The Rise of Digital Advice

A Look Back at Industry Growth

- *We currently estimate assets under management (AUM) by digital advisors to be in excess of $440 billion.*
- *Digital advice AUM continues to be dominated by a few major institutions (Vanguard, Schwab, TD) and startups (Betterment, Personal Capital, Wealthfront). Institutions have dominated market share largely by cross-selling existing clients.*
- *Digital advisors saw their first slowdown in AUM growth in 2018, consistent with the market downturn. The expansion of products offered, product innovation, and positive market returns helped digital advice providers return to gathering assets at impressive rates in 2019.*
- *The largest independent providers continued to attract investors and gather assets at impressive rates despite increased adoption by incumbent financial institutions.*
- *Acorns and Stash report staggering growth in assets and total accounts, capitalizing on a micro-investing niche that encourages incremental savings.*

Emergence of a New Industry: Growth in Digital Advice

When digital investing was first introduced, platforms quickly began accumulating assets. Digital advisors were labeled industry disruptors, as talks of fee compression, the commoditization of professional asset management, and disruption of the investment advice industry ran rampant. Over the last four years, the market has continued to mature, adoption has spread across major financial institutions, and new consumer trends have emerged. An increasing number of companies battle for market share and institutions develop their own offerings.

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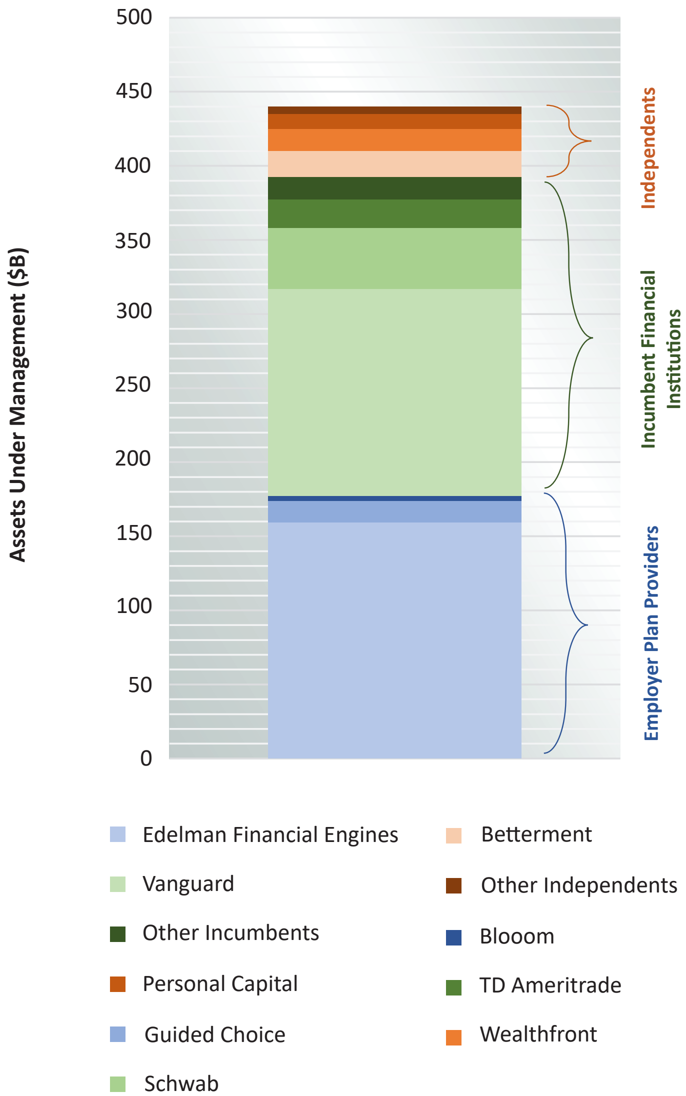
In the race to achieve scale, the largest independent advisors continue to expand product offerings to stay a step ahead of incumbent players and maintain impressive rates of asset accumulation. After years of fantastic growth across the digital advice industry and financial markets as a whole, a market decline in 2018 caused a significant slowdown in asset growth among digital advisors. Emerging in 2019, the expansion of products offered, product innovation, and the return of positive market returns helped digital advice providers regain their footing and return to gathering assets at impressive rates. Growth rates at digital advice providers have consistently outpaced the advice industry as a whole. Although still a relatively small segment of the financial services industry, digital advice is now, undeniably, a permanent fixture in the financial services industry and growing rapidly. As of June 30, 2019, we estimate assets managed by digital advisors to be $440 billion, with a majority of these assets flowing into these products since the start of 2015.

