Understanding Robo-Advisors: Pros, Cons & Dilemmas

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Keith: Welcome to The Empowered Investor. My name is Keith Matthews, and I'm joined by my co-host Marcelo Taboada for today's episode.

Marcelo: Keith, I'm doing great. I'm super excited for today's show. We have a very special guest and also a very exciting topic. I think people are going to enjoy it.

Keith: Absolutely. Today's topic is robo-advisors. And our guest is actually one of our colleagues, Lawrence Greenberg. Lawrence, welcome to the show.

Lawrence: Keith, Marcelo, it's fantastic to be here.

Keith: Very cool. So Lawrence is part of our next generation advisory team. The first generation, which would be the older crew in the firm, would be Don Tulett, myself, Edmund, and Hugh Campbell. The newer generation advisory group, the younger guys, would be Ruben, Marcelo, Lawrence, and Jackson. Lawrence, you're part of this group, but it is exciting. So tell us a little bit about your background and why you chose wealth management.

Lawrence: It all starts back to when I started my undergrad at Concordia. I knew I wanted to go into business, and I ended up landing on finance by happenstance, and it turned out to resonate very well. I had an internship in my third year here at the firm as a co-op student, and that really helped me hone in on the fact that while I do enjoy finance—it's a great tool to have—I'm really passionate about working with people. And that's where it became clear to me that the wealth management route is for me. So right out of school, I worked as a financial advisor. It's been five years, three of which have been at the firm, and the other two were spent at a big Canadian bank and another wealth management team.

Keith: Yeah, I absolutely remember meeting you, Lawrence, about five or six years ago. You were working as a volunteer at the Alzheimer charity event, and you were introduced to me as somebody who really wanted to get into this industry. And we met during the week after. What really struck me, Lawrence, was the fact that at a young age, you knew exactly what you wanted to do.

Lawrence: I am quite fortunate that pretty early on in my education and my working experience, I knew what I wanted to do with the rest of my life. I knew that being a financial advisor and working with clients and client families—it's fulfilling, it's engaging, and I'll be happy to be doing it for another three, four, five decades.

Keith: That's a long time, Lawrence. I do think it's amazing. You're doing an amazing job with our clients. I work with you on a very regular basis as we take care of clients and serve their needs. Marcelo, let's get into the show. Welcome, Lawrence, again. So today's show, we're going to be reviewing robo-advisors. We're going to focus on their role in Canada. We will review the advantages and the disadvantages of using a robo-advisor, and then we'll discuss how we actually use robo-advisors with some of our clients and some of our client families. And then finally, we'll comment and we'll have a discussion around what is becoming a little bit of a dilemma in the sense that robo-advisors really started by delivering portfolio services only, and they seem to now be getting into heavy trading concepts. And that's a bit of a dilemma for an investor, and so we'll discuss that—short-term versus long-term. Marcelo, let's jump in and start with what is a robo-advisor?

Marcelo: Yes, great question. Let's start with what they're not. A robo-advisor is not a robot that comes to your living room and invests for you. It's also not the type of robot that's going to take over the world in the next 20 years, right? In a nutshell, a robo-advisor is a service or a firm that's registered as a portfolio manager and is allowed to do investing for people. But everything is done through an application, and you do this through your phone, your computer, or your tablet. Now, essentially what then happens is once you sign up to invest with the robo-advisor, they use artificial intelligence to put you into a specific model. So for example, Keith, you're coming in, you're going to invest in a robo-advisor. I open my application, I sign in, and they will invest for me based on the portfolio they decide for me. So if it's a certain risk level, they'll keep me there, and it's all automated. So it's all based on technology and artificial intelligence. So that's what a robo-advisor is in a nutshell.

Keith: Thank you, Marcelo. Essentially what you're saying is they will determine the risk tolerance, the objectives of an investor, and then match a specific model portfolio of some sort.

Marcelo: That's exactly it.

Keith: What else would you add in there, Lawrence? What do you think is a robo-advisor? What's your definition?

