CONNECTING THE DOTS

Digitally Enhanced, Multi-Account Portfolio Advice Will Rule the Post-Robo World

By Jack Sharry

We've all become accustomed to using technology to help make individualized decisions in our daily lives—faster, cheaper, and smarter. We rely on algorithms to tell us what to watch on Netflix, make hotel suggestions on TripAdvisor, and consume news "recommended for you" on various websites.

A recent announcement by industry leader Morgan Stanley regarding its goals-based wealth management platform is the point of the spear of a small group of disruptive industry leaders that are leveraging algorithms and combining advanced software systems to create risk-smart, tax-smart, comprehensive and coordinated platforms for the optimal management of all accounts and products in a household. These platforms are designed to include robos at the same time as they make a quantum leap beyond these simple product offerings.

The quantum leap we will describe is the next significant advance for retail investors and follows in the footsteps of earlier important shifts that have occurred in the advice business over the past 50 years:

1. In the late 1970s when short-term interest rates rose to the high teens, money poured out of savings and into a new invention at the time: the cash management account.
2. Interest rates fell through the 1980s and trillions of dollars found their way to a variety of mutual funds as savers became investors, often creating diversification by chasing five-star funds.
3. Advisory programs saw significant flows starting in the 1990s as investors pursued more customized solutions and help in managing risk across multiple accounts and products.
4. Recently, we've seen the rise of the robo advisor, a product solution that underscores the importance of a simple, low-cost technology-based user experience to manage retail assets. Although robos accelerated the embrace of technology, we will argue the real generational shift is that thanks to technological advances, comprehensive household portfolio management will become the new norm because it improves after-tax outcomes for investor households without increasing risk.

Wealth managers, asset managers, and technology providers are now building comprehensive platforms that will benefit investors by leveraging new-age technology to optimize and coordinate the typical five to six accounts in a household and create improved after-tax returns and income without additional risk. At the same time, financial advisors will benefit by providing enhanced advice, enjoy greater practice efficiency, and attract held-away assets while retaining current client assets.

This next generation of optimized platforms is helping investors, advisors, and firms make more and keep more money. All advisors and firms will have no choice but to follow the leaders.

The next big disruption isn't robo advice; it's risk-smart, tax-smart, optimal multiple account management.

ROBO LESSONS LEARNED

The importance of the robo role is clear—but limited. Robos have done a very good job of offering:

- low cost;
- simplified and engaging online user experience;
- more intuitive platforms for younger investors to get started saving for retirement;
- a way for the industry to provide digital advice with albeit simple, single-account asset allocation; and,
- stirred all financial advisors and firms to awaken from our collective slumber to fully embrace and incorporate technology to more efficiently and effectively serve clients.

But as you follow the money, the original disruptor robos that started this seismic shift have more headlines than assets. Investors who use robos have largely made single-account purchases, bought and maintained low account balances, and are younger, on average.

As the more traditional—and much larger—fast follower entrants into the robo arena, such as Vanguard, Fidelity, and Schwab are excluded, the assets raised by the initial disruptors are tiny. The two leaders are Betterment with $10 billion in assets under management[1] and Wealthfront with $7.4 billion in assets under management.[2] Retail investor assets total $37 trillion as of year-end 2017.[3] These two leaders account for 0.047 percent of retail assets—not even a rounding error.

The later entrants such as Schwab and Vanguard (with many more traditional firms launching similar programs) are getting the vast majority of the assets. They offer their robo capabilities as a product, not as a stand-alone solution.

And although robos have lowered the barrier to entry to encourage novice investors to get started, that is insufficient for investors nearing retirement.

Older investors don't have the luxury of getting it wrong. They are largely on their own. Except for a lucky few, they don't have pensions. They find themselves with more products, accounts, and the confusion and complexities of an accumulated life but not the comprehensive guided solution they want and need.

They purchased products from two or three advisors—with no hint of a comprehensive strategy or a plan—but they are unaware that by coordinating the jumble of products they've accumulated, they can achieve a more productive way to improve their prospects.

