Why you should love robo-advisers

April 1 2019, by Liz Weston Of Nerdwallet

Robo-advisers have been around long enough that the question is no longer whether you should turn your investment decisions over to a computer. Now the question is: Why wouldn't you?

The success of Wealthfront and Betterment, two startups that helped launch the trend, led mainstream investment companies including Vanguard, Schwab and Fidelity to add robo-advice services in recent years. Depending on the robo-adviser, you may also have access to human financial advisers, socially responsible investments and tax-loss harvesting to help reduce tax bills.

This is not, and never really was, a niche product only for tech-happy millennials. From the beginning, investors of all ages spotted the significant advantages of letting computers run their portfolios. Among them:

ROBO-ADVISERS ARE CHEAP

Robo-advisers—also known as automated financial advisers—use computer algorithms to invest your money and rebalance the portfolios as needed to meet your goals. Robos typically use ultralow-cost exchange-traded funds and charge annual management fees of about 0.25%, for an all-in cost that can land under 0.5%.

Contrast that with traditional investment costs, which can be 1% or even more on top of the annual management fees. It's not unusual for investors to pay 2% or more annually, once all costs are considered.

This is a huge deal, since costs have an enormous impact on your ultimate returns and are among the few factors you can actually control.

Let's say you invest $10,000 and market returns average 7% over the next 30 years. If you lose 2% to fees, your investment would grow to about $45,000. But if your fees are just 0.5%, your investment could reach $70,000.

ROBO-ADVISERS AREN'T CONFLICTED

Robo-advisers won't put you in an investment that costs more or performs worse than available alternatives because they'll earn a higher commission or a free trip to Aruba.

That still happens all too often with human advisers. U.S. regulators have so far resisted calls to impose a universal fiduciary standard, which would require financial advisers to put their clients' interests ahead of their own.

Robo-adviser services aren't perfect. The SEC in December 2018 announced a settlement with Wealthfront for making false statements about its tax-loss harvesting service. Tax-loss harvesting allows people to defer tax bills by selling a losing investment to offset the profit from a winning one. But buying a "substantially identical" investment too soon after selling a loser can cause the IRS to disallow the deduction. Wealthfront failed to properly monitor accounts against such "wash sales," which occurred in 31% of the accounts with tax-loss harvesting over a three-year period, the SEC says.

But a quick scroll through the SEC's other enforcement actions last year show that this is far from the worst thing that can happen to an investor. From billion-dollar Ponzi schemes to stockbrokers getting paid to steer people to high-cost funds, humans pose a much bigger danger to investors.

INVESTMENT MANAGEMENT IS NOT FINANCIAL ADVICE

Robo-advisers may not be the best option for people who may panic and sell in a downturn. Those folks may need human financial advisers to hold their hands and talk them out of a bad decision. Also, you probably don't have access to a robo option within your 401(k) - at least not yet. (Your next best option may be a target-date mutual fund, which, like a robo, does the investment allocation and rebalancing for you.)

Otherwise, most people should at least consider a robo-adviser, and that's true even if they also need financial planning advice.

The distinction between investment management and true financial planning is often lost. That's not surprising, since financial planners who give comprehensive advice often charge a percentage of the investments that they manage. So do many stockbrokers, who may offer financial advice in addition to their main business of investment management.

But most investment management is a commodity, while good, individualized, comprehensive financial planning advice can be priceless—and can't be replicated by a computer.

It can make sense, in other words, to pay a premium for quality financial advice that a robot can't offer. It doesn't make sense to pay a premium for a service that a robot could do better.

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