FS Advice

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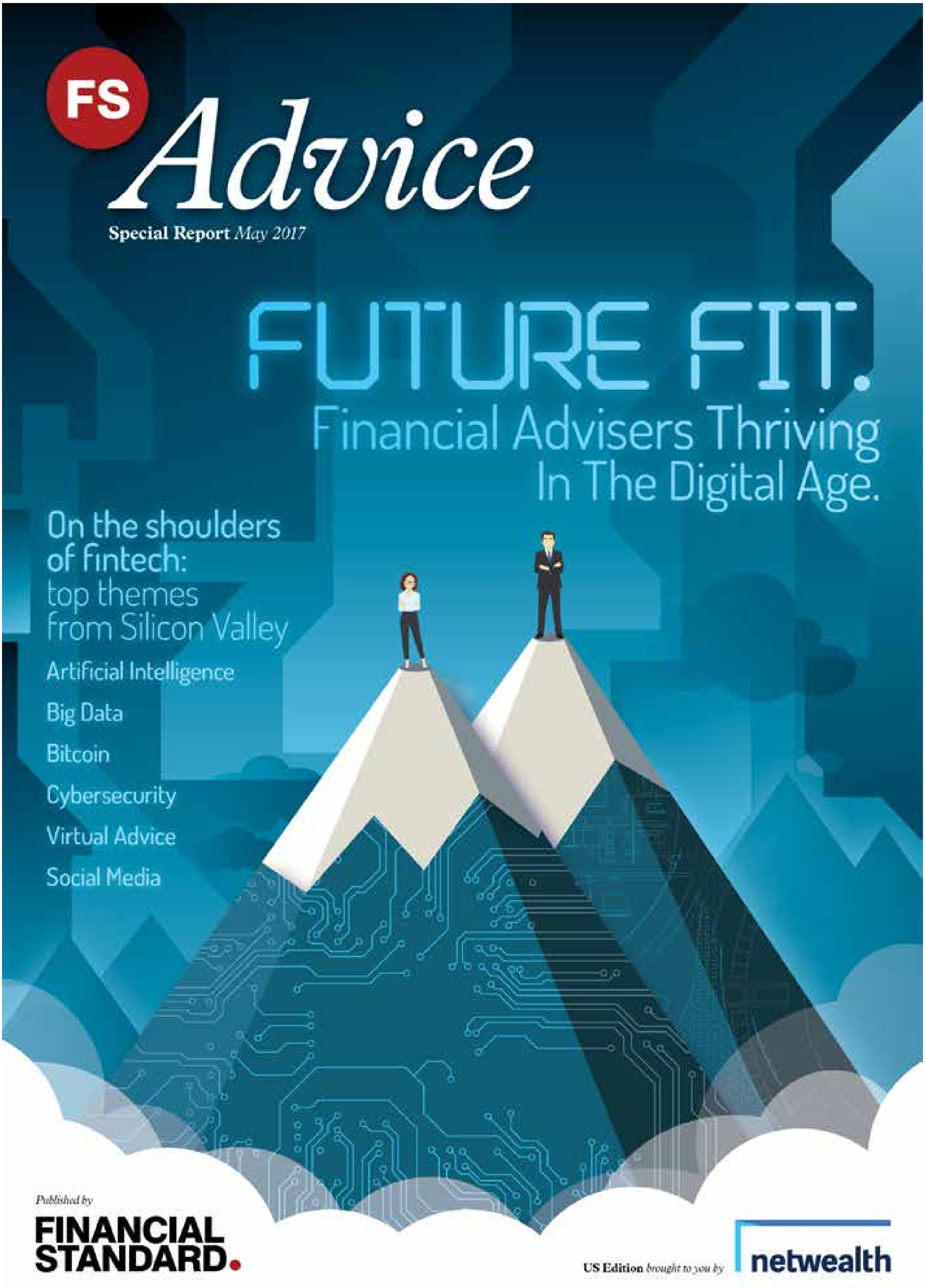

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Advice
Special Report May 2017
FUTURE FIT.
Financial Advisers Thriving
In The Digital Age.
On the shoulders
of fintech:
top themes
from Silicon Valley
Artificial Intelligence
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Financial advisers have a fresh canvas. Technology will provide the brushstrokes but it's the human touch that will make it a masterpiece.

This was the overarching theme of the 2017 Netwealth Group Study Tour, an intensive four-day program where more than 50 financial advisers and investment professionals gathered in Silicon Valley to learn from leading tech experts and advice practitioners.

It was a big reality check for Australian delegates in three ways. One, their US peers are way ahead in leveraging the latest in finance technology; two, these same technologies are ripe to replicate here, and three, that the industry's battle for survival will be waged not against traditional financial institutions but against the likes of Facebook, Google, Amazon and Apple.