Lawrence: It's really a platform to invest that's somewhere in between a do-it-yourself investor and a human advisor. So it's not quite as involved as if you wanted to buy specific stocks or funds on your own, and it's not for someone who needs the full service of a traditional asset management platform. It's automated, it's fairly simple to use, and that's where they fit in the spectrum of the investment options.

Keith: Okay. And to be clear, they are licensed as portfolio managers. So they have the portfolio management license, and then they essentially offer that service through a computer. That's at least one of the services they offer. So let's talk a little bit about advantages and benefits. So what makes this an interesting or a positive way to conduct business?

Lawrence: I think one of the biggest advantages that robo-advisors have is the fact that it's a very simple platform to use. They pride themselves on making the experience very user-friendly, easy to monitor, especially for someone who's a new investor or a younger investor—these are things that are quite important. Another big thing would be the fact that the underlying portfolios are constructed using low-cost passive index-based strategies, which is a huge win for investors. I think we all agree that is the appropriate route to take to put investors in a good position to do well over time. Another big advantage that the robo-advisors have is the fact that they automatically rebalance your cash flows, which is a big part of the convenience factor. So as you buy and sell and add and withdraw funds, they keep your target in line. They keep your portfolio balanced and where it should be. And in terms of fees, they are quite reasonable. You'll be paying less fees than if you were with a traditional asset manager but a little bit more than if you were a do-it-yourselfer.

Keith: Okay. So thank you, Lawrence. That's a list of advantages and benefits. What else? Do you need certain minimums? How do you act with new money coming in?

Lawrence: So generally for robo-advisors, there are no minimums. And if there are, they're extremely low. Back in the good old days, you needed a good chunk of change to be able to get in the door with investing. Those doors have almost been completely broken down, and you could have as little as $500 or $1,000, and you could get started with a balanced portfolio.

Keith: Nice. Nice. Yeah. What I like about the robo-advisor concept is for many years, Canadian investors were dealing with this idea of if they didn't have critical mass to get into a portfolio management firm, and let's say they had between zero and a couple hundred thousand dollars, the choices were limited, and it tended to be high fee, low service offerings. High fee, low service doesn't sound good when you're a consumer of anything. And we recognize that the robo-advisors don't have a massive service offering because it's a computer-related program, but at least they're charging rates that are much lower. So you have much lower fees and lower service, and that seems to be a better fit. And it's a huge solution for a significant portion of Canadians. But those are the advantages. So what are some of the downfalls? What are some of the things that they don't have?

Marcelo: I think the biggest disadvantage, in my opinion, and I'm sure you guys will agree, is that there's no financial planning. There's no financial advice because, Keith and Lawrence, at the end of the day, let's be real here, this is a commoditized service. And as great as it is, you cannot expect a personalized service for something that's commoditized. So I'll give you a very practical example that we see on a day-to-day basis with our clients. You have questions about whether you should put into an RRSP or a TFSA. You want to save for a house; what's the best avenue to do it? You want to save for your children's education; how do you go about doing that? All these questions are very specific, and they need a lot of tailor-made advice. You won't get this through a robo-advisor.

Lawrence: Absolutely.

Keith: Yeah. Those are questions that accumulators and the younger generation will have. And I would echo that and suggest that they don't have the planning for the older generation too, which are the retirement plan and the drawdowns.

Marcelo: Oh yeah, a hundred percent. You have someone who needs to retire and needs to see where the money's going to come from. They won't be able to provide you a breakdown of what's the most tax-efficient way to do this and that sort of thing.

Keith: Yeah. And to be clear, I know there's probably a dozen robo-advisors in Canada. Some are trying to explore how to give advice, how to charge for advice in addition to the execution of what is a portfolio service. I've often thought I'm not sure why they've been called robo-advisors because if they're not an advisor, it just doesn't make any sense. What they probably should be called is robo-portfolio.

Lawrence: Exactly.

Keith: Now that said, I know that some of them are trying to explore the idea of offering advice. Lawrence, any other disadvantages or any other weaknesses that you see that you want to add in here?

