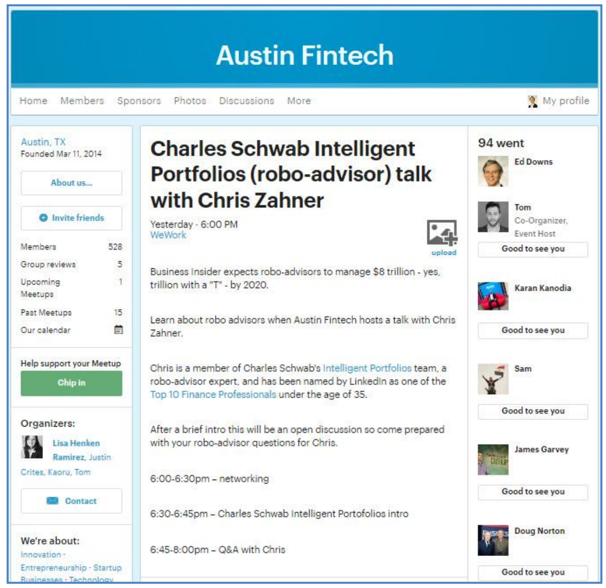
Charles Schwab Intelligent Portfolios

Austin FinTech Meetup: February 7, 2017

https://www.meetup.com/Austin-Fintech/events/235464046/



Here in Austin, we are fortunate to have a hotbed of fintech activity. Last night I had the good fortune of hearing a talk by Chris Zahner of Schwab Intelligent Portfolios at the Austin FinTech Meetup.

Chris studied engineering at UC Davis, and began working for Schwab in Austin in 2010. He was selected to head up the Schwab Intelligent Portfolios division in July 2014, and was given the task of catching up with the existing Robo Advisors as quickly as possible. They launched the platform in March 2015.

Schwab's Robo Advisor is pretty much a standard offering. It trades its own ETFs because of the residual revenue inherent in ETFs. And, like almost all other Robo Advisors, they promote the platform's low fees, re-balancing and tax-loss harvesting features as reasons to sign up.

There are 3 products, one of which is in development:

- Schwab Intelligent Portfolios (SIP)   AUM: $12.3b in 110,000 accounts
- Institutional Intelligent Portfolios (IIP)
- Schwab Intelligent Advisor ("human assisted" - to be released in 6 months)

SIP consists of 37 pre-built Portfolios for income, taxable, and IRA goals. Each Portfolio can have up to 20 ETFs. They trade 54 ETFs, 23 of which are Schwab-created, and Schwab makes money on these ETFs. Schwab is the fifth largest ETF provider, behind iShares, Vanguard and Powershares.

They ask 12 questions (compared to Betterment's 3).   After the questions are answered, Schwab recommends one of their portfolios, but only allows users to go up and down one portfolio on the risk scale. This is an unusual restriction.

They check customer accounts daily to make sure all ETFs are within the balance range, but re-balance rarely – 2-3 times per year. When a big market correction occurs that pushes the assets out of line, orders are sent to trading desks, and it is up to the traders as to whether to place the re-balance trades individually or as a block order. Re-balancing also occurs on cash in and out events.

There are no Stop Loss orders.

As with virtually all Robo Advisors, Schwab uses **Modern Portfolio Theory** for allocation. The user has no control over re-balancing. It depends on the market and cash additions/withdrawals.

Their fees are higher than Betterment's at .28% but are capped at $3,600 ($1.2 million under management). This is an unusual feature designed to increase AUM.

Risk and Reward metrics are derived from the Best and Worst Years over 20 years of history on each Portfolio. *[My assessment - this is a "back test" number]*

They discourage users from changing their Portfolio more than 2x per month. But some are gaming the system by running 2-3+ Portfolios on one account *[My assessment – customers want lower draw downs and are creating a portfolio of portfolios.]*

Schwab provides a white label version for RIAs, free for accounts over $100m and .10% for accounts under $100m. The RIA MUST maintain 4% of the portfolio in Cash (so Schwab can sweep it into money markets and make the return.)

Questions that were asked:

1. Do any trade actions ever happen in real time as a result of market movement? No.
2. Are portfolios that use stocks envisioned at any time in the future? No.
3. Can the user change the mix of ETFs in a portfolio? No.
4. Does Schwab ever use Inverse or Leveraged ETFs? No.

After the meeting, I asked Chris if anyone at Schwab is working on any kind of market timing for selection of assets. He said no, but that some of their high-end Advisors create "Tactical Portfolios" by selecting their own ETFs. OmniFunds could be a good fit for this group. I got his card and told him I would contact him at some point to meet with that division.

The industry appears to be focused on everything but returns. Adding human advisors, aggregating and viewing assets in multiple accounts, financial planners and improved user interfaces and lowering fees seem to take center stage.

The report below (page 27) shows the effect of shrinking revenues as fees continue to go down. Our belief is that higher returns with less risk could provide a competitive advantage and enable them to raise fees, making OmniFunds an attractive acquisition candidate.

Ed Downs

Hype vs. Reality: The Coming Waves of "Robo" Adoption (by AT Kearney)
https://www.atkearney.com/documents/10192/7132014/Hype+vs.+Reality_The+Coming+Waves+of+Robo+Adoption.pdf