Digital Advice

The Transformative Effect Robo and Digital Advice are Having on the Industry
Biggest Misconception: Why Robos are like Heli-Skiing
Kathy Walsh: Really ken ... stop jumping out of helicopters! 😳

Lisa Schapiro: Didn’t marry James Bond. Ken Schapiro doesn’t jump... only through hoops for me! 😊
Biggest Misconception: Why Robos are like Heli-Skiing

• Robo Investing is Like Heli-Skiing
• Not complex trading algorithms
• Passive index strategies
• Most “robotic” part is onboarding
What is Robo-Advice

- Providers of algorithmically driven automated financial advice and investing services
- Automated account opening
- Automated rebalancing and tax-loss harvesting
- Pioneered by Betterment and Wealthfront
Definitions

• Pure or Digital-Only Robo: A product or offering that does not have the option to speak to live advisors

• Hybrid Robo: A service that combines digital advice and the ability to speak with live advisors

• Independent Robo: Not an offering from an established financial services firm
Growth of an Industry

• Over $200 Billion in AUM
• Large financial institutions adding robo advice products
• Many offerings YoY AUM growth at or above 100%
• Still less than 1% of total US household financial assets
• $1 trillion in AUM by 2020 (Aite Group)
• Worldwide Adoption
The Misconception #2: Only low asset and young clients

- Percent of clients over age of 50:
  - Vanguard PAS: ~85%
  - Schwab Intelligent Portfolios: >50%
  - Merrill Edge Guided Investing: >45%

- 40% of Personal Capital’s AUM is from clients with over $1 million invested there

- Vanguard has a $50k minimum

- Depends on the robo, some offerings skew much lower (Acorns, WiseBanyan)
The Misconception #3: Traditional advice clients are flocking to robos

• Attraction is strongest to new-to-investing clients
  – First time investors
  – Previously self directed investors

• Robos are gaining market share by expanding markets more than stealing share from traditional advice
Transformative effect #1: Onboarding

- Most innovative aspect of robo advice
- Marketing differentiator
- Cost of customer acquisition much lower at robo advice providers
- Current advisor onboarding processes are outdated
- Client participation in onboarding
- Most efficient process in industry
Transformative effect #2: Digital Client Communication

• Client communication through personalized emails
• A.I. based on engagement
  – Event driven communication
  – Communicating right information at right time
  – Leads to better decision making
  – Advice on home purchase, education, weddings etc.
• Mass customization = Efficiency
• Models allow portfolio specific communication at scale
Transformative effect #3: Price Compression

- Betterment
  - Digital Only: 0.25%
  - Hybrid: 0.40%

- Vanguard
  - Hybrid: 0.30%

- Schwab
  - Digital Only: 0.00%
  - Hybrid: 0.28%

- WiseBanyan
  - Digital Only: 0.00%
Transformative effect #4: Branding

• Shifting power from advisor brand to company brand
• Young robo investors are attached to the company brand
• Robos are the newest proprietary product
Branding Cont.: Discount Brokers vs. Wirehouses

• Discount Brokers have mastered branding to the company
• At wirehouses the advisor brand is often stronger
• Broker Protocol
• Robos help brand to the company
Transformative effect #5: Emergence of Hybrid Advisor

• Vanguard PAS has ~4 times the AUM as next closest Robo
• Strong trend towards hybrid offerings
• Helps robos segment markets
• Investors can “graduate” if complexity of situation changes
Transformative effect #6: Market Segmentation

- Different investors = Different needs
- Robos offering different levels of service
  - Betterment now has live advisors
- Clients can “graduate” to higher levels of service if situation changes
- Helps explain rapid adoption by incumbents
Transformative effect #7: Market Expansion

- Best traction with new-to-investing and self-directed investors
- Expanded accessibility to professional advice
- Implies robo advisors are expanding size of market for advice
- Means less competition with traditional advice than many believe

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Market Expansion Cont.

- Total Market of US investors: ~135 Million US Adults
- ~65 million adults who have less than $100k in investable assets but are invested in the market.
  - Adults with less than $100k in investable assets make up 71% of the US adult population but only 4% of total investable assets.
- ~25 million adults with at least $500k in investable assets
  - Represents ~80% of total household investable assets
- ~70 million adults with at least $100k in investable assets
  - Represents ~95% of total household investable assets

Estimates created from US Census, Gallup, and Cerulli Associates data
Market Expansion Cont.

Investable Assets by Wealth

Market Expansion Cont.
Transformative effect #8: VC backed disruption

• Buying market share with overly competitive prices
• Many iterations of robo products due to large upside and scalability
• Customer acquisitions costs as low as $20-$50 but more typically in the $100’s
Transformative Effect #9: Online Fiduciary/RIA

• Unprecedented definition of fiduciary
• Transforming how we think of advisors and the role of fiduciary
• Many responsibilities on client to provide accurate information and understand limitations of robo advisors
• Digital-only online questionnaires have not been struck down due to suitability requirements
Transformative Effect #10: Non Financial Firms

• Reduces barriers of entry for providing advice
• Need minimal capital markets or advisor expertise to launch a digital only product
• Overstock.com
• Will Google or Amazon follow?

