

# INVESTMENTS & WEALTH MONITOR

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## Teaching Kids about Money in the Age of Algorithms

*By Norb Vonnegut*



**INVESTMENTS & WEALTH INSTITUTE**  
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# Teaching Kids about Money in the Age of Algorithms

By *Norb Vonnegut*

*Parent: “Why don’t you take a finance course next semester?”*

*College student: “Because I’d rather watch paint dry. You’ve got a financial advisor. I’ll get one, too.”*

Moms and dads tell me variations of this story all the time. My reaction is, “Not so fast.” It might be impossible to spark an individual’s interest in the markets, but financial advisors are no safety net for the next generation’s financial literacy.

Indeed, advisors are about to retire in droves. Fees are coming down. Account minimums are going up. As wealth advisory firms grapple with the one-two punch of changing demographics and shifting economics, it’s likely that fewer and fewer humans will serve an ever-increasing number of clients. Bottom line: Tomorrow’s investors increasingly will rely on call centers and algorithms to make financial decisions.

So how can today’s investors help their kids develop the right stuff to navigate the new world of wealth management? When I discuss this topic with parents, our conversations fall into three broad categories:

- The case for robo-advisors
- Teaching kids good financial habits
- Separating fact from fiction in the age of algorithms

The third category might be the most important of all, because algorithmic advisors are not created equal,

especially when it comes to putting a client’s interest first.

## THE CASE FOR ROBO ACCOUNTS

There are hundreds of automated investment platforms, the so-called “robo-advisors” that manage money with limited or no human interaction between advisor and client. Some robos are stand-alone entities. Their only product is algorithmic advice. Others operate as autonomous divisions within financial behemoths. I do not have paid relationships or fee-sharing arrangements with any of them.

But I encourage parents with young kids to open robo accounts, especially Uniform Transfers to Minors Act (UTMA) accounts and Roth IRA for Kids accounts (also known as “kiddie IRAs”), and use them as teaching tools. My reason is that advisory demographics, shifting economics, and the rise of automation are changing the face of wealth management and, consequently, the resources available to tomorrow’s investors.

## CHANGING ADVISORY DEMOGRAPHICS

Let’s start with advisory demographics. In 2016, JP Morgan and Focus Financial Partners published a joint study that made the following observations:

1. Among the 300,000+ U.S. financial advisors, the average age is 51.
2. Over the next 10 years, an estimated 10,000 to 16,000 advisors will retire each year—which is faster than they can be replaced.

3. One estimate suggests an industry shortage of some 200,000 financial advisors in the years ahead.<sup>1</sup>

The wave of retirements hasn’t started yet, leading some to question whether concerns about the shortage of human capital are overblown. A recent estimate from Cerulli Associates stated that the number of financial advisors declined by 2.7 percent from 2010 to 2017.<sup>2</sup> But these numbers strike me as the demographic equivalent of backtesting portfolios. That is, they’re unreliable indicators of future performance. In my view, it’s only a matter of time before age takes over and our ranks start to thin.

## SHIFTING ECONOMICS

Now layer on the impact of shifting economics. Management fees and operating expenses are replacing commissions, to some extent, as the bad boys of wealth management. According to the U.S. Department of Labor, for example, a 1-percent management fee over a 35-year career can reduce retirement savings by as much as 28 percent.<sup>3</sup>

At the same time, awareness about the corrosive impact of fees is increasing, undermining the old sales clichés extolling their virtues, such as, “We sit on the same side of the table as our clients.” Websites such as FeeX make it easy for investors to audit their expenses and identify their options, and they appear to be making an impact. (Again, I do not receive compensation from this organization.)

In 2017, Morningstar reported an 8-percent drop in the weighted average cost of mutual funds, the largest such decline since it began tracking such numbers in 2000.<sup>4</sup> In October 2018, in a story titled “The Price of Financial Advice Is, Finally, Falling,” the *Wall Street Journal* concluded that 1-percent management fees (the sacred cow of wealth management) are starting to decrease.<sup>5</sup>

### RISE OF AUTOMATION

The implication is clear. Unless advisory firms focus on keeping overhead low, it will be harder for them to earn a profit and for human financial advisors to earn a living. No wonder we’re seeing the rise of automation. Robos have rock-bottom fees. Their websites are slick and easy to use. And they offer the financial behemoths an inexpensive solution to compensate for gaps in headcount.

