1.0 EXECUTIVE SUMMARY

>> MyPrivateBanking Research estimates that global assets under management (AuM) of the robo-advisor services will reach $14 billion by the end of 2014. The lion's share of these assets of 83% will be managed by robo-advisors based in the United States. Within five years the global AuM of robo-advisors is forecast to grow to an estimated $255 billion. And this number does not even include assets which are invested under the recommendations of an automated financial advisor but controlled by private investors (the so-called D-I-Y investors). <<

"*Software is eating the world*" (Marc Andreessen)

Therefore, the market for robo-advisors is increasing rapidly but is still tiny in comparison to the AuM of conventional wealth managers. The aggregate AuM of all registered investment advisors is reckoned to be close to $5 trillion in the United States alone. Robo-advisors will win only a small market share of this total market in the near and medium term. In the light of this difference it may seem that the media attention focused on robo-advisors is pure hype. However, MyPrivateBanking's view is that, while wealth managers may not yet appreciate the need to respond to the challenge that robo-advisors present, they should be making the most of the opportunity to compare robo-advisor business models with their own now.

Reassurance that robo-advisors will be unable to generate adequate sufficient fee revenues to justify the investment their backers are making or that in the long run wealth clients will always prefer the face-to-face contact of their own dedicated personal advisor will not hold over the long-term. The robo phenomenon is here to stay and we believe that there is good reason to expect robo-advisors to be highly successful as a class.

In MyPrivateBanking Research's first look at the phenomenon of robo-advisors, we analyze what robo-advisor services comprise and what these new providers are setting out to achieve. So this report is intended to locate and position these new stars in the financial universe as accurately as possible. However, even more importantly, we wanted to check out robo-advisors for the implications they will have for conventional wealth managers. Although, our early warnings are necessarily provisional, the possible implications are both deep and wide-ranging.

To a great extent, the opportunities and the dangers presented by robo-advisors can be summed up in the single word 'technology'. Indeed, despite the media's focus on the term 'robo-advisor', most of the first wave of robo-advisors would probably prefer to be seen as automated advisors or technology driven investment managers. The key thing to appreciate is that this is not just another wave of technology that's available for conventional wealth managers to adopt (when they're ready for it). The widespread almost simultaneous uptake of a relatively limited range of technologies by new players in the investment industry suggests that a revolution in investment advisory services is underway and that in a relatively short space of time this will begin to affect neighboring disciplines such as financial planning and asset management. Many of the brains behind the robo-advisor companies not only fully understand the potential of the technology, they also have a keen appreciation that a tipping point has been reached in terms of how mass affluent investors see the technology can be deployed for their benefit.

The Heart of Robo-Advising

MyPrivateBanking's research of robo-advisors has identified three vital components:

- **Technology**
- **Passive Investing**
- **Investor Behavior**

Each of these characteristics is present in varying proportions in the robo-advisory firms that we studied. Technology provides the bedrock of the robo concept while passive index-tracking investment funds such as exchange traded funds (ETFs), which themselves depend upon technology to be feasible, have now become familiar to millions of mass-affluent investors. At the same time, technology and index-tracker investments have opened up new ways to nudge people towards consistent saving and investing habits.

These three components constitute the core of the challenge for the established wealth management industry:

- **Technology** - the range of characteristic technology deployed by robo-advisors includes self-assessment and portfolio recommendation tools for prospective clients and portfolio rebalancing and attractive, helpful portfolio dashboards for clients. (… more in full report)
- **Passive Investing –** robo-advising and passive investment strategies are sometime spoken of together as if all robo-advisors only using investment strategies that are completely, purely passive. (… more in full report)
- **Investor Behavior –** robo-advisors have good reasons to be focused on developing particular investor behaviors among their clients. (… more in full report)

In consequence, we believe that the robo-advisor phenomenon is creating a real risk scenario for conventional wealth managers, one that goes beyond winning some market share:

- **Winning over clients,** mainly in the segment of younger and affluent individuals who are instinctively at home on the Internet as service consumers
- **Popularizing passive and indexing products** as a sound basis for a life-time saving habit
- **Using technology as their primary marketing** tool with websites dedicated solely to client acquisition
- **Putting pressure on the fees of conventional wealth managers** with low advisory fees, low fund fees and a strictly limited range of services – not by trying to be all things to all wealth clients. Overturning the perception that portfolio recommendation and portfolio rebalancing are high end services

