Robo-adviser is an Oxymoron

- Published on August 24, 2017

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The lower your investment and adviser fees are, the higher your returns will be – right? This is the mantra of the relatively new robo-adviser concept, which is an automated portfolio management offering. Robo-advisers are spurring debate on whether the traditional financial adviser and their 1% standard fee model is in jeopardy of going extinct. I addressed this topic in a recent Daily Oklahoman Q&A, which you can read here: "Robo-adviser Investment Platforms Can't Provide Discipline to Clients"

Vanguard did a fantastic study a few years back that specified in concrete terms where an adviser can add value to an investor. Vanguard put the value at around 150 basis points, but even that appears a little low to me. You can find the study, labeled Vanguard Advisor's Alpha, right here: https://advisors.vanguard.com/iwe/pdf/FASQAAAB.pdf As an adviser with 15 years of experience, I can tell you that the biggest value investors receive is in the behavior modification area. In other words – discipline. DALBAR does a study every year about how much bad behavior costs investors, and the number tends to higher than the 150 basis points on average that Vanguard used in their report.

Last month, the Wall Street Journal published a front page article titled: "*Automation stalks Financial Advisers"* – which you can find here: [WSJ Article - "Automation Takes Aim at Financial Advisers"](). It was implied in this article that the traditional financial adviser's value to investors may be delivered now at a lower cost through automated "advice." The part of this WSJ article that stood out to me was the story about Joe McDonald of Titus, Alabama, a do-it-yourself investor, who admitted to pulling out of the market in 2008. He admitted his decision to go to cash was primarily based on Barrack Obama being elected President. McDonald is quoted as saying in the article, "I pulled out and stayed in cash until 2014, which was a terrible mistake." He went on to say, "I found I didn't really have the discipline to stick with my own plan."

In the rest of the story, McDonald mentioned that he considered hiring a traditional adviser in Florida, who charged 1% annually on assets, but he and his wife instead moved their roughly $500,000 into an automated offering that only charged 0.3%. When I first read the article, I had to read it again to make sure I didn't misunderstand this story. By going to cash in late 2008 due to Obama being elected, McDonald missed out on participating in one of the biggest market recoveries in history. Most indices from 2009 through 2013 went up well over 100%. The S&P

500 index, for example, went from 865.58 to 1,822.36 in this time-period.

Immediately, I was struck by Mr. McDonald's investment decisions being influenced by who was in the White House . This is a textbook investor mistake that a great adviser would never allow their client to make. You can read my past Q&A on this topic here: "Presidential election proves panic not an investment strategy"

I think it's important to identify the deeper reason for McDonald missing out on participating in this enormous market recovery. He said it himself – it was his "lack of discipline." Bingo, Mr. McDonald. I had to wonder had he been working with a "traditional" adviser, one skilled in counseling clients and in applying discipline, would he be holding a much higher account balance in 2014? Jim Parker from Dimensional did a great job of addressing the importance of investor discipline - Discipline: Your Secret Weapon

For fun, I did the math on how much Mr. McDonald might have cost himself by not having a trusted adviser. Let's assume he did hire an adviser back in 2008, and let's simulate that the adviser invested his money in a broadly diversified portfolio of 80% in global stocks and 20% in short-term high-quality fixed income. Let's further assume his portfolio was rebalanced annually and that his adviser was successful in keeping him invested through the entire five-year period. His 2009-2013 nominal returns before paying adviser fees would have been 29.7% in 2009, 16.0% in 2010, -2.8% in 2011, 14.7% in 2012 and 19.3% in

2013. The returns after paying annual adviser fees of 1%, would have been 28.7%, 15.0%, -3.8%, 13.7%, 18.3%. View Portfolio Visualizer

Mr. McDonald may have initially felt good about not “risking” his money in the uncertain market, and “saving” the 1% adviser fee each year. Unfortunately for him, he didn’t understand there were other greater risks to consider, such as loss of opportunity risk. Assuming he invested the $500,000 in the portfolio of 80% global stocks and 20% short-term high-quality fixed income, and projecting around $40,000 in total adviser fees - he would be holding around $960,000 in his account. That’s $460,000 in net investor return.

As we look ahead to the future of robo-advisers, I am curious how its investors will perform through future market downturns and world events. Will these investors receive the guidance and discipline when going through future uncertainty? What happens when stocks are down 30%? Or what if the US is hit with a major terrorist attack, similar to a 9/11? Will these investors have enough discipline to stick with their investment plan? If history is any guide, the hiring of a “traditional” adviser, who is successful at helping clients maintain discipline amid uncertainty, may turn out to be the very best investment decision an investor makes.