Understanding the difference between a personal advisor and “robo-advice”

Comparing software to a relationship with an expert.

AUTOMATED PORTFOLIO MANAGEMENT SERVICES – known popularly as “robo-advisors” – have made headlines in recent years. These online services use algorithms to make portfolio recommendations based on the information an investor provides in a questionnaire. These services are just starting to gain ground in Canada, with marketing campaigns that include TV commercials, billboards and full-page ads.

Although most investors continue to work with human advisors, the rise of web-based investment platforms has made understanding the difference between the two – robo-advisors and human advisors –more important than ever.

How does “robo-advice” work?

Because these platforms don’t offer individualized advice, the term “robo-advisor,” although catchy, is a misnomer. It’s actually just software. When a client registers for a service, she or he answers a set of questions that determines a generic investor profile.[1] The software then presents the client with choices of ready-made portfolios based on the profile.

Because the profiles are formulaic –quite literally based on a mathematical formula – they can only account for a limited range of goals and risk tolerances.[2] Robo-advisor software is designed to sort clients into broad categories and to serve those categories quickly and at a lower cost. This model relies on the investor answering the questionnaire accurately. It also places the responsibility of choosing the best portfolio on the client instead of the advisor, because there is no advisor.[3]

The role of an advisor

Human advisors are licensed experts who create comprehensive financial plans designed to build wealth, minimize taxes and accomplish a diverse range of other goals. These may include everything from being able to afford next year’s vacation to buying a home to living comfortably in retirement. Because money is more than an account balance – it’s a

[1] www.forbes.com/sites/rogergershman/2015/04/30/robo-advisors-versus-financial-advisors-which-is-best-for-you/#7ce364a817c3
[2] www.bloomberg.com/news/articles/2015-06-18/robo-advisers-to-run-2-trillion-by-2020-if-this-model-is-right
[3] www.slice.ca/money/blog/are-robo-advisors-the-future-of-financial-planning/67950

family's home, a child's university tuition, an emergency fund for tough times – creating a plan requires understanding the emotional importance of each financial goal.

An advisor also does much more than portfolio rebalancing. She or he can help rearrange investments for tax efficiency, review budget and saving strategies, and put in place the right financial protection.

As a result of understanding the full picture of a client's life, a financial professional can handle varying degrees of complexity. If a client experiences major changes, plans can be adjusted to respond to the client's new circumstances.

By the same token, if the economy changes, an advisor has the depth of knowledge to provide a proper analysis and plan of action. When faced with the decision of staying the course or making an adjustment, you can sit down with an expert intimately familiar with your investments. An advisor can evaluate what the decision will mean, not just for your portfolio, but for your long-term financial well-being.

The bigger picture

One of the primary advantages of working with an advisor is nuanced "big picture" planning. Investing isn't so much about buying a product; it's about acquiring the component parts of a far-sighted strategy. Ideally, investments complement each other and click neatly into place within a financial plan. They're allocated to generate growth or provide an income, to meet short- and long-term goals, to save taxes and to build a legacy. Furthermore, the plan must adapt – and the investments must be rebalanced – as the investor's circumstances change.

That's why off-the-shelf products available through "robo" portfolio management don't always generate the most value. One recent study compared investors who work with advisors to investors who don't. After four to six years, the advised investors had accumulated savings worth nearly 1.7 times as much as the unadvised investors. After seven to 14 years, they were up to 2.9 times as much. After 15 years, they had amassed 3.9 times as much. This suggests that the longer people work with an advisor, the more they benefit from advice.[4]

Translating a vision into a plan

Because priorities change and what's right today need not be a forever decision, a financial plan that takes into account a variety of objectives is essential. When it comes right down to it, beating the market isn't anyone's true objective. That's just a means to an end. The end is the flexibility to live life as you want and reach your financial and life goals.

An advisor's unique skill set supports the ability to translate a client's vision into a concrete, achievable plan. While financial acumen is part of that skill set, so are perspective, context and the capacity to help a client stick to a plan for years. Maintaining trust and motivation takes more than a mathematical formula – it takes a real relationship. ■

[4] www.ific.ca/en/articles/investor-centre-financial-advice-could-increase-your-wealth/

MK2819E FALL 2017

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Spectrum Financial Strategies
339 Huronia Rd
Barrie, ON L4N 8Z1
www.spectrumfinancial.ca
(705) 725-0562