Potentially Hidden Costs of Robo-Advisory Services

After a few years in practice, the limits of these tools are starting to show.

The hot topic in investing today is robo-advisers. Like anything new, everyone in the industry is quickly trying to add a robo-product to the offering list. But the question remains, what really is a robo-adviser? And more important, what should you know about robo-advisers?

Robos began to emerge around 2008, but didn't really start to pick up traction until around 2011. The original idea was to use computer algorithms to make better decisions, and do it at a lower cost than with traditional money management. Fees were very low—in some cases, there were no management fees at all. This low-cost, automated investing was deemed to be the future of investing and has attracted billions of dollars in assets under management.

The perception for retail investors was that all robos were the same, when in fact the performance of any given robo was highly dependent on the asset allocation of the investments in the product. Like most new things, the hype has given way to the product's limitations. Performance can vary widely amongst advisers based on the allocation—for example, how much of the portfolio is allocated to international, small-cap, mid-cap, large-cap, value or growth. Is the portfolio aggressive, risky, risk-averse, or conservative? Does the portfolio invest in value or growth?

> Investors have fears, questions and concerns. The inability of robo-advisers to address those has led to Robo 2.0: hybrid robo-advisers.

Investors, especially younger investors, whose first experience was the tech crash in 2000, are emotional, not cognitive. Robos are cognitive. Investors have fears, questions, and concerns. They need someone who can answer those questions, calm those fears and concerns and reassure them that they are invested correctly for their long-term goals. Robo-advisory firms have realized this as a major limitation and have since begun to adjust for this by rolling out hybrid robos.

These tools started showing up late last year and early in 2017, and offer the investor an opportunity to speak with someone for a higher fee. Since robos are still fairly new, we should expect to continue to see changes to the service level and fees.

When thinking of using a robo adviser, the same consideration needs to be made that you should make if you are evaluating mutual funds, ETFs (Exchange-Traded Funds) or hiring a money manager. They are not all created equal, and you should not choose one based on the lowest fee. You need to understand the investment process that the product uses and the asset allocation. You need to know whether the robo-adviser harvests losses and is tax-efficient. You should know what the customer service will be like; will you have access to a live person?

The support level is by far going to continue to be a major factor in the success or failure of robo-advisers. The current bull market in stocks has been going on for over 100 months. Investors have already demanded to have phone support in an up market, where most everyone is making money. At some point, however, we will see a bear market and investors will begin to get nervous as the accounts start to go down.

How will the robo-adviser adjust? Who can you call to discuss your fears, concerns and long-term goals? Will a representative on the other end of an 800-number, someone who has never met you, be able to reassure you that you will be alright and to trust the computer algorithm?

Certified Financial Planners, in general, offer the highest level of client service, ranging from an annual call to unlimited calls, depending on the level of fee you pay. The questions each inves-tor must ask himself, then, include, "Do the people I'm talking to have experience as investment managers? Can someone on the other end of that long-distance call give me accurate advice on my most important asset—my retirement money? And how, if they have never met me and do not know my whole financial situation?"

Like most things, robo-advisers have their place. Will they really revolutionize the investment industry? Not likely. They have a place for smaller accounts that don't qualify for money managers that have minimum-account requirements.

But in the end, working with investment professionals who have years of experience behind them, and who know you and your family, know your investment goals, your risk tolerances, income needs and long term investment strategy, still has value. I

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