Estimates of robo assets under management in 2018 range from \$200 billion<sup>6</sup> to more than \$397 billion, with projected compound annual growth of 38.2 percent through 2022.<sup>7</sup> Robos are here to stay, and like most technology-driven solutions, their offerings are likely to improve.

### TEACHING KIDS GOOD FINANCIAL HABITS

Given my view of wealth management’s future, I encourage investors to use algorithmic investment platforms to teach their kids the importance of saving regularly and investing for tomorrow. All it takes are a show-don’t-tell mindset, a written financial commitment, and willingness to share portfolio information. UTMAs, 529 plans, and Roth individual retirement accounts (IRAs) are great tools for teaching financial literacy.

### SHOW-DON’T-TELL MINDSET

To illustrate the meaning of a “show-don’t tell” mindset, I turn to Sir Isaac Newton, who famously said, “For every action, there is an equal and opposite reaction.” It’s a popular misconception that he was discussing physics. Newton’s

third law is really about parenting. If you instruct your children to do one thing, you can almost guarantee they will do the exact opposite.

Assume, for example, that a teenager earns \$5,000 at a summer job and is likely to earn the same amount for the next two years. Mom and Dad run the numbers, focus on the power of long-term compounding, and suggest that the teen fund a 529 plan. Or better yet, let’s say tuition is already covered and they suggest a Roth IRA.

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Current Internal Revenue Service rules allow anyone under the age of 50, even minors, to contribute up to \$6,000 to a Roth IRA in 2019 (\$5,500 for 2018).<sup>8</sup> Investors must have earned income and cannot contribute more than they make.

So, Mom and Dad have this discussion. Afterward, they enthusiastically explain the power of compounding to their son or daughter. The three \$5,000 contributions could grow tax-free at a 7-percent annual rate (or whatever number they deem appropriate) to more than \$400,000 by the time the youngster is 65.

Family dynamics differ. But I suspect many teenagers are likely to say something like: “I don’t care about playing shuffleboard when I’m 65. I’m saving to buy a car—now.”

Mom and Dad can argue the point. But in the spirit of show-don’t-tell,

I recommend they open the kiddie Roth and, subject to the okay from their accountant, fund an amount up to the teenager’s annual earnings.

### WRITTEN FINANCIAL COMMITMENT

Step two is a written financial commitment from Mom and Dad. Keep it simple. One line will do: “I promise to match whatever money you make for the next three summers up to \$5,500 and invest it in a Roth IRA for you.” Families can use any number of matching or funding permutations to suit their unique personal values and financial circumstances.

Sign the document. Hand it over or post it somewhere conspicuous. Now explain, “We put all our investment goals in writing and hope you do the same one day.” It’s a great habit. Even the most seasoned investors make better financial decisions by developing written plans that frame strategic investment decisions before markets turn volatile and equity freak-out takes over. And the good news is that it’s easy to keep investment policy guidelines simple, one or two pages at the most, if you use a table with minimum and maximum variances from target asset allocations.

### SHARE PORTFOLIO INFORMATION

When children or grandchildren are old enough, the final step is to share portfolio information, give kids online access to the accounts, and invite them into the process of reviewing it.

No, I’m not kidding.

Let’s say your budding investor is 10 years old. You probably don’t want to share passwords that would enable a 10-year-old to make investment decisions or transfer money to the class bully. But the educational value of UTMAs, 529s, or kiddie Roths are lost if your 10-year-old can’t participate.

Some asset management firms offer read-only access, which prevents

unauthorized individuals from trading. Some don't. There are other considerations. It might be impractical to log onto the account with your 10-year-old. Even if it is practical, forced "quarterly performance reviews" with your 10-year-old may turn tedious and counterproductive.

One solution is to use the account aggregation capabilities of robo-advisors. A number of robos enable investors to sync accounts and see read-only information from competing organizations. This feature solves the problem of sharing passwords for trading accounts. So in the spirit of show-don't-tell, investors can ask their kids over dinner, "How'd you do in the market today?"

I acknowledge that my process for teaching good financial habits can be replicated by human financial advisors working for financial behemoths or independent registered investment advisors. But that's not the point. If there are likely to be fewer human financial advisors 10 years from now, why not harness the power of robo-advisors today and help kids get comfortable with our evolving industry?

### SEPARATING FACT FROM FICTION IN THE AGE OF ALGORITHMIC ADVICE

In Stanley Kubrick's classic 1968 film, *2001: A Space Odyssey*, a robot named Hal 9000 famously says, "I'm completely operational and all my circuits are functioning perfectly."

