How are robo-advisors changing the investment industry?

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Algorithms will still require human intervention and advice to ensure that advisory firms are fulfilling their fiduciary role. (Photo: Shutterstock)

By **Frederic Slade** | February 21, 2019 at 07:55 AM

Who are and what are **robo-advisors**? They are not robots (at least not at this time). A simple **definition** of a robo-advisor is that of an online service which provides automated investment portfolios based on an investor's risk tolerance level, time horizon and goals.

In many cases, **robo-advisors** also allow investors access to human advisors. The list of robo-advisors with human advisor access includes Charles Schwab, Personal Capital, Betterment, Ellevest, Vanguard and TD Ameritrade. It is estimated that automated investment platforms exceeded $200 billion in assets in 2017 and will continue to grow.

Robo-advisors can offer a wide range of investment choices (including actively managed and niche assets), portfolio optimization and frequent portfolio rebalancing. However, there are a number of potential downsides and caveats with respect to robo-advisors:

Lack of transparency: There is no industry standard regarding the level of transparency required to be disclosed by robo-advisors to investors. This may result in allocations to asset classes which are not compatible with an investor's investment knowledge or sophistication.

ETF and fund flows: Stock and Bond ETFs, which are used frequently in robo-advisors' automated portfolios, may experience significant inflows and outflows due to automated rebalancing. These flows in turn may have significant market impacts. In the fourth quarter of 2018, heavy demand for shorter-term bond ETFs coincided with the stock market correction and an increase in long term interest rates.

Too-frequent rebalancing: Robo-advisors rebalance portfolio asset allocations with varying frequency, including daily, monthly and quarterly. In my November 28, 2017 BenefitsPRO blog on **portfolio rebalancing**, analysis indicated that annual rebalancing was as, or more, efficient than monthly rebalancing. While no one method is most effective in all markets, too frequent rebalancing may result in excess turnover, higher trading costs and capital gains liability for taxable accounts.

Lack of experience in down markets: From 2009-2017 as robo advisory platforms developed, equity markets produced positive returns in a bull market cycle. That changed in 2018, when the fourth quarter selloff produced negative returns for the S&P 500 Index and the Russell 2000 small cap index. Will robo-advisors be able to navigate the extreme volatility of bear markets? Or, will allocations be too aggressive and disappoint investors?

In summary, it seems certain that robo-advisors are here to stay and will continue to grow. However, their algorithms will also require **human** intervention and advice to ensure that advisory firms are fulfilling their fiduciary role.

NOTE: Information presented herein is for discussion and illustrative purposes only and is not a recommendation or an offer or solicitation to buy or sell any securities or invest with any robo advisory firms. Past performance is not a guarantee of future investment results.

Fred Slade has over 25 years of experience in the investment management and retirement services industries. He is Senior Director, Investments for **Pentegra Retirement Services**, a leading provider of retirement services to financial institutions and organizations nationwide, founded by the Federal Home Loan Bank System in 1943. Mr. Slade manages over $1 billion in internal bond portfolios and provides analytics and strategy for Pentegra's Defined Benefit and Defined Contribution Plans. Mr. Slade holds a Ph.D. in Economics from University of Pennsylvania and a CFA, and has presented at a number of seminars and conferences.