Robo-Advisers

Investors are increasingly turning to robo-advisers to help them manage their portfolios. Easy-to-use smartphone apps and online portals make setting up an account with a robo-adviser convenient and quick, which is contributing to their increasing popularity. For those considering a robo-adviser, it is best to take it slow and ensure this type of service meets your short- and long-term investing needs.

What are Robo-Advisers?

The term "robo-adviser" refers to electronic platforms that provide automated investment advisory services to customers pursuant to computer algorithms developed by the platform sponsors.

Robo-advisers thus in effect replace the roles of financial services professionals with computer algorithms. In so doing, robo-advisers may be able to offer useful services at comparatively low cost.

Robo-advisers may be discretionary or non-discretionary – i.e., a customer may allow the platform to execute trades automatically on the customer's behalf or may withhold trading authority and use the platform's advice as a mere recommendation for the customer's own investment decisions.

How do Robo-Advisers Work?

There are two general robo-advisory models: pure and hybrid robo-advisers. The pure model is entirely automated and offers little (or no) ability for customers to receive personalized investment advice from a financial services professional. In a pure robo-adviser, customers interact solely with the electronic platform. The hybrid model adds a level of human interaction to the robo-advisory platform, allowing customers to work with a financial services professional online or in person. Hybrid robo-advisers generally have higher fees than pure robo-advisers, but may provide greater portfolio customization, tailoring of advisory services, or personal comfort for their customers.

In the United States, robo-advisers can offer pure or hybrid services. In Canada, all robo-advisers operate under the hybrid model.

In both models, the level of service provided, and portfolio-building methodology can vary widely. Always make sure that you are comfortable with the type of service and the robo-adviser that you've chosen before you invest.

Is Robo-Advising For Me?

Before getting started, shop around and research different robo-advisers' investment product offerings and fee structures. Just because a friend or relative uses a certain service does not mean it is the right one for you. Robo-advisers use proprietary computer algorithms and software to build your portfolio based on how you answer a questionnaire or interview with a firm representative. Computer programs are unique and different programs can make very different investment and portfolio recommendations, even when presented with exactly the same investor profiles.

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Things to Consider When Investing with a Robo-Adviser

Even though robo-advisers offer a service that allows you to take a more passive approach to investing, you should continue to monitor and adjust your portfolio according to your needs. Handing off your investments to a robo-adviser and putting them on autopilot may yield unexpected or undesirable results. It is also important in selecting a robo-adviser to consider the extent to which you will need personalized investment advice or interactions with a financial services professional. Before you choose to use a robo-adviser, reflect on these questions:

- Does the robo-adviser build a portfolio based on your financial goals while taking into account your appetite for risk? When you invest, you should always keep track of your investments and ensure your portfolio meets your long- and short-term needs.
- Are you comfortable and familiar with the types of investment products the robo-adviser will use to build your portfolio? Research and understand the investment products the robo-adviser you are considering uses before you invest.
- Do you like discussing ideas or asking questions when seeking financial advice? If so, be sure you understand the level of human interaction you will get with the robo-adviser you are planning to use.
- Do you want the ability to make decisions based on market fluctuations? With robo-advisers, you may not have the ability to buy and sell securities in your account as the market moves up or down.
- Are you considering any tax consequences that you may encounter for investment losses and/or gains? When investing, you should consider your yearly tax situation. You may want to talk to a tax consultant to better understand how using a robo-adviser may affect you.
- Are you comfortable and familiar with the robo-adviser's fee structure and compensation model? You should know how much you are paying for the robo-adviser's services and how these costs will affect your returns over time.

How to Protect and Inform Yourself

- **Check Registration.** Firms that provide advisory services in the U.S. are typically registered with the Securities and Exchange Commission (SEC) or one or more state securities regulators. In Canada, robo-advisers must be registered with the securities regulators in the provinces it operates in. Check the SEC's Investment Adviser Public Disclosure database or FINRA's BrokerCheck. In Canada, use the National Registration Search.
- **Check Disciplinary History.** Robo-adviser firms in the U.S. and Canada must comply with the laws of the jurisdiction they are operating in. Take a look at the firm you are considering to see if it has been subject to any disciplinary action.
- **Research the Company and its Management.** Look at the background and experience of the firm's leadership. Be sure you are comfortable with the people guiding the investment and business strategy of the firm you are considering. You also may find news on a variety of topics such as its overall business strategy, management interviews, operational matters, or customer complaints.
- **Read Online Customer Reviews.** Online reviews will give you a sense of pros and cons of the service. You can get a feel for current or former clients' satisfaction with the firm you are considering and the services it provides. Understand, however, that portfolio performance is unique to every individual.

The Bottom Line

Robo-advisers are relatively new to the investing landscape. As with any new service, you should thoroughly investigate to make sure they are right for your investment needs.

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