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Warning! Alien Robot Approaching: What is a Robo-Advisor?

WEALTH MANAGEMENT
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The robot experience has percolated into most aspects of everyday life. Although it may not look like the robot from the 60s TV show Lost in Space, technology is driving innovation. In the investment world, the buzz has centered on the robo-advisor. Marketed to new investors, the robo-advisor scene has exploded. Promising well-diversified, low-cost portfolios, these products are something even a seasoned investor cannot ignore. But what's behind the hype?

Robo investments, available only online through dedicated websites, are typically a selection of exchange-traded funds (ETF). They are chosen, invested and rebalanced according to predetermined algorithms. For a new investor, it's a great idea. You can open an account for $5,000 or less and set up periodic investments. But you need to do some homework. First, who is the custodian of your funds? Make sure it's a legitimate SEC-regulated entity. Check fees. How much does the platform charge? How much are transaction fees, for instance, if you need to withdraw. Are there trading fees? All ETFs also have an annual internal expense fee that is taken from the returns of the fund. You can't see it, but it's still a drag on your returns. According to the Wall Street Journal, the average expense ratio is 0.44% or $22 for that $5,000 investment. Go to Morningstar.com and look up the funds held in the robo portfolio to research expense ratios.

There is no live help. Read their advisory agreement and product materials carefully. You can often "chat" with an online rep, but keep in mind that rep may be virtual and may not be able to answer your question. Another pitfall is the onboarding process. The robo will ask you to complete a questionnaire to determine how conservative or aggressive to invest your portfolio. Often it will present a graph of good and bad outcomes. For instance, if your investment can grow 50% in one year, would you be willing to lose 30%? Sound reasonable? But what if the loss comes first? Your $5,000 would become $3,500, and you'd have to gain 42% to break even. Carefully consider how much you would really be willing to lose.

Finally, consider tax efficiency. Automated rebalancing can create taxable gains, and most robos are programmed to rebalance, no matter what the consequences.

Using a robo advisor is worth investigating. For new investors, it is a first step in accumulating wealth. Investing can be overwhelming; automation makes it a simple process as long as you know what you are buying. As your wealth grows, you will need a real planner and advisor. Come and see us in a few years.

Contact us if you have questions regarding investments and visit the Schneider Downs Wealth Management Advisors webpage.

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