In order to demonstrate the disruptive force of roboadvisors we have quantified the threat potential of the analysed firms. The result shows that today WealthFront, Personal Capital and Betterment represent the highest disruptive potential to the wealth management industry. In particular their ability to win new clients, their marketing prowess and their deep funding pockets contribute to this threat. Overall, our comparison of robo-advisors' disruptive potential reveals that even though the robo-advisors are only just getting going as players in the wealth management industry, their presence is likely to be the cause of severe turbulence for traditional wealth managers.

Lessons to be Learned

Although we would certainly not recommend any wealth manager to merely imitate the techniques that our analysts found repeated among robo-advisors, there are undoubtedly some areas where they excel as a group. Good examples of this are the very focused nature of robo-advisor websites, the adequate provision of client service channels and the widespread use of social media to good effect.

There are also sensitive areas where robo-advisors already seem to have clear advantages in attracting clients. These include low fees, attractive self-assessment tools, rapid enrolment and the widespread availability of portfolio rebalancing. These are all present challenges to conventional wealth managers; at the very least they should examine if any of them threaten their ability to continue to acquire clients in the way in which they have been accustomed to.

Perhaps equally importantly, MyPrivateBanking has identified a number of likely or possible developments that will mean that robo-advisors may soon have influence on the development of traditional wealth managers that is out of proportion to their current small size. Listed below are some of the most important possible trends with serious implications for conventional wealth management business:

(... more in full report)

Report Approach

MyPrivateBanking's analysts kept these core characteristics as their focus throughout our study of 14 individual robo-advisor companies, eight of them in the United States and six in Europe. Our definition of robo-advisor includes wealth management organizations which offer automated investment services such as algorithm-based risk assessment, automated portfolio selection, and automatic portfolio rebalancing. For our market sizing model we have included only assets under management of robo-advisors, i.e. assets that are transferred to an account that is either with the robo-advisor or managed accounts where they are the investment manager.

Our research is based on in-depth study of the publicly available interfaces of each of the 14 robo-advisors and interviews with senior management figures of these robo-advisors, plus background reading on individual advisors and the industry as a whole from independent sources including vast material that was filed with the SEC (U.S. advisors). Consistent with our customary approach we look at these providers firstly as a group in general chapters looking in more detail at the report's focus and the strategic implications for wealth managers. In our Summary of Findings chapter we highlight a number of important trends among robo-advisors with examples from individual providers. The next section, the individual profiles, is the center of the report, with detailed information on each robo-advisor and including wherever possible a test drive of the provider's self-assessment/portfolio recommendation tool. In the individual profiles we have endeavored to identify the unique features of each provider's service, especially in relation to their target market and deployment of technology. Lastly, we provide a brief survey of robo-advisor best practices in the area of client communication. The best practices have been selected primarily as inspiring ideas that deserve to be replicated by wealth managers in general rather than because they merely provide a competitive advantage against other robo-advisors.

There are two specific areas of this report where MyPrivateBanking wanted to place robo-advisor developments in the wider context of wealth management businesses. Firstly, each of the individual profiles includes a short list of '**Wealth Manager Learning Points**'. Normally, MyPrivateBanking makes recommendations in each of its provider profiles but in this case we wanted to highlight ways in which robo-advisors are in fact sharing the wealth management market place with conventional providers and to suggest areas in which wealth managers could adapt robo-advisor features. Secondly, in our strategy chapter we have included the results of our comparison of individual robo-advisor's **capacity for disruption** among wealth managers. Here we have produced a short benchmarking comparison of robo-advisors that includes how substantial they are as businesses along with our estimation of how attractive their services and methods of user interaction could be to existing wealth manager clients.

In producing this report, the MyPrivateBanking research analysts' approach has been informed by the principles that we have emphasized in earlier reports on subjects such as wealth manager websites and social media and the potential of client dashboards in client and client relationship manager mobile apps. As with all our reports, we have also aimed to be wholly objective in weighing up client interfaces.