The Rise of the Cyborg Advisor

By Michael E. Kitces, MSFS, MTAX, CFP®, CLU, ChFC, RHU, REBC, CASL

As the world moves increasingly into the digital age, technology-driven solutions continue to threaten the traditional way things are done. The world of investment management is no exception. Numerous "robo-advisors" have cropped up in recent years with an aim to threaten and disrupt financial advisors. Yet the reality, at least so far, is that virtually all of their offerings are narrowly constrained to just portfolio solutions—where the world of mathematics and algorithms work well—with little capability of addressing the rest of an individual's financial picture.

But perhaps the biggest limitation of robo-advisor-driven solutions is with regard to managing the self-inflicted "behavior gap," where many investors, as a result of their own greed and fear, achieve inferior results. It's unclear whether robo-advisors will have any solutions to these behaviorally driven problems. Just as a website that says "eat less and exercise more" doesn't solve the country's obesity problem (because it's a behavioral problem, not an information problem), robo-advisors and their portfolio construction recommendations alone are unlikely to solve investors' behavioral challenges. For right now, only human advisors address the entire set of comprehensive financial planning goals for clients.

Nonetheless, the reality is that a purely human solution isn't always better. Many of the things advisors do can in fact be implemented far more efficiently with technology. Overall, it's important to acknowledge that some things really are done better by computers. In the end, the real winners may not be robo-advisors, or human advisors, but technology-augmented humans—the cyborg advisors—who blend humanity and technology into an optimal financial advice solution for consumers.

THE RISE OF THE ROBO-ADVISOR

One major theme of recent years has been the rise of the so-called robo-advisor—online computer platforms that provide financial advice directly to consumers by mathematically analyzing a client's situation to come up with portfolio recommendations. These companies, such as Betterment[1] and Wealthfront,[2] claim to promise less expensive and more accessible financial advice for the mass of consumers by cutting out the cost of the advisor.

Using the tools of modern portfolio theory, robo-advisors have built algorithms to construct optimized efficient-frontier portfolios for their investors (assuming, of course, that you still trust purely quant-algorithm-based portfolio construction in the aftermath of the financial crisis). On top of this portfolio construction advice are some additional value-adds that are conducive to technology scaling (and algorithmic analysis), such as effective asset location (if you have multiple types of accounts with the platform), automated rebalancing, and ongoing tax-loss harvesting. Each of these features has been shown in separate industry research to potentially bring significant value to the table (although in many client situations, blindly implementing tax-loss harvesting without an awareness of client circumstances can result in wealth destruction, not wealth enhancement).[3]

On the other hand, although they do leverage technology for some significant value-adds, at this point the algorithm-driven platforms generally are constrained to only analyzing investment portfolios. To date, no robo-advisors have implemented any algorithms to analyze a client's estate plan and help a client understand how to best protect, manage, and distribute money to heirs. Nor do any robo-advisors evaluate a tax return, or show a client the risk exposures that need to be insured (and how much to insure them for), or coordinate retirement withdrawals with prudent tax planning and the beginning of Social Security benefits, etc. In other words, robo-advisors at this point are little more than robo-investment-advisors; they do not compete with comprehensive financial planning, which remains a significant differentiator from commoditized passive strategic portfolio management.[4]

HUMAN ADVISORS SERVING HUMAN CLIENTS

Notwithstanding the lack of comprehensive financial advice, the most significant fundamental problem with a robo-advisor-driven solution is that it assumes our problems are problems of information; it assumes that if only we had more knowledge, and better tools, we could all achieve financial success. Therefore, as the business pitch goes, robo-advisors will use technology to scale the solutions for this information problem, bringing quality portfolio solutions to the middle class.

The caveat, though, is that most of our problems are not really problems of information. Having a website that constructs for all Americans a well-balanced portfolio and tells them to save more and spend less won't solve our country's financial woes, any more than having a website that constructs for them a well-balanced diet and tells them to eat less and exercise more would solve our country's obesity crisis. The problem is not one of information, knowledge, and technology-scaled execution. The problem is behavioral.

And behavioral problems are one thing uniquely suited to human-to-human interaction, because we seem to be hard-wired to feel more accountable to other human beings than we do to computers.[5] It's easy to just stop opening the statements that show your account balance or to stop logging into the website that shows how badly your investments are doing. It's a lot harder to blow off an established personal relationship with a human advisor serving as your accountability partner. In fact, for years many advisors have suggested that their primary benefit is not designing quality portfolios but helping clients stick with their portfolios and deal with the so-called behavior gap, which is the difference between the returns the investment markets deliver and the returns investors actually earn after accounting for their potentially poorly timed decisions.