Amazon  Google  Overstock.com
Transformative effect #11: Account Aggregation

• Not just robos: Banks, Fintech, etc.
• Consolidated financial picture
• Holistic advice
• Funnel assets towards advisor
• Increased visibility = Increased opportunities
  – Possible to leverage A.I. for opportunities
Transformative effect #12: Models and Scale

- Models make portfolio construction scalable
- Makes portfolio specific, mass communication possible
- Allows robos to mass market and keep minimal back office support
- Possible for one investment committee to manage infinite accounts and clients
- Use of models growing in other areas (model marketplaces)
Transformative effect #13: Comparability

• Wider use of models opens the door for comparisons at manager/advisor level
  – Accounts can provide a window into advisor’s practice
• Little to no accessible performance data on advisors
• Low adoption rates of GIPS
• Increased transparency is good for clients
• Transparency and comparability will bring disruption
Comparability Cont.: BackEnd Benchmarking & The Robo Report

- Opened accounts at largest most prominent robo advisors
- Publishes performance and reviews of services
- Covered in: WSJ, Barron's, Money, Investment News, Kiplinger's, AAII and many more
- Brings transparency to the Robo advice industry
- Super Disruptive
The Robo Report

• Dispersion of asset allocations
  – International ranges from 20% to over 50%
  – Larger differences in fixed income
• Value tilt is common, growth tilt is rare
• Typically simple portfolios
  – Vanguard has only 5 ETFs
• Very little trading
The Robo Report

- Schwab has most consistent outperformance
- Acorns and Wealthfront have lagged the group
- Leader almost tripled laggard returns in fixed income over two year period
- Equity performance varies widely quarterly but has reverted to the mean over time
The Robo Report Recent Results

• Diversity in fixed income portfolios (Global, High-Yield, etc.)
• Active strategies/funds posted strong 1st quarter results
• Acorns and Stash largest number of clients but smallest account size
• Vanguard and Schwab have largest AUM but many were existing customers
# The Robo Report Recent Results

## 1-Year Trailing Top Performers

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<thead>
<tr>
<th>Category</th>
<th>Best</th>
<th>2nd</th>
<th>3rd</th>
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<tbody>
<tr>
<td>Total Portfolio</td>
<td>TD Ameritrade</td>
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## 2-Year Trailing Top Performers

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*Produced by Backend Benchmarking for TheRoboReport.com™*
Opportunities for Traditional Advisors: Efficiency

- Models
  - Possible to customize on a per client basis
- Trade order management systems
- Transfer of accounts
- Onboarding
- Is my business model scalable?
Opportunities for Traditional Advisers: Digital Communication

• Blogs
• Mass emails
  – Can be customized by portfolio or other groups
• Reusable content
• Articles
• Onboarding process
• CRM
Opportunities for Traditional Advisers: Robo Adoption

• White Label Providers: Betterment, Schwab, Jemstep, SigFig, Future Advisor and more
• Often investment option or other restrictions
• How does this fit into my business model?
• Need to achieve scale and a marketing plan
• Fit existing need for younger generation or low assets clients
• Possible to expand client base
Opportunities for Traditional Advisers: Define and Defend Value Proposition

• 20/20/20 BPS for $2 million relationship
  – Portfolio Construction
  – Financial Planning
  – Relationship
  – Trending downwards

• How do I stand up to Vanguards offering which costs 30 bps?

• Do you offer planning?

• What other value-add services above and beyond a hybrid robo do you offer?
Opportunities for Traditional Advisers: Aggregation

• Holistic = Better advice
• Visibility = Opportunities
• Can differentiate an advisor
• Ability to study direct competition
• High value to clients

by all accounts
data for smart decisions

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Where is Robo Advice Headed?

• Only a few independent Robos will survive
  – Cost of customer acquisition and brand recognition
  – Need for massive scale
  – Increased competition
  – Incumbents have more revenue streams
• Permanent fixture of advice landscape
• Further integration of digital and traditional advice
• Pricing pressure across the industry
• Pressure traditional advisors to be efficient and provide value
The Future of Data

• Aggregation allows for unprecedented view into a client’s financial life
• Also allows a view into outside advisors strategies etc.
• Marriage of investing and transactional data
• Whoever has the most data wins
Beyond The Robo Report: BackEnd Benchmarking

• Developing a personal finance app with the goal of bringing transparency across the financial services industry
• Will leverage user accounts to crowd source data on advisors, services, and products
• Robust benchmarking, planning, budgeting, performance, and single view of user’s whole financial picture
Return insights from user data back to the community

– Peer comparisons
  • Performance
  • Investment selection
– Advisor comparisons
  • Fees
  • Performance
  • Strategies
  • Services
– Strategies to modify investor behavior
– Provide user transparency of financial services industry
Beyond The Robo Report: BackEnd Benchmarking

• Disruption through transparency
• Unbiased third party opinion for investors
• Arbiter of financial services industry (no custody of assets)
• Seeking funding in 3rd and 4th quarters of 2018
Questions?

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