The future is bright if Australian advisers can do two things. First, work to win back the public's trust. Thousands of financial advisers who have earnt their keep as fiduciaries are unduly getting the rap for those who haven't. Industry associations should work harder to bridge the trust gap.

Second, financial advisers need to become digital activists - early adopters of finance technology as opposed to trailing behind. There's no better way than just doing it.

Those who joined this study tour manage around $14 billion in funds under advice: our society will be all the better for it if they boldly unlock the digital potential of their industry.

This Special Report highlights the main themes and lessons of the study tour.

We've taken care to incorporate adviser feedback and have included sections on AI, big data, digital advice, cybersecurity, social media and bitcoin/blockchain technology.

On behalf of Financial Standard, I would like to thank the team at Netwealth for organising a unique program; the presenters for sharing their insights with us and the delegates for their participation.

This edition aims to be a handy starter guide to help navigate the massive changes ahead for financial advice.

Michelle Baltazar

Michelle Baltazar | Director of Media and Publisher

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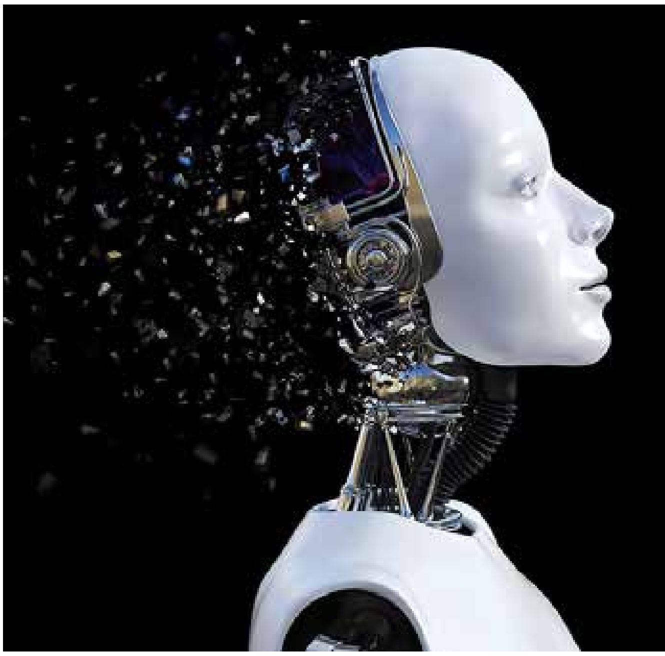
ALEXA, WHERE IS MY FINANCIAL PLAN?



From virtual personal assistants to fitness trackers and self-driving cars, artificial intelligence (AI) will transform all sectors of business, not least financial planning and wealth management.

Rest in peace, street directories. You've had a good run but Google Maps are here to stay. Artificial Intelligence (AI), in one of its simpler strains, has changed street navigation forever.

It is going to have the same dramatic effect on financial planning and wealth management.

Let's go back in time. Imagine an investment portfolio that, during the financial crisis of 2008, returns 24% against its benchmark's loss of 22%. Four years later, in the financial crisis of 2011, it returns 31% against its benchmark's loss of 0.6%.

Over the period of its 10-year existence to 2016, it returns 281% versus its benchmark's 74%. Its volatility rate at 10.41% is almost on par with its benchmark's 10.4%.

That portfolio already exists. The numbers are the back-tested results of a new AI-driven portfolio run by Sanlam Global Investment Solutions. Driving the portfolio's performance are 600 AI 'analysts'. Each AI analyst operates independently and comes up with its unique view of an investment, which is then analysed by the head analyst (also a machine) and an asset allocator (another machine) before the desired portfolio is constructed.

Sanlam is one of the pioneers. Many financial institutions are starting to make commitments but few, if any, have launched into it in a big way.

The next industrial revolution

David Itzkovits, Head of Investments at Sanlam Global Investment Solutions, said that "We are potentially seeing the start of the next industrial revolution, one based on Artificial Intelligence, where machines have the ability learn by themselves and even improve their own performance."

An 'industrial revolution' is usually not categorised as one until years later, when viewed in hindsight.

"If you look at the previous industrial revolutions (See Figure 1: Evolution of Revolution), they all had one thing in common: machines that do the same job traditionally performed by multiple humans, in a quicker, more efficient way."

AI has become such a big part of everyday life yet many people aren't even aware of it. From Google-based searches, online shopping and smart refrigerators, to cognitive computers such as Watson, AI and machine learning has become routine technology.

For financial services professionals, understanding how it might be applied and in which industries is key, said Itzkovits.

"Advisers which are able to identify trends in the application of AI stand to benefit the most. There are industries that are moving faster than others. You identify which industries those are and take strategic action based on that."