AUM at Digital Advisors (As of 6/30/2019)



2015 Through 2017 Witnesses Explosive Growth

Digital advice providers had the advantage of emerging during a historic multi-year bull market. Digital advice has brought down the barriers of investing and democratized professional money management, resulting in impressive growth over the past years. Prior to Schwab and Vanguard launching competitive products in 2015, the independent digital advisors still retained their first-mover advantage. In 2015, Betterment doubled in size from $2 billion to $4 billion in AUM. During this time, Personal Capital grew 70%, adding $880 million to their $1.2 billion. Wealthfront grew 84% from $1.4 billion to $2.6 billion from 7/30/2014 to 7/30/2015.

While these are fantastic growth numbers, Vanguard and Schwab launched products in 2015 and quickly showed how leveraging existing large client bases and assets is a far easier road than acquiring new-to-firm clients. By the end of 2016, Vanguard had amassed $50 billion in AUM and Schwab had already reached $12.3 billion. While these are impressive numbers, in interviews around the end of 2017, representatives from Vanguard acknowledged that 90% of their AUM was clients with existing Vanguard relationships, while Schwab acknowledged around 70% of their digital advice customers were not new-to-firm. Schwab has recently reported that new-to-firm clients are increasing as a percentage of newly attracted assets, and that figure may stand closer to 37% for clients who recently signed up for their platform.

Both 2016 and 2017 would yield similarly impressive results for these firms. Although growth in percentage terms would slow in 2017, growth in dollar terms would continue to increase. Betterment increased average quarterly growth from $510 million in 2015 to $1.4 billion in 2017. Personal Capital would go from increasing AUM, on average, $220 million per quarter in 2015 to $610 million per quarter by the end of 2017. Wealthfront grew from a quarterly average of $300 million for the fiscal year ending 07/30/2015 to $920 million a quarter by 07/30/2018.

Showing their institutional might, Schwab and Vanguard added an average of $3.7 billion and a staggering $12.8 billion per quarter, respectively, in 2017.

Both companies more than doubled their AUM in 2016 and 2017, and have user accounts counted in the millions.

Additionally, micro-investing apps Acorns and Stash need to be mentioned. Both companies appeal to younger and less wealthy customers but have not gathered the amount of assets of larger independent digital advisors or the major incumbents. This aside, both companies more than doubled their AUM in 2016 and 2017, and have user accounts counted in the millions. Acorns is reported to have 4.5 million accounts and Stash reports more than 3 million. Although average account size is much smaller at these providers, this is significant consumer engagement compared to total accounts reported on the recent ADV filings at Betterment (542,000), Personal Capital (52,300), and Wealthfront (281,400).