Then Hal goes haywire and threatens humanity.

I'm net positive on algorithmic advisors and acknowledge their importance to the future of wealth management, but they are far from perfect. I believe human financial advisors offer real value to clients and their families by identifying independent third-party resources that analyze robos, by questioning their marketing claims and noting the pitfalls in their customer agreements.

No matter how fast, easy, and intuitive the online investment experience, no matter how compelling their research papers, robos are not created equal when it comes to performance and the fine print. Some are guilty of the very same conflicted business practices that undermine trust in our industry.

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*The representative replied, "Specific indexes are not included on the dashboard itself, but you can use Google Finance to see how any given index has performed in the time you've been with us."*

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### ROBO INVESTMENT PERFORMANCE

Many websites offer independent third-party reviews with clickbait titles such as, "How to Choose a Robo Advisor." Comparisons of investment performance, however, are still few in number. But note that *Barron's* is now ranking robos and highlighting the performance differences among them.<sup>9</sup>

Some of the marketing claims are troubling. During 2016, for example, I became a client of "Robo A" (I'm no longer a client today). After about six months, my account was up 2.7 percent. The robo reported that my investment returns had exceeded those of an "average investor," and it based this claim on an index that tracks "real performance delivered to private clients of participating advisors."

I had never heard of the index, so I emailed Robo A and asked how to compare my investment returns to a more familiar index. The representative replied, "Specific indexes are not included on the dashboard itself, but you can use Google Finance to see how any given index has performed in the time you've been with us."

The Robo A representative added helpfully: "As for which index to use, the S&P 500 is a fairly poor index for the purpose of our portfolio as it is a United States domestic index. Your portfolio has an international tilt here at [Robo A], so a much better index to use would be the All Country World Index (ACWI)."

All this begs the question: If Robo A knows ACWI is a valid comparison, why doesn't it show the comparison rather than make clients do it themselves?

At the time, I noticed that "Robo B" was using the same private-client index to justify its claims of outperformance. I followed its links and discovered that the index pulled its data from 65 money managers in the United Kingdom and four in Switzerland.

You can draw your own conclusions about whether such data is relevant to U.S.-based investors. Non-robo money managers sometimes use inappropriate index comparisons, too. But it's worth noting that robos, which claim to be the future and to offer a better investment experience, have yet to move beyond some of the more questionable business practices from the past.

### ROBO CUSTOMER AGREEMENTS

Robos' customer agreements disclose such practices in black and white, and nowhere can the differences among competitors be more profound. But come on, who wants to spend hours and hours sifting through all the legalese (see table 1)?

Financial advisors can't give legal advice. I believe, however, that it's

**Table 1**  
**LENGTH OF ROBO CUSTOMER AGREEMENTS**

Organization	Number of Pages
Robo B	141
Robo C	5
Robo D	21
Robo E	8
Robo F	10

reasonable for financial advisors to give investors a list of “trouble” words. Using the command-F function on their computers, investors can then search PDF documents quickly, zero in on potential problems, and identify differences among competitors.

Here’s a partial list of the words I search for in these agreements:

- modify
- change
- written notice
- amendment
- remuneration
- sole discretion
- reserves the right
- suspend
- force majeure
- indemnify
- hold harmless

Word searches do not eliminate the need for investors to read documents in their entirety before signing. By using command-F to find “remuneration,” however, I discovered that Robo F “receives remuneration, compensation, or other consideration for directing orders for equity securities to particular broker-dealers or market centers for execution.”

This is a classic “pay-to-play” arrangement. If investors sign Robo F’s customer agreement, they are acknowledging the firm’s conflicts of interests and agreeing to suffer the consequences, whatever form they take. Or, now that investors have quickly and efficiently identified a problem, they can move on.

## CONCLUSION

No wealth management firm, whether human or robo, is free from conflicts of interest. I believe robos are a must-use teaching tool, but I also must point out that many registered investment advisors (which are driven by humans) are fierce about minimizing conflicts of interest and serving clients as true fiduciaries. At least for now, it’s clear that some algorithmic investment platforms have yet to code this core value into

their firmware, so it’s still up to human advisors to help investors sort through the differences. ●

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## ENDNOTES

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8. See “Roth IRA Contribution Limits,” <https://www.rothira.com/roth-ira-contribution-limits>.
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