Robos provide low-cost, easy-to-use products but not comprehensive and optimized household solutions. And unless robos offer products other than their own, you won't see them become anything more than just another product.

Table 1

BENEFITS OF HOUSEHOLD LEVEL MANAGEMENT

Morningstar	EY
Asset allocation: 0.38%	Increase in income: 33%
Asset location: 0.52%	
Dynamic withdrawals: 0.54%	Increase in legacy: 45%
TOTAL: 1.44%	

THE PROBLEM WITH ROBOS—AND OTHER UNCOORDINATED INVESTMENT STRATEGIES

Robos don't provide a holistic, multi-account retirement strategy. Simply put, they are just another financial product. Like many other financial purchases, they often are acquired in a vacuum. The typical investor nearing retirement owns five to six accounts and products, managed by two to three advisors. Maybe there's even a robo in the portfolio.

Most of these investors have taken a haphazard approach to investing, tending to buy what just worked and sell what didn't. According to the 2016 DALBAR Quantitative Analysis of Investor Behavior, the 20-year annualized S&P return was 7.68 percent but the 20-year annualized return for the average equity fund investor was only 4.79 percent, a shortfall of 2.89 percent annualized.[3]

Using a "grass is greener" approach of buying the next product or strategy from the next advisor or firm in hope of doing better than the last time clearly doesn't work.

But as the DALBAR study demonstrates, investors' behaviors leave them in a position of falling behind. Buying high and selling low in an uncoordinated way falls far short of what investors need to get where they intend to go.

It's often overlooked that with a robo you can only invest with cash. You can't transfer assets to a robo because they only offer proprietary products. For the older investor, this means coming up with cash, or liquidating holdings and possibly suffering significant unwanted tax consequences.

When investors who have accumulated assets in these various robo products get serious about how best to prepare and manage their retirements, they have a lot of frustrations and questions but not a lot of clarity about what to do.

Morningstar and Ernst & Young (EY) have prepared separate studies finding that when multiple household accounts and products are managed in a coordinated and strategic way investors can realize significant incremental after-tax returns and income.[4]

The Morningstar study says this approach can produce an additional 100–200 basis points per year in enhanced returns. EY found that investors can improve after-tax returns and income by as much as 45 percent over an investor's lifetime (see table 1).

NEXT BIG DISRUPTION: COMPREHENSIVE, DIGITALLY ENHANCED ADVICE

Systematically managing multiple accounts for an investor over many decades can add hundreds of thousands of dollars in improved outcomes. A handful of wealth management, asset management, and fintech firms are partnering to create comprehensive, connected, and optimal platforms.

To be clear, we are not referring to a new and improved hybrid robo offering. We are describing the post-robo era, which is far beyond anything we've seen from these upstarts.

Figure 1

COMPREHENSIVE, COORDINATED APPROACH TO LEVERAGING DIGITALLY ENHANCED ADVICE

FINANCIAL PLAN	DATA AGGREGATION	INVESTMENT PROPOSAL	ASSET LOCATION	REBALANCE PORTFOLIOS	TAX-SMART WITHDRAWALS	IMPLEMENT
• Identify goals • Determine risk • Create asset allocation	Combine accounts from multiple custodians into a single portfolio	Recommend compliant products and investments	Suggest tax-smart advice across multiple accounts and models	Implement asset allocation and asset location	From multiple accounts and products	• Send trades to order management system • Assign models to SMAs/UMAs

DIGITALLY ENHANCED ADVICE DEFINED

We define digitally enhanced advice in the post-robo era as the combination and coordination of tools, capabilities, and products designed to optimally improve investor outcomes across all holdings, investment strategies, accounts, and income sources—up to and through retirement.

Through account aggregation and planning tools, advisors already have the data needed to provide digitally enhanced advice across an investor's portfolio. Advisors don't have the connections and full tool set, however, to take advantage of this holistic view and actually implement optimal solutions across multiple taxable and tax-advantaged accounts as well as income sources such as Social Security.

