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inside information

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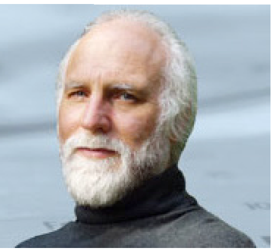

In-House Robo

Synopsis: ***If you're currently outsourcing client assets to outside robo platforms, or thinking about creating a service model for middle-market clients, then this might be a solution for you to consider.***

Takeaways: ***In addition to the streamlined onboarding experience, you can receive some advanced portfolio management features—and optimizes around legacy client holdings as well.***

Let's imagine that in the future you decide to ditch your entire investment management team (and process) for a robo solution. You give your prospects a link, so they can go to a website and answer an eight-question risk tolerance instrument. After that, they're shown the portfolio most appropriate for them based on their risk tolerance score, but they can also see other model portfolios in case they feel like the one selected isn't right for them.

The prospects can also do a quick upload of their existing portfolio, either as a percentage of asset classes or through a CSV file, and see how it compares to the model portfolios on a risk/return basis—historically and also based on expected return, volatility, Sharpe and Sortino ratios and a variety of other metrics.

If the clients like the new proposed portfolio, they can click a button, which brings up the paperwork necessary to transfer the assets over to the robo platform, with e-signatures and straight-through processing. The system will handle the movement of client holdings from the client's existing asset mix to the model portfolio, and from there on, it will automatically rebalance the assets back to the original asset mix.

> ***Instead of referring smaller clients to an outsource robo, why not bring that service in-house?***

Nothing new, right? Many of you are already doing this with Schwab Intelligent Portfolios and Betterment Institutional, which allows you to manage the assets of unwealthy clients without taking on a lot of overhead.

There are actually a couple of differences between your robo and those outsourced portfolio management solutions—the most important being that your robo experience is entirely managed within your firm, using a part of your own software stack, branded to your firm, so that the URL you gave the prospect was actually your own advisory firm's website.

Once the portfolio has been transferred over, unlike those outsourced robo solutions, with your own robo, you can set your own billing structures, with virtually unlimited AUM breakpoints—and, of course, this saves you from having to pay basis points to the outside robo.

Instead of fairly generic ETF-only portfolios, the model portfolios the client sees are your in-house model portfolios, where you can use a mixture of ETFs, index and actively-managed funds. And for smaller clients, the system will accept and manage portfolios as small as $250.

Another difference is that your own robo will accommodate legacy assets—something the outsource providers are still unable to do. In the onboarding process, a client can specify that a certain legacy holding will not be sold. Your robo will then automatically optimize the remaining assets so that the expected risk and return of the client portfolio with the legacy holding is as nearly identical as possible to the model portfolio the client has selected. Your robo will also, if you wish, automatically create an investment policy statement for these new clients—with your firm's logo and brand identity.

> ***Unlike the robos that sell directlly to consumers, Northern Trust's goal with Emotomy is to allow advisors to elevate their own brand and still provide a seamless digital experience.***

Your robo also has a wider array of rebalancing options. You can have the portfolio rebalance quarterly or annually, or you can set quantitative factors that you want to keep stable in client portfolios, so you're rebalancing to the original Sharpe or Sortino ratios; that is, your robo will rebalance to maintain a stable amount of portfolio efficiency or downside risk. You can also set stop-losses on the portfolio as a whole or certain components of it.

And the paperwork that the client e-signed includes your own account agreements, the ACATs forms plus the custodial agreement at your independent custodian—basically all the majors, at this time, except Fidelity.

This, in a nutshell, is the in-house robo called Emotomy (*https://www.emotomy.com/emotomy/emotomy-pws/*). It is already part of the tech stack of 200 advisors.

Feature set

I wrote about Emotomy two and a half years ago, when it was introduced to the marketplace as kind of the opposite of the online investment platforms (robos) that were popping up everywhere. Opposite in the sense that where the robos were creating very simple ETF portfolios, Emotomy was built to serve very sophisticated investors who wanted to create and automate very complex hedge-fund like strategies. The feature set included the aforementioned rebalancing to quant factors, automatic computation of daily trades to a strategy based on rolling Sortino ratios in real time, z-scores, correlations and other factors in the market, and metrics like peak-to-trough times to recovery based on back-testing of each portfolio.

