

Portfolio Perspectives

Monthly Insights for Investors

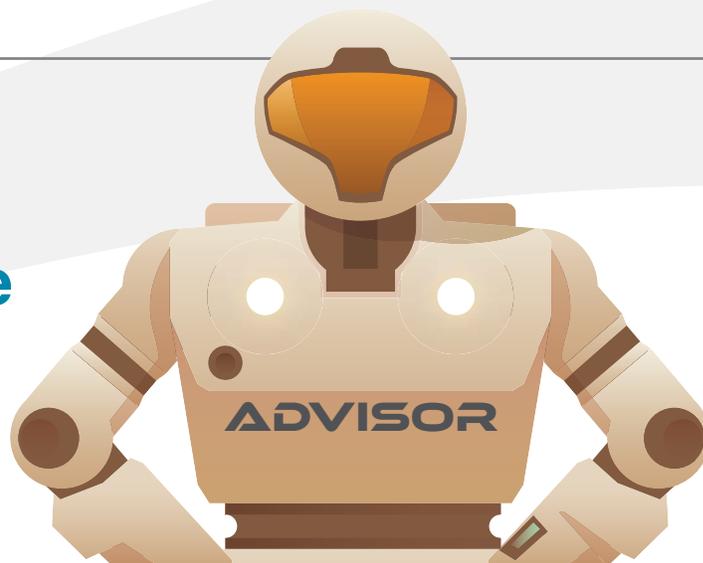


Robo Advisors: Looking Beyond the Low-Cost Service

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Robo-advice platforms — referred to as robo-advisors — are growing in popularity among millennials and other investors by providing an affordable digital investment platform to manage investment portfolios with initial investments as low as \$1,000. While it is good news that millennials are starting to manage their wealth early, the growth of their wealth is highly dependent on comprehensive planning, not just the portfolio put together by an algorithm. The strength of a portfolio can be measured by its key characteristics such as asset allocation, diversification, stock and bond risk, investment costs, and overall portfolio risk and trading efficiency.

Results of a new study from Loring Ward comparing the portfolios from the top five robo-advisors to a benchmark portfolio with several decades of measurable performance reveal that while



the robo-advisor portfolios are very well diversified, they also contain construction gaps that should not be present in well-constructed portfolios.

The key gaps identified in the Loring Ward robo-advisor paper include:

- Large allocation of assets to emerging markets
- Lack of small-cap and value tilts that can increase returns over the long term
- Higher credit risk in the bond portion of the robo-advised portfolios, through exposure to junk bonds
- Significant variations in asset allocation recommendations across ostensibly similar risk profile offerings, particularly with respect to large allocations either to stocks or to cash



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Gaps in Moderate Portfolios of Robo-Advisors					
	Vanguard	Schwab	Wealthfront	Betterment	Personal Capital
Asset Allocation		X	X	X	X
Global Diversification					
Stock Concentration Risk					
Stock Risk Analysis	X		X	X	X
Bond Quality	X	X	X	X	
Bond Maturity					
Management Expenses					X
Trading Costs					
Portfolio Efficiency			X	X	
Portfolio Risk Profile			X	X	X

The Portfolio Gap Analysis performed on the portfolio recommendations of the robo-advisors reveals significant gaps with respect to the benchmark portfolio (see Table). Vanguard and Schwab portfolios have gaps in two of the 10 key portfolio characteristics, while Wealthfront, Betterment and Personal Capital have four or more gaps in their portfolios. None of the robo-advisors had a perfect portfolio.

Robo-advising is an innovative service that will most likely have an impact on future money management. The low asset minimums and low fees gear the service towards millennials who do not have the resources to invest with a traditional financial advisor. While inexpensive, the portfolios of these robo-advisors appear to be constructed inefficiently and may expose investors to risks they may not fully understand.

Low cost may also mean low service as robo-advisors lack the benefits of holistic wealth

management with a real-life advisor who takes into account specific situations with fiduciary implications, such as moving to another state in retirement or personal situations such as planning for a special needs child or for specific charitable bequests. Computer processors and algorithms cannot comprehend these real-life situations. And what about the value of compassion and empathy when it comes to helping someone navigate life? Compassion and empathy just don't exist for robo-advisors, which makes holistic wealth planning difficult for them. This holistic wealth planning, along with a little compassion and empathy that a human financial advisor can provide, may be the difference between a client reaching their investment goals and possibly falling short.

We believe that holistic wealth management is vital to achieving future financial independence for many investors.

All investing involves risk: principal loss is possible. Past performance does not guarantee future results.

Diversification neither assures a profit nor guarantees against loss in a declining market.

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