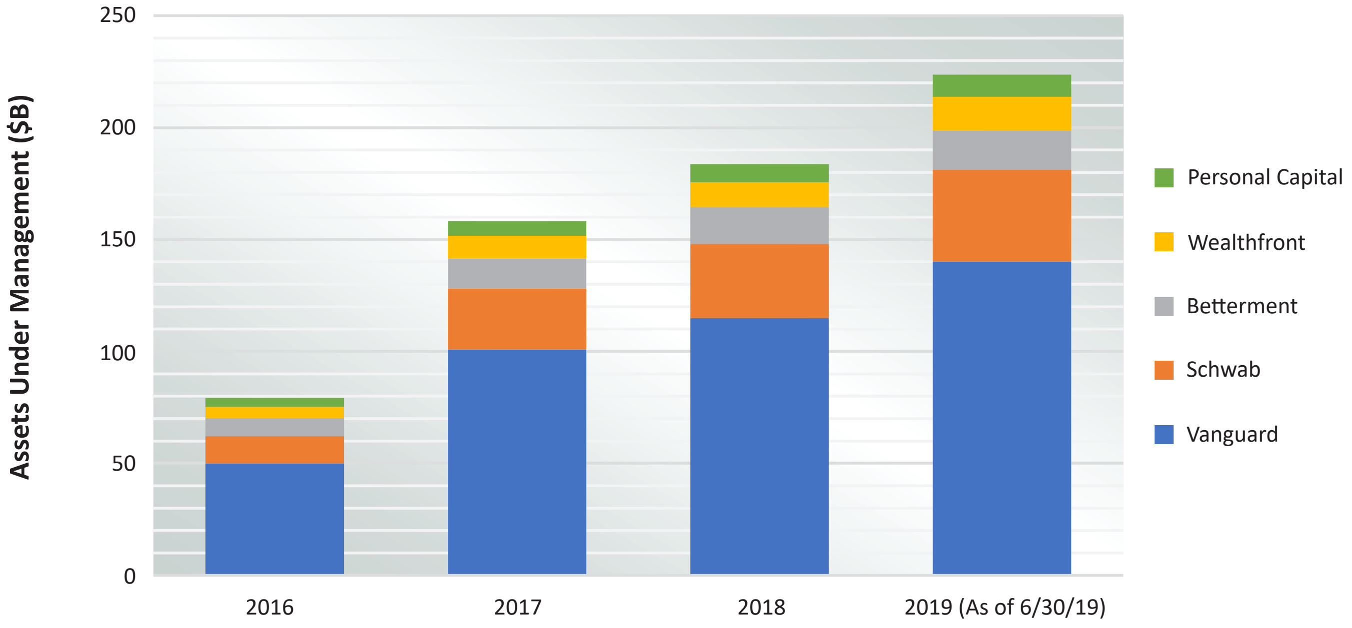
Fastest-Growing Segment of Advice

In 2016 and 2017, Vanguard, Schwab, Betterment, Wealthfront, and Personal Capital combined grew AUM at an annualized rate of 86%. Spurred by a bull market that witnessed a nearly 22% total return of the S&P 500, Vanguard and Schwab both more than doubled AUM in 2017.

It is clear that digital advice is outpacing the industry as a whole in terms of annualized growth.

Numbers published by the Investment Advisor Association, which measures the total assets managed by SEC-registered investment advisors, show that assets grew at an annualized rate of just 11% over 2016 and 2017. Cerulli reported in late 2018 that independent broker-dealers grew at an annualized rate of 11% over the previous five years, while the four major wirehouses grew at an annualized rate of just 6%. While digital advice still represents a relatively small portion of the professional advice mark, it is clear that digital advice is outpacing the industry as a whole in terms of annualized growth.

AUM Growth at Largest Providers (As of 6/30/19)



Product Development Drives Growth Results in 2018 and 2019

While 2018 showed a dip in growth at digital advice providers, the leading firms are returning to strong growth in 2019. Slowing growth in 2018 was against a backdrop of a down market, as 2018 was the first time the S&P 500 had a negative total return since the 2008 crisis. AUM is affected directly by market movements, of course, however investor confidence also typically decreases when markets become more volatile, in turn making individuals less likely to sign up for a new investing product.

When markets fall, investors increasingly look to hold cash, which coincided nicely with the recent trend of digital advice companies launching cash savings products. Betterment, Personal Capital, and Wealthfront have all launched savings products since December of last year. Cash accounts, debit cards, private equity exposure, and flat-fee pricing are all product developments we have seen at different providers over the past year. These developments, combined with the return of rising markets have helped digital advice providers regain previous growth highs.