Most of these fancy features were things that mainstream advisors would never use, which greatly hindered widespread adoption of a product that could be easily scaled down to the description above if you took the time to turn off all the things that would excite a hedge fund manager. In September of 2019, Northern Trust purchased Emotomy from San Francisco-based Belvedere Advisors, and basically did the scaling back for you—on the theory that the advisor market is ready to bring robo features in-house.

"There are a lot of features on the platform," says Sabrina Bailey, Emotomy's CEO, "but depending on the advisory firm we're working with, they may not use those features in their business. We've been focused on making it easy for clients to use the system, and for advisors to access those other features as needed." Unlike the robos that sell directly to consumers, she adds, "our goal was to allow advisors to elevate their own brand in front of their clients, but still provide that seamless digital experience."

What features are advisory firms using today? The most popular is the automated digital onboarding experience, which looks very much like any of the consumer robos, and very much more sophisticated than the new digital onboarding with custodians. The difference is that Emotomy allows the advisor to jump into the process and talk with the client about the portfolio they've selected. Do they have legacy assets? Do they have certain assets that need to be set aside for an imminent cash need like a down payment on a vacation home?

"There is usually a quick call from the advisor to the client, just to ensure that the portfolio the system recommends truly aligns with the goals the client has entered," says Bailey. If there needs to be customization, the system can optimize around those limitations, and the client would get the same basic portfolio, but with a different asset mix.

Bailey says that many advisors are using Emotomy to serve less-wealthy clients, although few are accepting portfolios down to the $250 baseline limit that Emotomy will handle. "If anybody has $250, they can open an account," she says. "More typically, the advisor will set a minimum of $5,000." Either way, there is virtually no overhead cost to managing the smaller portfolio; everything is automated, and the metrics and performance data is all available through a robo-like client portal.

Most advisors use the 8-question risk tolerance questionnaire that the system provides, but they can customize by adding their own questions. "They can then select an answer and click on an audit feature, and the audit shows what happens to the risk tolerance score based on how the client answers it," Bailey says. "And the risk tolerance ties directly to a risk number that is associated with each portfolio."

Not all prospects will upload their existing portfolios, but the advisor can handle that and walk the client through the differences between what they own and the proposed model portfolio and every other model portfolio in risk-return space and historical returns.

I was not surprised to learn that most advisory firms direct the automated rebalancer to do the trades on a calendar basis, rather than the fancier 'rebalance to factor' options. But here, too, there are features that you don't find in the online robos, such as the ability to see all the trades before they're executed, and to have a summary of all trades that have been executed since the inception of the client relationship.

What else are advisors using from the Emotomy feature set? Bailey says that the stop-loss feature has been popular with advisors who use that feature for their most risk-averse clients. Many wealthier clients will come in with legacy assets, so the automated optimization feature, around those holdings, has been popular, albeit with a relatively small subset of clients.

Advisors using emotomy can accept portfolios as small as $250, though the more typical minimum is $5,000.

And another feature that advisors are starting to incorporate will personalize the model portfolios. When clients go online to see their portfolio performance, instead of "Moderate Growth Model Portfolio," they see where the advisory firm renamed it: "Jane's Retirement Portfolio." "It's likely to be one of the firm's model portfolios," says Bailey, "but we have the ability within Emotomy for an advisor to rename it and customize it for the client."

You don't have to be a Northern Trust client to use Emotomy, but Northern Trust does make available some of its own model portfolios on the platform that advisory firms can use instead of their own models. These are somewhat complicated and sophisticated, and take advantage of Emotomy's original feature set. One of them uses a machine learning algorithm that dynamically rotates among factors like value, momentum, size and growth. Another is a very concentrated technology portfolio with a 20% stop-loss embedded in it. "The exposure of each is limited to 10% or less of advisor client portfolios, to help mitigate risk," says Bailey.

