Alyson Brown (ab65225)
Amy Dang (ad36853)
Lining Jiang(lj8823)

Assignment 6: Credit Modeling & RoboAdvising

A. What are the issues associated with traditional financial advisory services? What are the "pain points"?

Although human advisers could provide advices as well as guide their clients to avoid emotional biases, such as irrational withdrawal, there are still several issues:

1. Lack of transparency
2. Inefficiency and the ability of some advisers are not reliable
3. High cost of services

The pain points are: limited monitoring and computing capabilities of human advisers, misaligned incentives between clients and advisers and misselling by financial advisers.

B. What is Wealthfront's core service and value proposition?

The core service is robot investment adviser, which is introduced in December 2011 and was the primary service of Wealthfront until now.

Clients can use Wealthfront's service was qualified,transparency and with low cost of both advisory service and underlying funds.

C. How does Wealthfront carry out portfolio construction? What are its value-added services?

The whole asset management process was automatic and it has several steps:

1. The core principles of Wealthfront's portfolio construction is passive investment and low transaction costs with following the Modern Portfolio Theory. The portfolio will be optimal by choosing various assets such as U.S. equity and real estate.
2. The portfolio will also be determined by the risk score of each client based on the survey regarding client's risk preference.
3. Wealthfront will select the proper investment vehicles and determine the weigh.
4. The portfolio will be rebalanced automatically in order to reduce risk and increase return.

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Value-added services include:

1. Tax-loss harvesting: realize capital losses earlier and defer tax payments
2. Dynamic direct indexing: perform tax-loss harvesting at the stock level
3. Single-stock diversification: introduced for Twitter employees, then for Facebook employees, which allows them to gradually unload and diversify holdings over a period of two years.
4. Dynamic portfolio rebalancing: the portfolios would be carefully monitored and rebalanced by algorithms automatically.

D. Overall, do you believe that Wealthfront can address the problems associated with existing financial advisory services? What factors enable them to do so? What factors are missing?

Yes because of the several factors: automatic process, transparency and the investment team.Firstly, Automatic process allows Wealthfront to replace most human element with robots and can provide low cost to clients. Second, clients can also construct and implement the same portfolio as Wealthfront by using the key information on Wealthfront's website. In the other word, the process of Wealthfront is high-level transparency. Finally, the investment team is experienced, and it can provide very sophisticated models and algorithms. So, Wealthfront could provide quality service for each client.

However, they do not have human contributions, which does not allow Wealthfront to build personal relationship with clients.

E. What are the key differences between Wealthfront and Betterment? How do you evaluate their different business models?

The key difference between Wealthfront and Betterment is that Betterment has the option for clients to interact with a human advisor. Other than that, both are very similar in that they are stand-alone robo-advisory companies with similar management fees (Wealthfront: 0.25%, Betterment: 0.25%-0.5%), investment vehicles (ETFs),free tax-loss harvesting for clients, continuous rebalancing, and account minimum are low (Wealthfront: $500, Betterment: $0). Another notable difference is Wealthfront's focus on positioning itself as a software company (as opposed to a financial institution), backed by eight Ph.D. members on their investment team, compared to Betterment's two.

According to the latest AUM obtained from Form ADVs filed to SEC by each firm in early 2017, Wealthfront had $5B and Betterment had $7.3B. In addition, Betterment has more total funding, $205M, compared to Wealthfront, $129.5M.

Betterment differed front Wealthfront in that they believed customers want a 'high-tech yet high-touch' service, and that human contributions were an indispensable element in the financial advisory process. They introduced Betterment for Advisors (allowing advisors to focus on relationship-building), Betterment Plus, and Betterment Premium services, both of which allowed clients to get human advice from certified advisors annually (plus) or any time (premium).

As mentioned in other articles, this is a tough business model due to the high customer acquisition cost and low payback (based on percentage of assets, the targeted younger clients have less accumulated funds for investment). Considering the high acquisition cost for stand-alone robo-advisors, Betterment's integration with human advisors and leveraging its existing client base with B2B services allowed it to reduce this cost, while Wealthfront has stuck to their original business model with minimal human intervention. However, the use of AI and technology has allowed fintech companies like Wealthfront to lower operational cost, and these benefits are partially passed on to consumers. With the rapid evolution of digital advisory, Wealthfront should consider a more dynamic business model to keep up with competition.

F. Do you think a bionic model, currently experimented by financial advisor incumbents, that integrated both automated and human services can be the solution?

As mentioned before, Betterment believed that customers wanted a 'high-tech yet high-touch' service and incorporated human advisors into its services (both B2B and B2C). This allowed Betterment to lower customer acquisition costs, take advantage of robo-advising algorithms, while building trust/relationship with their clients. As a result, Betterment caught up with Wealthfront in AUM and other competitors have also integrated human elements in their robo-advisory services. The "warm body effect" aids in building client trust and relationships, educating unsophisticated investors, while allowing robo-advisors to still eliminate misaligned incentives and biases that were associated with human-only advisory services. Based on current industry trends and reports, hybrid bionic models seem to the be dominant trend and can be the solution to bridge the gap between human-only and robo-only financial advisory services.

G. What is Wealthfront's current financial situation? Can it break even or make any profit from its current operations?

Wealthfront has kept its pace of growth, but their competitors have moved faster, including Betterment. In addition, industry incumbents like Vanguard and Charles Schwab also introduced their own robo-advisory services that surpassed start-ups like Betterment and Wealthfront in terms of client base and AUM. A major pain point for startups like Wealthfront is the high customer acquisition cost and low pay-off due to low service fees. With Wealthfront’s current operations, they do not seem to be making money, and could potentially break event if more clients join their platform (benefiting from economies of scale) or if clients with more money for investment joined (making more money from the percentage-based fees).

H. What are the strategic moves that Wealthfront should take?

As mentioned before, which how fast the digital advisory industry is evolving, Wealthfront should consider a more dynamic business model, with possibly the introduction of human advisors (optional for clients would want additional value-add services). This could help Wealthfront develop relationship and gain trust from their clients and in turn, their clients would be more educated about their investments so that they could make better-informed decisions. Already, Wealthfront is well positioned to use their “software” and AI technology for “mass customization”, allowing for more tailored portfolios for their clients that should be dynamic based on changing client needs/risk tolerance. If Wealthfront decides to introduce human advisors into their business model, they could still focus on their AI technology and work on enhancing/seamlessly integrating robo and human advisory in order to better serve their clients. In addition, Wealthfront could consider strategic corporate sponsorships/partnership and fundings as opposed to being acquired or seeking funding from VC’s. This would allow not only bring financial stability, but they could also gain public trust with being backed by an accredited financial institution, and benefit from financial expertise.