With connected data flow, tool set, products, models, and income sourcing, we can provide optimal guidance and decision-making across the household portfolio. And, if this is rendered consistently over a decades-long timeframe, significantly more assets are accumulated, distributed, and ultimately passed on to heirs.

The specific tools, products, and capabilities of this comprehensive and coordinated platform include the following:

- financial planning
- account aggregation
- risk management/asset allocation guidance
- investment and product proposal generation
- tax optimization across multiple products and account types to ensure tax-smart asset location
- ongoing household-level management and rebalancing of all holdings, products, and accounts, including: advisory models, brokerage holdings, and annuities
- optimal income sourcing and sequencing from multiple accounts, products, and other income sources such as Social Security and pensions, as well as Roth individual retirement account (IRA) conversions
- trading platforms
- household-level reporting

The individual technology elements already exist. What has been missing until recently is the connective tissue. That connective tissue is not limited to tools and data flow but includes the art—the handholding, understanding, interpretation, experience, and guidance only a human advisor can provide.

The art will be in combining all these elements of existing taxable and tax-qualified products and accounts with human advice. These connected tools empower financial advisors to deliver improved individual financial advice and counsel. This combination of human interaction and digitally enhanced advice is all part of the new post-robo future.

Wealth managers, asset managers, platform providers, and fintech firms are now collaborating, connecting, competing, enhancing, and quantifying the benefits of these comprehensive platforms that empower financial advisors to provide guidance on how to manage all accounts and products owned by a household.

These platforms provide advisors and clients with the following benefits:

Integrated workflow

Various tools designed to enable advisors to help investors do the right things have been available for a long time. What's been missing is the connection and coordination of the data that needs to flow to ensure a comprehensive approach to the management of their accounts. These digitally enhanced advice platforms connect and streamline—and most importantly—work from the same set of data and assumptions for each household to clarify and provide customized guidance as to what to do in a more efficient, consistent, and effective way.

Improved outcomes

There are only three ways to improve investor outcomes:

Consistently beat the market. This is no small challenge and is rarely achieved.

Reduce investment costs. The industry has been in a race to the bottom on costs over the past many years. Costs continue to spiral down for the benefit of investors.

Reduce taxes. Hearts & Wallets found that for families with $500,000 or more in investable assets, taxes are the single largest investor expense—more than all other expenses combined.[5]

The Morningstar and EY studies found that investors can enjoy significant after-tax improvement of as much as 100–200 basis points per year when assets are managed in a risk-smart, tax-smart household fashion.

For example, a $1-million household managed in this way could improve retirement assets by up to $250,000 over 10 years during the accumulation phase. A multi-account income optimization could add another $250,000 over a 20-year period of retirement income.

There are only two predictable ways to improve investor outcomes: lower costs and reduce taxes. Digitally enhanced advice is predicated on delivering both.

Quantified financial benefit

It's one thing to improve investors' outcomes, but it only matters if the investor can see it. Software exists that shows investors how much their after-tax returns and income can be improved through coordinated, optimal management of household assets.

Complexity made simple

Digital tools can help advisors provide an optimal level of guidance. Most investors have accumulated holdings in a less than cohesive way in preparation for retirement. The variety and complexity of product structures, not to mention the complexity of different tax treatments, extends beyond the capacity of any human being or spreadsheet.

That's why algorithms and software exist. Software provides a level of efficiency to benefit an advisor's practice that makes it efficient in terms of both time and cost to have software do the work.

A study by behavioral research firm Boston Research Technologies found it takes an advisor from one to three hours to determine a single optimal income recommendation across multiple accounts for a single client using spreadsheets. Software now exists in which that computation takes less than five seconds.

Optimal implementation across multiple accounts

All goals-based financial plans produce a household-level recommendation on what to own to meet the target allocation. What those plans don't suggest is how to organize the holdings to maximize asset location among the various account types, which can generate up to 50 basis points per year in incremental after-tax returns, according to the Morningstar study. New software capabilities exist to suggest how to implement optimal asset location among multiple accounts in a tax-smart way.