Lawrence: I think that's the big thing is you have to understand the limits of these types of platforms, and it's not for everybody. So it's important to understand your situation. Does this make sense for me? For some, yes. And especially once your lives get more complicated financially speaking, then there may be a point of no return where you have to look at other options that are more comprehensive and more holistic.

Keith: Yeah, absolutely. Our service set, if you will, is fairly extensive in the sense that there's portfolio, there's planning, there's tax, there's estate, there's retirement, and this is a really well-rounded approach. So the robo-advisor will really attack one component, and there'll be limitations to that. Okay. So that said, we really endorse the whole concept. We think it's a wonderful solution set. We've started to use, suggest, and recommend robo-advisors. In particular, we're making suggestions for one. I'll set the framework up. Usually, it's when a client who has adult children comes to us and says, "Listen, my kids are between the age of 18 and 25. They're ready to start investing. They're ready to start opening up tax-free saving accounts, RRSPs. Can you guys help? Can you offer a service?" And we're not actually set up necessarily to offer these services for smaller accounts because there's a lot of clients. There's a tremendous amount of work that goes in. What we typically do is offer a guidance program where we say to our clients, "Listen, we'll work with the adult kids and we'll help set them up accounts." And so, Lawrence, you've had a lot of experience in helping a lot of our families out in terms of opening accounts with Wealthsimple and guiding them through the process. Tell us a little bit about how that starts and how these young adults respond to the guidance that you provide.

Lawrence: Yeah, thanks for asking. So I've spent a fair amount of time with, I'd say, 10 to 15 different people in the age of 18 to 28 who are in a situation where they want to start investing or they've been doing it for a little bit of time and they need guidance on how to move forward, what makes sense for their situation. So what I'll do is sit down with these individuals, walk them through some core concepts on investing, saving, and portfolio, and help them through the onboarding process, making sense of what these questions are and what the data that they're trying to gather means. Once they're set up, try to create some habits and a plan of attack for the next years to come. Generally, in this age group, you're saving, you want to optimize your TFSA depending on your situation, your RRSP, and then go from there.

Keith: Generally speaking, how have people found Wealthsimple?

Lawrence: I think, as we've honed in on before, the platform is quite easy to understand and easy to use, which is a really big win, especially for this age group. They're able to log in, and it's quite lean, which is a good thing. I think from the perspective of being able to really understand what you're doing and what you're looking at.

Keith: Lawrence, what do you mean by quite lean? What does that mean?

Lawrence: There are some times where the information presented is on the limited side. You may have to dig to get some more detailed performance on your cash flows. This is feedback I have received from people who have been using the platform. They want to make it very accessible information, so your balance, where your portfolio is at. But if I would ask someone who is in their mid-twenties, "What do you own? What types of funds do you own?" There are times where I've gotten the feedback that, "You know what? I'm not quite sure. I know I have a portfolio, but not necessarily what's inside the portfolio." And you may have to do some digging if you want to learn more about your investments.

Keith: I see. What you're talking about is the information is fairly general, or the individuals we've worked with didn't find it was easy to see what's underneath the hood.

Lawrence: Absolutely.

Keith: Okay. I know prior to Wealthsimple, we used to refer a lot of our younger adult clients to Tangerine, which essentially is a service now owned by Scotiabank. And that was, in the early days, a lower-cost index-based portfolio solution where you did a risk questionnaire and you could only choose three portfolios. And it would guide you, and you would end up buying into it, all of which was still following sort of some of the general principles that we discussed in The Empowered Investor and principles that we use with our existing clients, which is using index-based portfolios to drive their long-term returns. So what's the difference, Lawrence, between Tangerine and Wealthsimple? I know that Tangerine will come in at maybe half the cost, half the price. Instead of 1.07%, I know that Wealthsimple will be somewhere in the vicinity of 50 basis points plus or minus, and then there's exchange-traded funds.

Lawrence: So definitely with Tangerine, they were one of the first movers to start adopting this type of platform. And at the time, they were the only show in town, and they did a great job in offering portfolios that were reasonable from our perspective. From that time, there have been more entrants into the market that have been more reasonable with their pricing. And that's why, for instance, we generally recommend Wealthsimple for that balance in fees and the usability and access.