Although it's unclear how large the behavior gap is for all investors in the aggregate—DALBAR has tried to measure the phenomenon for years, but its results are highly sensitive to the point of comparison[6]—it is clear that at least some subset of investors experience the problem. But can a robo-advisor alone talk these investors off the ledge when they're panicking from a market decline? (To their credit, several of the robo-advisors have now hired behaviorists to at least try to tackle the problem). Similarly, can robo-advisors keep investors from just chasing returns in a bull market? Perhaps the entire growth of robo-advisors is just investors chasing appealing short-term returns in the first place; after all, robo-advisors have been established only since the financial crisis and none have ever navigated a single bear market.

THE ADVISOR OF THE FUTURE—NOT JUST ROBOT NOR HUMAN, BUT CYBORG

Let's agree that it's important for human beings to engage other human beings about their behaviorally driven financial problems, not to mention the entire range of tax, estate, insurance, retirement, and additional topics that comprehensive financial planners address. But the reality is that, even though purely robot-driven solutions may not drive enough behavior change, purely human-driven solutions can be remarkably inefficient, which leads to higher costs for consumers and makes financial advice unaffordable for many. Indeed, there are some things that humans do far better than computers, but there are also many things that computers do far more efficiently than humans.

This is one reason why technology has been on the rise with advisors in their own firms as well. In fact, the aforementioned list of robo-advisor investment value-adds are not unique; most rebalancing software packages used by advisors,[7] from iRebal[8] to Tamarac[9] to TRX,[10] are capable of implementing some or all of this, from good asset location decisions, to timely rebalancing, to tax-loss harvesting. Good advisors have been leveraging dedicated software and technology to provide all these features for nearly a decade already since the first rebalancing tools came out, long before robo-advisors appeared on the scene. At best, robo-advisors have simply repackaged (and perhaps done a better job at marketing and communicating) what the best human advisor firms already do—but without the rest of the financial planning advice.

On the other hand, this kind of technology adoption thus far has been a best practice, not a standard practice. Not all advisors have embraced and implemented technology. The 2018 T3 Advisor Tech Survey revealed that nearly 60 percent of advisors still have not adopted rebalancing software in their practices.[11] The distinction is starting to matter. A Fidelity industry study found that the practices of younger Gen X and Gen Y advisors are starting to outperform advisors at more-established baby boomer advisory firms, largely as a result of their better, smarter tech use.[12]

As time passes, it's becoming increasingly clear that the threat to human advisors is not technology and robots but technology-augmented humans, who bring together the crucial relationship aspects of working with a human being with the scaled benefits of leveraging technology.[13] This represents both the cutting edge of what many technology-focused advisors are doing now (as supposed by the Fidelity study), as well as recent venture-capital-funded start-ups such as Personal Capital[14] and LearnVest[15] that pair technology and an online platform with real human financial planners (and thus aren't really "robo" at all). In fact, as I've written in the past, heavily technology-augmented human advisors in a model such as LearnVest may be a glimpse of how financial planning to the masses will be delivered in the future.[16]

The bottom line, though, is simply this: In a competition between human advisors and robo-advisors, the real winner may be the technology-augmented human, which I am hereby dubbing the "cyborg" advisor[17]—part human, part technology, integrated to allow each part to do what it does best for the most efficient, most comprehensive, and most behaviorally accountable client solution.

Michael Kitces, MSFS, MTAX, CFP®, CLU, ChFC, RHU, REBC, CASL, is a partner and the director of wealth management for Pinnacle Advisory

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Group, cofounder of the XY Planning Network, and publisher of the financial planning industry blog Nerd's Eye View. *Follow him on Twitter at @MichaelKitces.*

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ENDNOTES

1. See https://www.betterment.com/.
2. See https://www.wealthfront.com/.
3. See Michael Kitces, "Is Capital Loss Harvesting Overvalued?" (May 1, 2013), https://www.kitces.com/blog/Is-Capital-Loss-Harvesting-Overvalued/.
4. See Michael Kitces, "Is Financial Planning Becoming Commoditized?" (February 11, 2013), https://www.kitces.com/blog/Is-Financial-Planning-Becoming-Commoditized/.
5. See Michael Kitces, "Technology Will Improve Financial Planning and Augment Planners, But It Won't Replace Them" (May 14, 2012), https://www.kitces.com/blog/Technology-Will-Improve-Financial-Planning-And-Augment-Planners,-But-It-Wont-Replace-Them/.
6. See Michael Kitces, "Does the DALBAR Study Grossly Overstate the Behavior Gap? (Guest Post)" (October 3, 2012), https://www.kitces.com/blog/Does-The-DALBAR-Study-Grossly-Overstate-The-Behavior-Gap-Guest-Post/.
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14. See https://www.personalcapital.com/.
15. See https://www.learnvest.com/.
16. See Michael Kitces, "LearnVest—A Glimpse of Financial Planning's Future Serving the Masses in the Digital Age?" (May 7, 2012), https://www.kitces.com/blog/LearnVest-A-Glimpse-Of-Financial-Plannings-Future-Serving-The-Masses-In-The-Digital-Age/.
17. See https://en.wikipedia.org/wiki/Cyborg.