Optimal sequence of withdrawal

Capabilities also exist to do the following:

- show when to take Social Security benefits to maximize income;
- suggest the optimal timing to convert assets from a traditional IRA to a Roth IRA over time without kicking into a higher tax bracket;
- illustrate the optimal sequence of withdrawal from taxable, tax-deferred, and tax-free accounts, and,
- coordinate all the above to create a strategic approach to maximize income from multiple account registrations, investment products, annuities, Roth conversions, pensions, and Social Security.

Implementing a financial plan is complex and fundamentally important. The hardest part is creating a maximized income strategy. Tools now exist to coordinate all the different elements to maximize accumulation and income across multiple accounts.

If advisors can make optimal recommendations, shouldn't they?

Recent industry trends such as fee compression and regulatory change—especially the Department of Labor fiduciary rule—have made it more necessary for advisors to embrace new tools. Advisors intuitively understand the need to tap into the next wave of fintech to help manage client portfolios cost-efficiently and holistically.

There is technology that suggests optimal rebalancing and income generation across all the accounts in a household that can also quantify the financial benefit for the client. Managing multiple accounts, products, and income sources in a risk-smart, tax-smart way over the course of accumulation and retirement in one fell swoop is a powerful offer, especially when the benefits can be quantified in dollars, cents, and basis points. In light of the clear trend toward the fiduciary standard, if you can do all this, isn't it malpractice if you don't? Clearly those advisors who are embracing digitally enhanced advice in the post-robo era recognize this is the right thing to do and a real differentiator for their practices.

User experience

These connected, digitally enhanced advice tools have been designed to improve results. But as has been the case with any kind of digital offering in any industry, the user experience must be so simple and intuitive that anyone could connect the dots and reap the enhanced rewards.

Identifies clients in need

By combining client data available through digital account aggregation and customer relationship management tools along with asset location and tax-smart income generation software, the advisor can easily identify a list of clients who would benefit most from digitally enhanced advice as well as the dollar benefit the clients would enjoy.

Everyone wins

What's most significant about these emerging capabilities is that everyone benefits—clients, advisors, and firms.

- Clients enjoy improved returns and income, and a higher likelihood of a comfortable retirement and peace of mind. The good news for investors is that they will be far more successful as their assets are managed at the household level, which is an incentive to consolidate.
- Advisors improve customer retention, asset consolidation, referrals, and compensation. Advisors report that

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POST-ROBO WORLD . . .

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when taxes are reduced across a household portfolio, fewer assets leave to pay taxes, freeing more investments to compound in value over time. Advisors find that improved results for investors increase asset consolidation and referrals, leading to an increase in the book of business.

- Firms see a reduction in compliance issues and costs as well as an improvement in revenues and profitability.

CONCLUSION

We are now in the early stages of this brave new post-robo world. As these technologies become more broadly available and more fully connected, those who embrace them will come out ahead. By taking full advantage of the advances in multi-account technology, advisors will be able to provide smarter, more-comprehensive advice and improved investor outcomes, allowing investors and advisors alike to make and keep more money. The emerging post-robo world provides significant and quantifiable benefits for clients, advisors, and firms.

Wealth management, asset management, and fintech firms are now forging partnerships to create tools and connectivity that offer digitally enhanced advice as part of a larger platform to aid financial advisors in providing comprehensive solutions. This approach goes well beyond supporting one-off accounts and takes entire households with all their intricacies and complexities into perspective to provide the following:

1. more effective management of risk across all the accounts and products in the household;
2. reduction of taxes through optimal asset location as well as multi-account, multi-product, and multi-model optimization; and,
3. suggestions for the optimal sequence of withdrawals from those multiple account registrations, products, models, and income sources.

As investors move closer to retirement and work with their advisors to embrace a more coordinated, tax-optimized full-portfolio management approach, they will bolster their nest eggs with additional assets and income, becoming the ultimate winners in this post-robo world.

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ENDNOTES

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