But first, the industry jargon.

Artificial intelligence (or AI) is a sub-field of computer science that uses computers to generate knowledge and solve challenging tasks that people can't solve.

"It is the exercise of extracting meaningful and actionable intelligence from data." Itzkovits said.

There are two types, General AI and Specialised AI.

General AI is the theory and development of intelligence comparable to that of a human. The technology for General AI does not yet exist.

By contrast, specialised AI is the concept of machines performing specific tasks but they do it better or quicker than a human. Examples include self-driving cars, Google translate and virtual personal assistants, like Siri or Alexa.

Much of Specialised AI is done through 'machine learning'.

"Machine learning is an enabler of AI where machines can autonomously learn from data by themselves without being explicitly programmed," said Itzkovits.

The one on robo-advice

Many finance professionals mistake the current iterations of robo-advice platforms as AI but this is misleading.

"Sophisticated AI is not currently being leveraged in robo-advice," Itzkovits said.

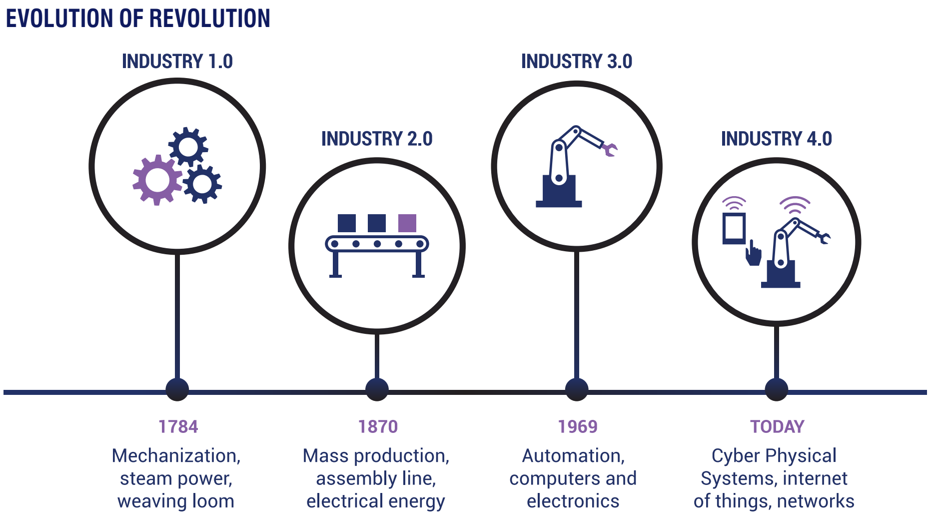
Robo-advice platforms use algorithms to implement and set strategic asset allocation for an end-investor. The client fills out a risk tolerance tool online and it generates a portfolio based on their answers.

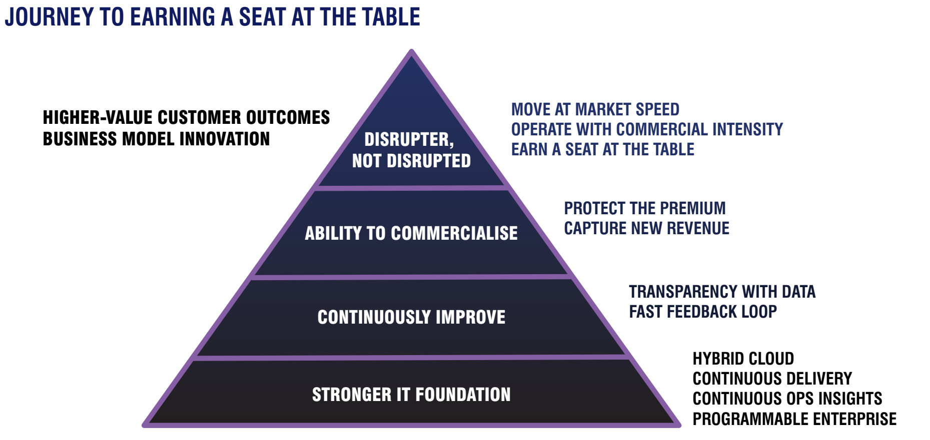
But real AI use goes beyond semi-regular portfolio rebalancing. "Robo-advice of the future could use AI to constantly process data and adjust to a multitude of market variables in real-time."

Still, Itzkovits stressed that AI is not a silver bullet in all market scenarios.

"It can have good predictive accuracy or good generalised performance but it'll never be 100% or even close to that."

Rather, it is an incredibly advanced way to make sense of the markets and improve a client's investment outcome.





Source: Splunk

Shaking the foundations

For example, it addresses the fundamental disconnect between what investors consider to be their risk - capital loss or drawdowns - versus the investment industry, which often quotes volatility.

