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Robo Advisor Performance For Q1 2018 Now Available for Advisors

By Ken Schapiro of BackEnd Benchmarking, 5/14/18

BackEnd Benchmarking produces The Robo Report™, which publishes a quarterly report on the digital advice industry. The report includes performance data on real accounts opened by BackEnd Benchmarking. Providing performance data allows for comparison across different digital advice platforms, helping investors make informed decisions when selecting a robo advice product.

The first quarter of 2018 was another active quarter in the digital advice industry. Clients and AUM continue to grow across digital advice platforms, although some have raised concerns about slowing growth rates, particularly at the independent robo advisors. Increased competition has likely contributed to slower growth rates and persistent high costs of customer acquisition. Over the past year there has been a continual increase of established financial firms rolling out digital advice products: Morgan Stanley, Wells Fargo and UBS have all recently launched their platforms, while JP Morgan Chase is in the process of rolling out their digital advice product. Goldman Sachs is rumored to be working on an offering of their own to accompany other financial products available under their consumer-facing Marcus brand. Customer acquisition will increase in difficulty, as many of those who find digital advice attractive have already selected a provider, while those who have not now face a wide array of product offerings, and likely have an option at one of the institutions where they already do business.

Large existing customer bases give the incumbent advice providers an additional advantage over independent robos. This has played out in the race for AUM, as Vanguard and Schwab have brought on $101 billion and $27 billion in assets for their robo products as of the end of 2017, respectively. This compares to Betterment and Wealthfront finishing 2017 with AUM of over $13 billion and $10 billion, respectively. Although Schwab and Vanguard have been more successful bringing assets into their digital advice programs, the numbers may be misleading when considering the number of assets that are new to the firm. Last year, a Vanguard spokesman was quoted as saying 90% of assets in their Personal Advisor Services came from clients with existing Vanguard accounts. In an interview conducted by The Robo Report™ with Schwab, a representative shared that 30% of the assets in their digital advice offerings were new to Schwab, with the remainder migrating from other business segments. Looking at assets new to the firm highlights two important insights. The first is that Betterment and Wealthfront are proving equally, if not more, effective at attracting new assets as Schwab and Vanguard. The second is large existing customer bases are helping incumbents quickly build up their digital advice offerings. New-to-investing and previously self-directed investors are providing the largest segment of rob advice clients. Robo advice products now being offered where many self-directed clients already do business is an additional hurdle for independent robos.

While Vanguard and Schwab are leading in AUM, providers that are focusing on introducing investing to those who have never invested before are proving the most successful at attracting new clients. Acorns and Stash Invest boast 1.8 million and 1 million accounts, respectively. Acorns' most prominent feature is their "round-up" function, where users connect credit card and bank accounts and Acorns "rounds up" the users card transactions, funding investment accounts with with the difference between a transaction amount and the nearest even dollar amount. Stash focuses on educating clients and recommending investments that they believe will resonate with their users based on the users interests and user-selected "themes." Both are

proving successful at lowering the barrier to an investor making a first-time investing decision. Although user and client counts are impressive, the average account size is small. Using numbers from the most recent ADV filing for Acorns and Stash, average account sizes for both companies are less than $500. For comparison, Betterment's most recent ADV shows 440,000 accounts, implying an average account size of more than $30,000. Without a doubt, becoming the first investing relationship of an individual is an opportunity, but it still remains to be seen whether these companies can turn these opportunities into robust profits.

Funders of these two companies have certainly not lost their appetite. Stash raised a $37 million round in February of this year, while Acorns also had a fundraising round for an undisclosed amount. Additionally, Wealthsimple, a Canadian-based robo, announced a $51 million round, while NextCapital, a primarily B2B digital advice platform, raised $30 million in the first quarter. Not all fundraising news was positive at the start of the year, as it was reported that Wealthfront's most recent raise of $75 million in January was completed at a lower valuation than their previous round in 2014. The valuation of the company at this round has been disputed. This reported down round has added to speculation that high customer acquisition costs and slowing growth are becoming a concern for investors in the company.

Turning to performance, the first quarter was an interesting test case, as markets bucked the low volatility trend of recent years. The robo accounts as a whole performed as one would expect from a group of mostly passive, globally diverse portfolios. Despite being in line with what one would expect from diversified portfolios, there was still dispersion among the results, particularly in fixed income holdings. Some of the largest differences between the portfolios are in the types of fixed income used. Portfolios that ventured into riskier areas of the bond markets were rewarded over both the shorter and longer term. In particular, Schwab stands out with their fixed income. Their holdings in high-yield and international fixed income helped spur their outperformance. Ellevest and Personal Capital also outperformed in fixed income, with allocations to high-yield municipals and high-yield corporate bond ETFs, respectively, as well as the same emerging markets bond ETF as Schwab. FutureAdvisor also benefited from sizable positions in an international bonds fund, as well as a TIPs ETF positioned at the shorter end of the yield curve. Our results implied that investors should look for diversification not only in the equity holdings, but also in fixed income holdings.

The first quarter of this year was another busy quarter in the digital advice industry. These platforms continue to be attractive and provide a good entry point to professional advice for many investors. The Robo Report™ looks forward to continuing our coverage of the industry and providing transparency to investors interested in digital advice products.

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