Marcelo: By the way, Keith, I just checked online right now, and the Tangerine funds have gone down in price from 1.07% to 0.77%.

Keith: Wow. That's great. And again, that's not necessarily a robo-advisor, but it's pretty similar in the sense that it delivers a portfolio and ongoing portfolio service—no planning, no discussion. I wouldn't say disadvantage, but what are the other things that the computers lack and they don't have at all when it comes to working with clients or young investors or investors at large is they don't have empathy. And I know that you guys are probably both chuckling because I know we talk a lot about that and how we want to work with individuals, but that's one of the biggest things that, unfortunately, is not in these systems is a human touch and the understanding as to what might be your priority.

Marcelo: No, but think about Lawrence's story and even myself. A lot of people come into finance because they love investing, and they love the numbers and the complexity of a portfolio and all that stuff. But we end up staying in the industry because of the human connection and the difference we're making in people's lives. So I think it's a huge part, Keith.

Keith: Absolutely. A hundred percent. So Lawrence, what are some of the final comments that you might have with regards to the young clients' experiences around using these?

Lawrence: Yeah. In terms of the experience, the feedback that I get in the demographic that we're talking about here is quite positive. Generally speaking, the onboarding process is extremely smooth. There's a series of questions, both personal and financial in nature. And each of those questions acts as an input to the algorithm that will ultimately produce your portfolio. So it's important to understand that. The way they gear these questions, they're trying to gauge your risk levels, your goals, and your overall financial standing in order to hone in on the portfolio that ultimately attempts to fit your overall allocation and what your portfolio should look like. After the fact, in terms of using this platform over years and really interacting with it and getting to know it, the feedback that I get is quite good. They're able to stay on target. They're able to understand their accounts and what's going on in there. For the most part, I have heard of some times where it's becoming clearer and clearer as the assets grow. Maybe you start having kids, thinking about marriage, the needs start to go above and beyond what's available through these robo-advisors. It absolutely does a good job in managing a portfolio and creating a platform that is simple to use.

Keith: Okay. So when you just said needs, what do you mean by needs?

Lawrence: Really, it's planning needs. That's what I'm referring to, right? There generally is a point where just the portfolio management doesn't fit their overall needs. And by that, I mean planning and financial advice, more tailored servicing.

Keith: Makes total sense. And so you see that feedback from the younger generation.

Lawrence: Yeah, absolutely.

Keith: Very cool. Let's switch gears a little bit here. Thank you so much, Lawrence, for those responses in terms of what we're seeing with our younger adults of existing clients and how you've worked with them in helping them with their portfolio execution at Wealthsimple. Marcelo, what do you think about this whole idea of robo-advisors democratizing access to investing?

Marcelo: Honestly, I think we live in a remarkable time. I think last podcast, I told you that if we would have had the pandemic in the 1990s without the infrastructure that we have now, the economy would have collapsed. So I think it's like the same time for investing. There hasn't been a better time for the average person and a young person to start investing. Think about what it was back in the '80s, the '70s. People who had $1,000—there's no way that they could have access to a fully diversified portfolio. So I think the whole movement has a lot of positives. One, it teaches young investors how to access the market. It's decreasing our reliance on big banks. So think about it before. If you had $1,000, you had to go to a branch and get into a very expensive mutual fund, probably charging 2.5% for a very small amount. Now you can get a very reasonable, low-fee portfolio that gives you a good chance of having a good return. So all these things are amazing. And the fact that we're living, I think sometimes we've got to stop and recognize that it's probably the best time to be alive if you want to invest.

Lawrence: Well said.

Keith: You're bang on in terms of democratization. I've never seen so much choice. I've never seen so much well-priced choice. And essentially, if you get back to one of the reasons why we put pen to paper almost 20 years ago in talking about exchange-traded funds, is that it's really these tools that have really democratized, and these robo-advisors have adapted themselves according to these tools. And then the technology.

Marcelo: Yeah. And I love that they've embraced passive investing, which we have decades and decades of evidence that active management and trying to beat the market is a futile game. So I'm very happy to see that.