The Morningstar Conservative, Moderate and Aggressive Target Risk Index volatilities from 2007-2016 (which Sanlam's AI portfolios are compared with) were 4%, 10% and 17% respectively, yet their maximum drawdowns were 12%, 35% and 53%.

"That is three to four times worse an outcome than expected," said Itzkovits.

In addition, most asset allocation solutions are backward looking and wrongly assume past and future risk and correlations to be stable.

As an example, the MSCI World Equity Index and Barclays Global Aggregate Bond Index correlation 10 years prior to September 2008 was -0.21, but during Global Financial Crises became 0.97, almost perfectly correlated.

"With equities at an all-time high and bond yields at an all-time low, investors will soon be in need of an asset allocation capability that is forward looking and highly adaptive." Itzkovits said.

From an industry-wide perspective, David Wright, managing partner and joint founder of Zenith Investment Partners, said that AI will once again change the balance of power in wealth management.

Boutique managers just won't have the resources needed to build AI solutions in the same way that the big institutions can. "They just won't be able to afford the artificial intelligence solutions coming from the UK, for example," he said. FS

IN CONVERSATION WITH MATT HEINE

In May this year, Netwealth joint managing director MATT HEINE helped organise a Silicon Valley study tour for financial advisers and fund managers. He tells FINANCIAL STANDARD his key learnings from the intensive four-day program.

Why did you decide to host this study tour?

I was fortunate enough to come to Silicon Valley and to San Francisco last September and met with a number of seriously impressive and very inspiring companies.

I just felt like our clients needed to hear from them. It's very easy to get stuck in the day-to-day and not look at the big picture and some of the huge macro themes that are going to change our industry and people's lives in general. So to come here and hear it firsthand really brings it to life.

The first session was on artificial intelligence and AI investing. How do you think AI will change the wealth management industry?

We're looking at it on two fronts: from an investment perspective but also from a client perspective. So if we just talk about investment for a moment, we met with Sanlam (Head of investments David Itzkovits was the presenter). They're basically using artificial intelligence to run global investment portfolios without any human intervention. And they're doing this by using machine learning and big data.

For each asset class they've got somewhere in the vicinity of 600 different algorithms. You can imagine if you've got eight asset classes times 600 different algorithms, you'd get some very, very powerful insight into what's happening around the world in a real-time basis.

From a client engagement perspective, the amount of data that we now know both in their offline and their online environment means that advisers need to get far better in effectively having deep relationships with their clients.

Cybersecurity was the last session. It seemed to have alarmed the delegates.

We were having a conversation with the chief technology officer of big data group Splunk the other day who, during the discussion, pulled out his mobile phone, and basically showed us on that spot a list of all the iphones in the area with bluetooth on and from that list he was able to easily hack into those phones and steal information. Now that was really scary given the amount of information we hold on our mobile phones these days and what you can do with that information.

I don't think cybersecurity is particularly well understood within the financial advice industry. So many of our clients are almost ignorant to the threats out there. Hopefully, the cybersecurity session helped expand their knowledge.

Robo-advice is the buzzword everybody loves to hate.

There was a great comment at the study tour (from Sanlam's David Itzkovits) that it's not about robo-advice taking away our clients, it's about man with machine winning against man without machine, and when you start to think about that, I think it's definitely true that advisers need to better use technology in their businesses to enhance their offering as opposed to replacing it.

So robo-advice is still very embryonic but we think it's going to be a critical part of ongoing engagement of advice in the future.

Do you think social media plays a role in financial advice?

Many advisers are simply not using technology in their businesses or if they are, they're only using 2% of what may be possible from their system, so marketing automation is another big area that I think advisers need to start looking at and taking very seriously.

We had a session at Franklin Templeton where a panel of social media experts are talking about the ways you can start to really ramp up your social media marketing efforts at very low cost but with huge outcomes.

For example, people are using Twitter to get financial ideas and find financial professionals when they need help. I think advisers should definitely look at how they can use Twitter for their business.

So, are the delegates 'future fit' in the digital age of financial advice?

I hope it's been a huge wake-up call for the delegates to see what's actually happening and the pace that new technologies are being adopted.

Clients aren't comparing

our services to other financial services, banks or other financial institutions, they are comparing us to the companies they love like Netflix, Google and Facebook. That's the new expectation so we need to look outside our industry and start to adopt new technology to be consistently successful in the future.

What was the biggest takeaway for you from the tour?

We can't wait three years or five years. We need to start using better technology now in our businesses.

At Netwealth, we see a big part of our responsibility to advisers is to hopefully help them access these latest technologies, which gives them the benefit of great tools to drive better business outcomes. FS