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The New World of the Robo-Advisor

In the finance world, our work has been made easier through computer-aided technology. Stock orders went from paper to computer entry and research went from physical company visits to sleuthing relevant information on the Internet. More recently, there has been a move to utilize "robo-advisors" as a replacement for financial advisors.

Robo-advisors are web-based services which allow an individual to make their own investment decisions. In many instances, the software is quite similar to that utilized by investment advisors. For instance, a computer application will ask a series of questions about an individual's ability to withstand down markets, lose money, time frame for accessing investments and then generate a recommendation for asset allocation (weightings for equities, fixed income, cash and international investments).

Other than asset allocation recommendations, robo-advisors also guide their customers through developing investment goals (emergency fund or retirement), determining taxable or tax-deferred account preferability and taking the emotions out of market volatility. Most robo-advisors don't purchase individual stocks, but utilize managed investment products as the investment vehicle for low cost and tax efficiency.

The robo-advisor alternative seems like a good match for younger investors. They have grown up with computer technology in most aspects of their lives and should not miss, at least initially, the lack of a human interface when starting their savings plans. Estate planning, tax concerns and a longer time horizon for saving (allowing for more risk and less concern about market volatility) might minimize the importance of personalized plans designed by financial planners. Additionally, many of these investors are currently "underserved" by the financial planning profession due to the minimums imposed.

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With lower fees, 24-7 access and the endless ability to perform "what if" scenarios, the future of the robo-advisor looks bright. Online advice platforms such as Charles Schwab, WealthFront and Betterment are heavily investing in their robo-advisor products.

Given this technological breakthrough, is there a need for a human financial advisor?

It depends. Most robo-advisors limit their advice to asset allocation and portfolio management. This can also be true of human financial advisors. Some advisors focus on stock selection while other financial advisors add insurance services, income tax advice, employer benefit information and estate planning guidance. This will be a personal decision for each investor.

When I started my own practice, it was almost solely because I enjoyed the "numbers" side of the business. Over time, I've come to appreciate the "human" side.

Last week, I visited with a client who is a Ford Motor Co. retiree. A few years ago, when Ford stock was trading for $1, she called to purchase some. Advantageously, this stock has appreciated; she sold the amount of her initial investment and left her profit in the market to increase (or decrease). We have discussed selling the stock several times, but there hasn't been an optimal time to incur the capital gains taxes yet. Her oldest granddaughter will graduate this year and we were chatting about a gift. I recommended that she gift her some Ford stock.

This will likely be good from a tax and portfolio standpoint (the "numbers"), but more importantly, it's a meaningful gift ("the human side"). My client worked there for 40 years and is, hopefully, also encouraging her granddaughter to start her own saving and investing regimen, an important value for this family. It is unlikely that this recommendation could be made by a robo-advisor.

In the future, as advances in a robo-advisor's artificial intelligence grows, the ability for holistic planning, which balances risk, performance and income estimates, will inevitably become possible. More difficult to replicate will be the joy of the connection between advisor and client which grows through the years.

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