Keith: So we're excited about all the pros and all the benefits and all the advantages. Now part of the show is going to talk about right now some of the controversy or areas that we think have some controversy. And specifically, what we're talking about is some of the trading applications. So Lawrence, explain to us what we now call the three doors at Wealthsimple. What are those three doors we're talking about here?

Lawrence: Yeah. So that's a great question. To clarify here, so far in the show, we've been referring to Wealthsimple, and that's Wealthsimple Invest. There are two other platforms that are available when you first go on their website. It's Wealthsimple Invest, Wealthsimple Crypto, and Wealthsimple Trade. Now those are all doors you could go through through Wealthsimple, and other robo-advisors are embracing these other platforms where in Wealthsimple Trade you have access to free trading for stocks, both in Canada and in the U.S., and Wealthsimple Crypto, you have access to cryptocurrencies, right? So that is a whole new door that has been opened, especially in an era where there's a lot of speculation, a lot of froth in the market. And we're seeing pockets of bubbles that have been opened in part by these new platforms and this new access that investors are seeing.

Keith: I guess the real leader here is in the United States with an organization called Robinhood. And Robinhood really started this process a few years ago. And again, they named themselves Robinhood after the sort of the story of Robinhood—taking from the wealthy and giving to the poor. And their version of Robinhood is to take from Wall Street and democratize the entire investing solution. Ironically, some of these platforms are less about portfolio construction and more about active trading. And it seems like a firm such as Wealthsimple now opening up these doors, it starts to get real tricky because while you say, "I really like this door about diversified portfolios and staying the long course, the long term," they've also opened up these doors and saying, "Trade actively, trade frequently, buy and sell securities." They've also opened up a door called "Come into our crypto world and we'll help you trade." We believe that speculation... And I'm sort of a new user of Instagram, and I got to tell you, the only advertisements I see of Wealthsimple on Instagram are trading in crypto. And I'm like, "What about their good stuff?"

Marcelo: Keith, you got to stop talking about it with your friends because your phone is listening to you. That's the problem.

Keith: Oh boy.

Marcelo: Yeah.

Keith: What about the good stuff? What about that boring, diversified portfolio? To me, that's the real value. And I think by opening up these other doors... We've been in this world where, in the last 18 months, speculation has paid off technically. And those that have been chasing these high-flying securities have done well, but that's not going to last forever. My concern is a lot of individuals who were going down the right path are going to be exposed to the sort of the darker sides of investing. And I think that's going to derail some people.

Marcelo: It would be interesting to see the people who are in the passive portfolios, how many of them are being tempted to go in and open the door for the crypto or the day trading. It would be interesting to know.

Lawrence: Yeah, I'm seeing lots of chatter on people in the younger age groups and on these online platforms that maybe they have a portion of their portfolio that's the safe money, and that's through the portfolio aspect. And they have a small chunk that's for trading and speculation, but it's a slippery slope. And by not having your eyes on the prize, it could be destructive at times.

Keith: Lawrence, did you read the second version of The Empowered Investor? Because we had a chapter called "Core and Explore: The Slippery Slope." I know that's just kind of happenstance in terms of the way you put it together, but how ironic.

Lawrence: I know. I think that's happenstance. I think I got involved at the third edition of the book and became familiar with it.

Keith: Great minds think alike.

Lawrence: Exactly.

Keith: Yeah, we're not big believers of core and explore. I've been doing this for a while, and I think what happens is people use that core component to feel good about their portfolio and the direction. And they say, "I'm only exploring with 10 or 15 or 20%." The problem is the 20% that gets them into trouble. And all they talk about is their 10 and 15%. And so you lose track of things. And that's my concern with these different doors at these robo-advisors—they've got a beautiful door, and we want individuals to embrace that door.

Marcelo: There's a beautiful quote that I read from an article that you sent me, Keith. It said, "A portfolio is like the bar of soap. The more you play with it, the smaller it becomes." So I guess it's too much temptation for that.

Lawrence: I like that. I'm going to use that. It's a good one.

