PORTFOLIO STRATEGY

Why robo-advisers are starting to lose clients back to humans

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Score one for the humans in the battle between robo- and traditional advisers.

Robo-advisers are still a financial industry newcomer, but they've been around long enough to start losing clients who were unhappy with their experience. Financial planner Rona Birenbaum recently took on someone who moved some money from a full-service brokerage firm to a robo-firm, and then was disappointed not to get financial planning in addition to investment management. "This person wanted a consolidated approach and to speak to real people," Ms. Birenbaum said.

Adviser Kurt Rosentreter of Manulife Securities figures he's taken on close to five people who previously had a robo-adviser. One was a senior who had left a full-service advice firm to try a robo-adviser and didn't get the advice he was looking for. "He had questions about the Canada Pension Plan, about when to convert to a RRIF [registered retirement income fund], about his ex-wife and about tax planning," Mr. Rosentreter said. "That's something that robo-advisers aren't built for."

This anecdotal loss of clients to traditional advisers in no way invalidates the vital function provided by robo-advisers. But it does highlight the fact that some investors don't yet understand what robos are and what they do.

A robo-adviser is an online portfolio-management service. You tell your robo-firm who you are and what your financial goals are and it builds and maintains a portfolio of exchange-traded funds for you at a cost that averages something in the area of 0.5 per cent in addition to the fees associated with your ETFs. Robo-advisers have staff you can talk to by phone, Skype and such because they know clients need to speak to a human once in a while, but interactions are primarily online.

Robo-advisers are a good choice for anyone who wants to hand off management of their investments for a modest fee. Young adults starting to save for retirement could be in this group. So could Gen Xers or boomers who don't have accounts large enough to attract the attentions of an elitist investment industry that is mostly contemptuous of small investors. You're invisible to some firms until you have $500,000 to invest – at minimum.

The overriding caveat with robos is that they are portfolio managers, not financial planners who tell you whether you can afford to buy a house, how much to save for retirement if you don't have a pension, whether to emphasize a registered retirement savings plan or a tax-free savings account, how to turn retirement savings into retirement income, when to take your CPP retirement benefits and how to pay no more than your fair share of taxes.

The best human advisers deliver the consolidated planning and investing that Ms. Birenbaum's client was seeking. But this client's story is as much about the failings of some traditional advice firms as it is about the shortcomings of robo-advisers.

"The only reason why this client went to [a robo-adviser] was that he was so unhappy where he was and didn't know where else to go," Ms. Birenbaum said.

Also, this client is in the high-net-worth category. People in this group absolutely need financial planning, ideally delivered in a way that guides their investments. It's pathetic that the client's original firm didn't offer this.

Mr. Rosentreter thinks the personal touch explains why people have swapped their robo-adviser for him. "We're still all humans underneath, and people like to talk to people," he said. "That's something that robo-advisers are going to struggle to deal with, especially as they get bigger and bigger."

To Mr. Rosentreter, the all-in fees charged by robo-advisers are a poor value compared with do-it-yourself investing. As I noted in this recent article for Globe Unlimited subscribers, you can build a portfolio of exchange-traded funds for half the cost of using a robo-adviser. However, my sense from answering ETF-related questions from Globe readers is that many are struggling to make sense of the hundreds of funds listed on the Toronto Stock Exchange and need help to get good results from their investments.

In conducting my annual guide to robo-advisers, I asked whether written financial plans are available. Several firms said yes, sometimes for an extra cost or via referrals to outside planners. But my own experience with financial planning involved multiple face-to-face meetings with my wife and me in which a rapport with the planner was developed. It's hard to see how this is possible via the robo-experience.

Some U.S. and British robo-advisers have introduced more of a human touch via phone or even face-to-face meetings. Michael Katchen, chief of Canada's Wealthsimple, said his firm has to some extent moved in that direction since it opened 3.5 years ago.

"When we launched, Wealthsimple was a really simple investment solution mostly catering to smaller clients that were younger," he said. "Now, our fastest growing segments of clients is our Wealthsimple Black offering, which is a higher value client and a more involved relationship."

For clients with a minimum $100,000 to invest, Wealthsimple Black provides slightly lower advice fees and the option for clients to set up a call with the firm's financialadvisory team. Other services include tax-loss harvesting (strategic portfolio adjustments to generate capital losses that can be applied against gains) and access to VIP airline lounges around the world.

Mr. Katchen said Wealthsimple plans to continue evolving in a way that offers a more personalized experience. Meantime, the firm has taken an important step to reach another client group that was unsuited to robo-advisers.

That would be people who are putting money away as an emergency fund or to reach short-term savings goals. Robo-advisers, with their portfolios built on stocks and bonds, are suitable for people who don't need their money in the near term.

"If a client needs their funds in less than three years, I would generally tell them that we're not a fit," Mr. Katchen said. "And so we were turning away a whole bunch of clients we would much rather work with."

The no-fee savings account is supplied through a partnership with EQ Bank and pays 1.7 per cent (EQ itself offers 2.3 per cent for its savings account). The benefit of saving through Wealthsimple is being able to keep your savings and investments together. Mr. Katchen said clients who make regular contributions to their Wealthsimple accounts can have the money apportioned to both savings and investments.

As for financial planning, you don't necessarily need to dump your robo-adviser to get it. Instead, try a fee-for-service planner who charges a flat or hourly rate to consult or create a plan. Here's a cross-country directory of such planners that I've shared with a lot of readers lately.

Pros and Cons

PROS

- Low advice cost of 0.5 per cent or so is less than half what human advisers charge for small and medium accounts, and even some larger ones
- Stocks and bonds are mixed according to your personal situation and needs
- Portfolios are built with exchange-traded funds that produce low average fees of 0.2 per cent (total robo cost would be 0.5 + 0.2 = 0.7 per cent)
- Money is invested for you, and rebalanced so you keep to your target mix of stocks and bonds
- High levels of transparency on fees and returns

CONS

- DIY investors can build ETF portfolios for half the cost of robo-advisers

- Little to none of the financial planning that some – not all – human advisers provide on retirement and more
- You can talk to humans at robo firms, but they're unlikely to be someone who knows you personally
- No face-to-face contact is typically available
- Robos mainly use ETFs and will likely dismantle a good portfolio of individual stocks and bonds or mutual funds that you have currently

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