Presentation tools

How are advisory firms using Emotomy's various robo-like features? Interactive Financial Advisors in Chicago works with advisors in 45 different offices around the country, whose clients are primarily middle market. "We needed to have software that would allow us to do a good job managing client assets and make us look smart," says Joanne Woiteshek, the firm's Secretary/Treasurer and Chief Compliance Officer. She says that Emotomy will automatically open accounts at the firm's E*Trade custodian using its own investment management forms along with the normal paperwork for signing on a new client.

Interestingly, most prospects don't sign on without talking with an advisor. "We give clients a presentation online through Emotomy to show them different portfolio options," says Woiteshek, adding that the most persuasive statistic is the maximum drawdown in a bad market. "We look back over two market cycles," she says, "and clients want to know how the portfolio is going to perform when they have to take their money out. The whole educational process with Emotomy really helps people feel confident in what they're doing. It has a wealth of information built into it."

Woiteshek says that different advisors will use different charts and graphs to make client presentations, but none of them use the full set of analytical tools unless they happen to be working with an engineer client. "There is no limit to what analysis you can do on the system," she says.

What about usability? "Since Northern Trust has purchased Emotomy, the user interface has gotten so much better," says Woiteshek. The advisors also have access to the Northern Trust Institute, which serves as an educational resource for clients and advisors. "They have their five-year report, and what the Fed is doing, and a lot of statistical information on the markets that go along with your portfolio analyzer," she adds.

Streamlined onboarding

Keith Weber, of CuVantis Wealth Planning in Carlsbad, CA, also follows a nontraditional business model; the firm has advisors in credit union offices, whose customers are generally middle market. "Our goal is to bring reasonable wealth management to mass market consumers," he says.

Where does Emotomy fit in? "We use Emotomy as a starting point for the smaller investor," says Weber, "to bring them into the market and give them their first taste of investing." When these clients have accumulated $50,000 or more, then they will be moved to portfolios that are managed in a more hands-on fashion.

There is no limit to the analysis you can do on the Emotomy system, and it comes with the Northern Trust Institute for client and advisor education.

Clients can either onboard themselves or go through an advisor-assisted process; either way, they are taken to model portfolios that CuVantis has set up. Weber says that the process is much more efficient (meaning less costly) than when advisors have to go through a full onboarding routine. "It allows us to take the client through the process very quickly," he says, "as opposed to someone who has more advanced planning needs that would require multiple meetings and more depth to the experience."

Because the onboarding is easy and labor-free, and the investment process is automated once the client signs up, CuVantis is able to charge just $150 a year, flat fee, for its middle-market portfolio management services.

What about the sophisticated metrics and analytics that are available through the program? "We actually went so far as to strip out some of those really advanced features from the landing page," says Weber, "because we didn't want to expose our advisors or clients to them." But the Northern Trust Institute data helps advisors bring more investment information to these unsophisticated clients. "We're trying to bring financial education to a market that is tremendously underserved," Weber concludes. "Can we use Emotomy to serve the affluent? Sure. We have all the tools and resources available to do that as well. But there are a lot of financial advisors out there serving that market. We want to expand wealth management to a market that isn't getting that kind of attention."

I suspect that Emotomy will eventually get most of its traction from advisory firms that are creating a separate service model for younger clients, or those who have been using Schwab Intelligent Portfolios or Betterment Institutional as their outside vendor to manage middle market client portfolios on a cost-effective basis. Why send those clients to somebody else when you can handle them in-house at a relatively low expense point?

But as advisors get more comfortable with the user experience with their less wealthy clients, they may decide that they can automate the onboarding process for the model portfolios they offer wealthier clients as well—and take advantage of the automated rebalancing features, optimization around legacy holdings, and even the automated stop-loss function. Robo-izing the investment management process basically means allowing computers to handle chores that they're better suited to do than humans—and having automated investment onboarding and management in your tech stack instead of as an outsource option could be in the profession's near-term future. ■