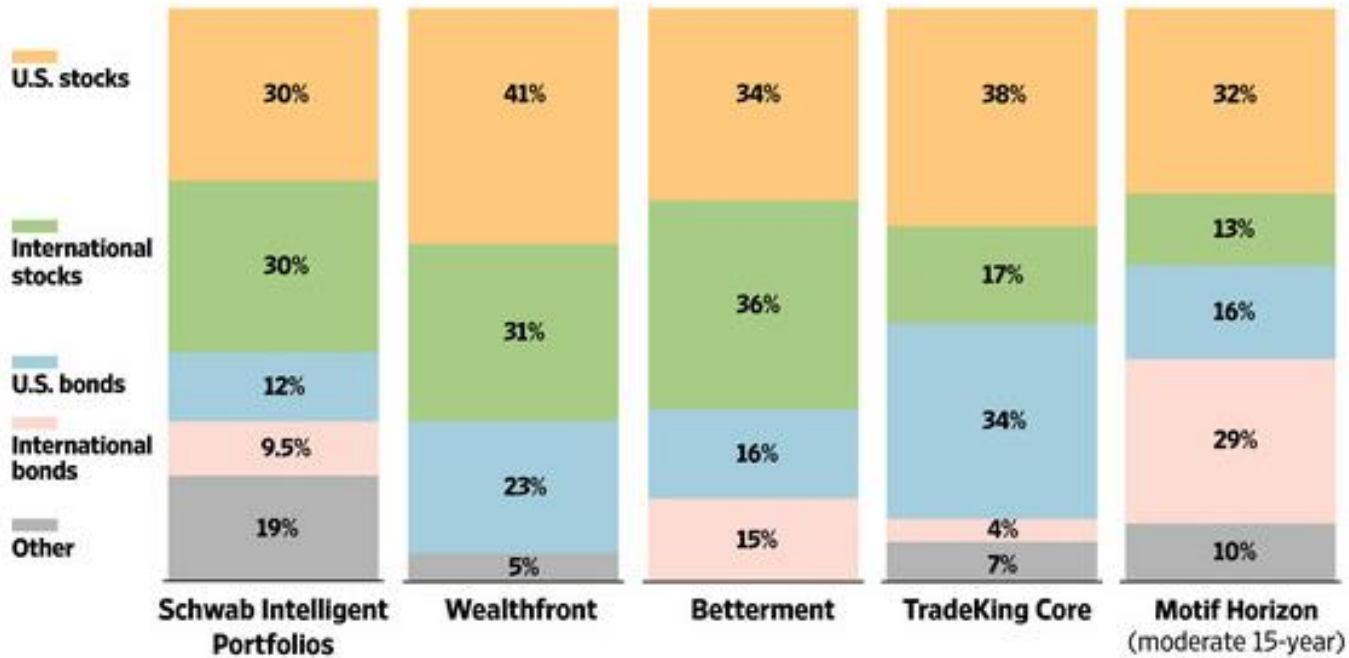
- **“The global stock market is often volatile. If your entire investment portfolio lost 10% of its value in a month during a market decline, what would you do?”** Possible answers: sell all of your investments; sell some; keep all; buy more. ([Wealthfront](#))
- **“When it comes to making important financial decisions...”** Possible answers: I try to avoid making decisions; I reluctantly make decisions; I confidently make decisions and don't look back. ([Charles Schwab](#))
- **“If a family member or friend who knows you well were to describe you, they would generally say you are...”** Possible answers: cautious by nature; a risk taker; somewhere in between cautious and a risk taker. ([Hedgeable](#))
- **“How do you feel about this statement: ‘I'm comfortable with investments that may experience frequent, large declines in market value if there is a potential for higher returns.’ ”** Possible answers: strongly disagree; disagree; somewhat agree; agree; strongly agree ([TradeKing Advisors](#))

<http://www.wsj.com/articles/putting- robo- advisers- to- the- test- 1429887456> |

Robo concerns

Different Strokes For the Same Folks

With robo-adviser services, investors can get diversified, low-cost portfolios, most commonly made up of exchange-traded funds. But the suggested holdings can vary significantly among the firms. Here are asset-class mixes recommended by five firms for an investor with a moderate risk profile.