Wealthfront's savings account has attracted significant assets. After appearing to not substantially grow AUM during the last five months of 2018, they have regained their footing in 2019. Since launching the account in mid-February, they announced in late April that they had already attracted more than $1 billion into the new cash product alone. Spurred on by the success of their competitive-yielding account, they raised the rate they were paying on it twice, and are now offering 2.32%, one of the highest rates currently available as of September 1, 2019. Wealthfront announced that it has accumulated $20 billion between their managed portfolios and cash accounts. This number was listed on their website last December as over $11 billion, meaning they have attracted roughly $9 billion since the end of 2018. Undoubtedly, much of these new assets have been attracted by their cash offering and may swing the other direction if they determine offering high rates is unsustainable, but in the meantime, it has proved an effective asset gathering tool.

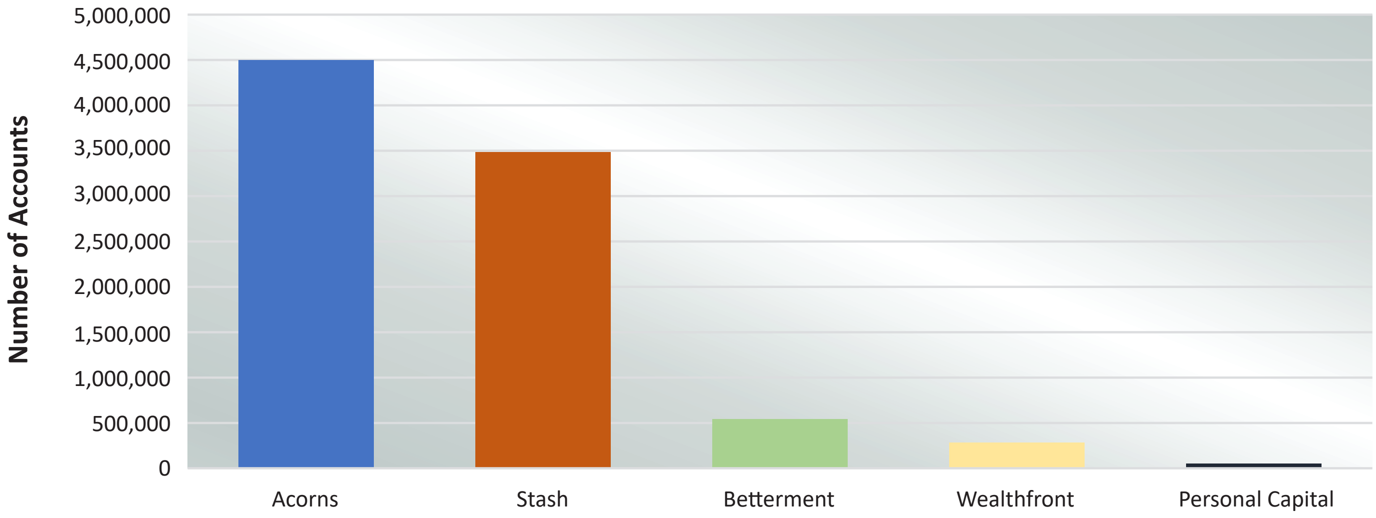
> *Since launching the account in mid-February, they announced in late April that they had already attracted more than $1 billion into the new cash product alone.*

On the other hand, Betterment's cash product has not been as successful, but recent announcements may change that. In late 2018 Betterment launched a cash management feature set, including an ultra-conservative bond portfolio, which did not appear to match Wealthfront's success. In recent news, Betterment launched a significant modification to their cash offering. Their new cash product will be FDIC-insured up to $1 million in deposits and, as of September 1, 2019, offers a 2.38% APY for users who join the debit card waitlist and have a brokerage account at Betterment. For those who do not meet those requirements, the rate is 2.13% APY.