Keith: Guys, if we look at even Robinhood, I think part of what's going on in Robinhood and the Wealthsimples is their obsession with creating market value for themselves. Robinhood is a company that will be going public in the near term. Wealthsimple is in the newspaper with regards to their valuations and where they're at. And I think what drives these valuations is investor activity. What drives investor activity is trading. It's not building these diversified portfolios. And we look at Robinhood. They've been fined twice. And the reason they've been fined twice is because they're building platforms that are very hard for them to supervise. Their number one trading situation is trading options. And that's a very hard thing to trade. It's a very hard thing to supervise whether the end user is educated enough to be allowed to trade options. Who's to say that the end user of a robo-advisor is sophisticated enough to trade cryptocurrencies? I think if you look at a Robinhood, the problem, the challenge is their valuations are so large. And when they get fined, it hits the newspaper, but the fines are so small relative to their valuations that as a business owner, they probably just drive on and say it's all worth it.

Marcelo: Yeah. And by the way, Keith, you've been an advisor for 25 years or more. We've always had this speculative behavior across generations. This is not a new thing. I think the dangerous thing now is that it comes in an application that almost feels like a game, and it's gamified. So the access to it is way easier than it was back in the, let's say, dot-com bubble, for example.

Keith: I agree with you a hundred percent because now you've got the buzzers and the beeps going off on your smartphone about different trading activity. But you're right. This is the dilemma that we wanted to highlight in the show around the robo-advisors. On a principal basis, we love the concept. We use the concept. We support it. There's a lot of great benefits, but there are risks. And I think individuals need to understand. We're going to call it the darker side because that's how we view investment froth, but people have to understand that. Otherwise, they're going to get themselves into trouble. So one of the nice things also, I think, on Robinhood, and it's in the press, is they're about to do an IPO. And true to their form, they are thinking of the little guy. They want to make sure that somewhere in the vicinity of 30% of their shares go to their own end users, which is an enormously high percentage of shares. Another sort of movement against Wall Street, against the large mutual fund company, in the direction of the small investors. So there is this movement that kind of wants to say, let's reward the small person, the small guy, the small girl, and move forward on that front. So let's start to wrap up here. This has been a really wonderful show. I think, to me, we need to create a show on do-it-yourself investing just to allow this idea of who might be the right candidates for do-it-yourself investing. So just discussing robo-advisors makes us want to think about that. But let's switch gears and talk about takeaways. Each of us gets a takeaway to wrap up the show. Go ahead, Lawrence.

Lawrence: I think the biggest takeaway for me is to really understand what your options are as an investor and to find a platform or a service offering that suits you. So if you love self-learning and really taking a hold of everything and being very controlled, maybe do-it-yourself is more relevant for you. If you're more of a delegator, maybe you find a financial advisor that you trust and can work with. And for a robo-advisor, if you're somewhere in the middle, you want some convenience, it may be the route for you.

Marcelo: Awesome. Great takeaway. Lawrence hit it right on the nail there. But my takeaway is that I'm very optimistic. Even though we've highlighted the risks of robo-advisors, I'm very optimistic that the new generation now has access to the ideas that we've been pioneering and championing in the firm, which is diversification, stay invested, don't do anything crazy, and low-cost investing. So it makes me feel good that these things are available for people.

Keith: Outstanding. Thank you so much, Marcelo. It's a great takeaway. You guys have covered so many great points. The only point I would add is we fully endorse the concept, and I think it's a great way for the young, especially the younger generation, to start saving $100 a month, $200 a month, whatever it is. You can be building diversified portfolios, and you can make it work with your bank account. And I think that's an empowering process—all underneath a guided portfolio that is low-cost and makes a ton of sense.

Lawrence: Put.

Keith: So listen, let's wrap up. Lawrence, listen, you did an amazing job. Thank you so much for participating in your very first podcast. You've been with us for five years. I know some of our existing clients will love hearing you on this show today. And so kudos for stepping up, and thank you for your research. Marcelo, as always, thank you. And thank you to all of our listeners for tuning in. Have a wonderful rest of the week, and we'll see you in our next episode.

Lawrence: Thank you.

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