Note: For a full list of each firm's recommended exchange-traded funds, look for the related story at blogs.wsj.com/totalreturn/.

Source: the companies

THE WALL STREET JOURNAL.

<http://blogs.wsj.com/totalreturn/2015/04/24/five-robo-advisers-five-very-different-portfolios/>

See also <http://www.marketwatch.com/story/we-asked-4-robo-advisers-4-human-advisers-for-portfolios-for-the-same-investor-2015-04-21>

Robo concerns

The woman was sleeping on the floor of her home when the robotic cleaner ingested her hair leaving her in agony



📷 Firefighters try to rescue a woman at her house in Changwon, southeast South Korea after her hair was sucked into a robot vacuum cleaner. She lost about 10 strands of hair but was not injured. Photograph: Yonhap/AAPIMAGE

<http://www.theguardian.com/world/2015/feb/09/south-korean-womans-hair-eaten-by-robot-vacuum-cleaner-as-she-slept>

Investor Mistakes & the Behavioral Gap

Some believe the primary value add of Robo Advisors is to help investors avoid the behavioral gap. Shortly prior to the initial robo-advisor creation, in the fall of 1995, Stephen Nesbitt published “Buy High, Sell Low: Timing Errors in Mutual Fund Allocations” in *The Journal of Portfolio Management*. Nesbitt found that timing costs investors 1% per year. Since then there has been a steady stream of evidence that most investors consistently underperform.

In April 2000, Brad Barber and Terrance Odean published “Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors” in the *Journal of Finance*. They got ahold of data for “66,465 households with accounts at a large discount broker during 1991 to 1996” and found “those that trade most earn an annual return of 11.4 percent, while the market returns 17.9 percent. The average household earns an annual return of 16.4 percent.”

In March 2007 Ilia Dichev published “What Are Stock Investors' Actual Historical Returns? Evidence from Dollar-Weighted Returns” in *The American Economic Review*. He found “dollar-weighted returns are systematically lower than buy-and-hold returns averaging 1.5% for 19 major stock markets around the world over 1973-2004.”

A Nov/Dec 2009 article titled *Absence of Value: An Analysis of Investment Allocation Decisions by Institutional Plan Sponsors* by Stewart, Neumann, Knittel, and Heisler in the *Financial Analysts Journal* found “Much like individual investors who switch mutual funds at the wrong time, institutional investors do not appear to create value from their investment decisions.”

In Spring 2013, John Haslem published “Mutual Funds Win and Investors Lose” in *The Journal of Index Investing* “So why do investors persist in earning below market returns? Four possible answers are discussed: (1) investor overconfidence; (2) fund strategic repricing decisions; (3) fund 'sentiment contrarian behavior;' and (4) investor dependence on brokers with agency conflicted broker incentives.”

See also DALBAR’s annual *Quantitative Analysis of Investor Behavior (QAIB)* and Morningstar’s “Mind the Gap”

Differentiating between investing, speculating, and gambling

"An investment operation is one which, upon thorough analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."

Graham and Dodd's Security Analysis (original 1934 edition)

Speculation: The activity of forecasting the psychology of the market.

Speculative motive: The object of securing profit from knowing better than the market what the future will bring forth.

John Maynard Keynes in The General Theory of Employment, Interest, and Money

"A prospect that has a zero risk premium is called a fair game. Investors that are risk-averse reject investment portfolios that are fair games or worse."

Zvi Bodie, Alex Kane, and Alan J. Marcus in Investments

Subdiversification: Ownership of a mix of assets other than a fully diversified, market-weighted portfolio.

Speculation: Subdiversification with the intention of earning a superior risk-adjusted return.

Martin Fridson, "Exactly What Do You Mean By Speculation?"

Journal of Portfolio Management, Fall 1993

More at <http://investorhome.com/gambling.htm> and <http://investorhome.com/investulator.htm>

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www.twitter.com/Gkarz