Although Betterment's slump in growth extended from 2018 into the first half of 2019, their new cash account may turn the tide. Betterment ended the year with $16.4 billion in AUM and ended the second quarter with $17.6 billion, adding an average of $600 million a quarter this year. This is below their average pace last year of $735 million a quarter, and 2017 when they averaged $1.4 billion a quarter. Judging by Wealthfront's success when theirs was the market-leading savings account rate, we expect that Betterment will rebound in the second half of 2019 due to their new FDIC-insured savings account given that their savings account rate is now higher than even Wealthfront's.

Acorns and Stash have both launched debit cards, which have helped both companies continue to onboard users at impressive rates. It is reported Acorns currently stands at more than 4.5 million accounts and Stash has crossed the 3 million account mark, figures that dwarf other independent digital investing services.

Estimated Total Accounts Per Provider (As of 6/30/19)



Personal Capital is the most recent to join the high-yielding savings account trend, launching its FDIC-insured account in June. They have posted impressive growth results in 2019, growing $2 billion to cross the $10 billion mark since the end of the year. While it is unclear what role their cash account played, their model, which targets wealthier, more established clients, has proven successful. Like many in the industry, they saw a significant slowdown in 2018, averaging an AUM increase of only $380 million compared with $612 million in 2017. ADV filings also showed they opened 45% fewer accounts in 2018 than they did in 2017. Going into 2019, they expanded their services by acquiring and integrating a firm called iCapital, which gives their high-net-worth clients access to private equity at lower-than-traditional minimums. Whether it was the iCapital integration, their savings account, market growth, the return of investor confidence, or some combination, Personal Capital has shaken off 2018 and has grown, on average, $1 billion a quarter in the first half of 2019.

While much of this can be attributed to market growth, they are still adding quarterly assets in the billions.

Similar to Personal Capital, Vanguard has always connected their clients with live advisors and carries higher minimum investments than most others in the field. Vanguard is also continuing to add assets. In the first quarter of 2019, they added $15 billion followed by an additional $10 billion in the second quarter. While much of this can be attributed to market growth, they are still adding quarterly assets in the billions.

Product innovations also appear to be helping Schwab maintain growth. Schwab made headlines at the end of the first quarter when they announced flat-free pricing for Intelligent Portfolios Premium, their service that provides access to live advice and planners. Since announcing, they added $3.3 billion in assets, on top of $4.7 billion in assets in the first quarter. Schwab reported significant increases in account openings, average household assets, and new-to-firm households within the Intelligent Portfolios Premium product, showing that flat-fee pricing is proving attractive. Schwab's pricing change has other providers on notice; Bank of America's Merrill Edge is already considering following Schwab's example by switching to a subscription model for its services.

TD Ameritrade, with the third-largest AUM among digital advice products that publish AUM numbers, has actually reported a decrease in their digital advice assets over the previous year. Their Selective and Essential Portfolio products grew $3.7 billion between 6/30/2017 and 06/30/2018 to a total of $19.7 billion. As of 06/30/2019, they reported AUM of $19.9 billion, showing an increase in AUM for the first time since their 09/30/2018 reported number of $19.8 billion.

Four Years of Growth in Review

Digital advice took hold and experienced fantastic growth across providers from 2015 through the end of 2017. Despite increased adoption across incumbent financial institutions, the largest independent providers continued to attract investors and assets at impressive rates.

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Due in large part to poor market performance, 2018 witnessed a slowdown in growth among many digital advice providers. Entering 2019, independent digital advisors continued their march of innovation and increased the breadth of services. Wealthfront, Personal Capital, Acorns, and Stash have all posted impressive growth thus far in 2019. Betterment, on the other hand, has seen their growth falter into 2019, a trend that will likely turn around in response to the market-leading rate on their newly introduced savings account, as of September 1, 2019.

Results from the large financial institutions that publish numbers of the digital advice products were more mixed. Vanguard and Schwab continue to add billions a quarter, while TD Ameritrade showed lackluster results in through the first quarter of 2019.

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