

SENIOR CONSULTANT

The Voice of the Investment Management Consultant

E*Trade Circumvents Advisors To Provide Advice Direct To Consumers

Stephen C. Winks

E*Trade, a global leader in electronic global finance, has announced an agreement with DirectAdvice.com to integrate their direct advice financial planning module into E*Trade's web site in the first quarter of this year. Through its proprietary systems, DirectAdvice.com will deliver direct to the investor a comprehensive financial plan that is customized to the needs of the individual investor. Closely replicating the experience of working with a professional financial planner, DirectAdvice.com allows consumers to create "smart strategies" to achieve their financial goals, such as buying a home, understanding tax issues, saving for college tuition and preparing for retirement.

The move by E*Trade to provide on-line investment advice is significant, not because of the sophistication of the initial iteration of advice offered, but that on-line advice, whatever its form, will substantially elevate the bar for financial advice. A minimum threshold criteria is being established for financial advice that must be greatly expanded upon in order for financial advisors to add value.

The high level professional investment counsel provided by investment management consultants is not threatened by E*Trade or DirectAdvice.com, but the advice of the traditional commission stockbroker who, by definition, cannot add value without a process, will come under increasing competitive pressures. If an E*Trade client can enter all their holdings, both assets and liabilities, and get a virtual, real-time balance sheet and income statement that reports account performance, the days of executing trades without any accountability for results are over. There will no longer be any free rides. When investors understand their account performance, they will demand that value actually be added. This will drive the commission brokerage financial services mainstream to process and investment management consulting.

For the moment, commission brokers have nothing to fear from DirectAdvice.com. It doesn't have asset

study capability and is more directed to beginner investors. It addresses issues such as (1) helping investors determine how much they should save to achieve their financial goals, (2) how to invest in mutual funds and cash management products, (3) how to maximize the benefits of defined contribution plans and IRAs, and (4) how to select stock and bond mutual funds to construct a portfolio. For \$75, clients profile themselves and their objectives electronically, and Direct Advice.com will provide an electronic recommendation. The recommendations are meant for the

beginner-investor layman and do not have the built-in sophistication of a senior consultant. In fact, a leading consultant with \$600 million under advisement recently profiled himself and was disappointed with the recommendation to invest in an IRA. Managed accounts, individual securities, private investments, options, futures, etc. were not included as investment options, and the "advice is fairly amateurish." Yet, this will not always be the case. In fact, it is a blessing that it is not particularly robust because it gives the broker time to adapt their business toward

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high level professional investment counsel and the engagement of their services for on-going advisory fees.

David Loeper, chairman of FinancialPlan Auditors.com, observed, "The challenge for cyber advisors is that it relies solely on the do-it-yourself user's input to derive a solution. It is like showing someone how to perform an appendectomy on-line. It is a very simple and easy procedure that anyone can perform. The only reason one has to go to medical school is to learn what to do, if something goes wrong. Similarly, in investments, the consumer wants to hear and delights in how easy it is to invest. The problem with cyber advice is that the do-it-yourself user does not know the implications of their decisions and how quickly things can change, nor do they know what to do when things go wrong. Isn't a 200% return in a new technology IPO automatic? They are very likely to

chase the promise of extraordinary returns which, by definition, can never be sustained. That is why the returns they are chasing are extraordinary. Investing is a very complex business that requires professional investment counsel, process, methodology, investment discipline and technology. There is no substitute for professional advice. Under ERISA, institutional investors are almost compelled to engage professional investment counsel. In our software licensing agreement, we insist users engage professional investment counsel. We believe you cannot leave investors out there on their own without professional assistance. Who would put their \$3 million or \$3,000 portfolio at risk for \$75? It is like performing your own appendectomy. There is a huge market out there that wants investing to be oversimplified, that doesn't quite understand the implications of oversimplification. Failure is a necessary part of the cyber advice market maturing. The marketplace is about to learn that offering the process, methodology, investment discipline and technology of advice over the internet is not the same as advice; they are the tools of advice. As a consequence, we believe cyber advice firms that work with advisors to enhance their professional investment counsel will be a more successful model than cyber advice firms that seek to replace advisors." Indeed, E*Trade and DirectAdvice.com would appear to supplant the advisor, thus leaving them vulnerable to be measured on the basis of the results that the do-it-yourself user achieves.

Michael Silver, vice president of Marketing of E*Trade, said, "E*Trade is committed to providing customers with the electronic delivery of information that empowers them to be successful. Through our relationship with DirectAdvice.com, E*Trade will provide customers with sound professional knowledge that will help investors plan for their future. Through this innovative, all on-line service, E*Trade customers can truly take control of their savings and investment decisions." Brian Hollander, president of DirectAdvice.com, said, "Our revolutionary technology is leading the way for investors to do their financial planning on-line. The combination of Direct Advice.com's financial planning service and E*Trade's wealth of investment information will benefit individuals who are interested in controlling their financial future.

DirectAdvice.com is a leading U.S. provider of on-line financial planning services. The company's interactive service approach combines the benefits of comprehensive, personalized financial planning and objective product information. Direct Advice.com's proprietary technology engages households to consider all their financial goals when making sound saving and investment decisions. DirectAdvice.com is a registered investment advisor with the U.S. Securities and Exchange Commission and is headquartered in Hartford, Connecticut.

E*Trade is the world's most visited on-line investment web site, according to Media Matrix. In addition to the U.S., E*Trade presently serves customers through branded web sites in Japan, Sweden, France, Australia, New Zealand and Canada. The site offers value added investment and features which is central to the firm's overall strategy of adding value through internet-based advice. With Merrill Lynch creating their Unlimited Advantage account, giving away trade execution for free and moving the entire financial services industry toward advice, E*Trade and other internet brokers are forced to compete on the basis of their advice, which is not their strong suit. E*Trade does not have a large base of independent financial advisors and does not have a large number of branch offices in the U.S. which can provide personalized services. Thus, personalized, high level advice and adding value is E*Trade's weakest link. Either E*Trade will have to go downstream, or it is going to have to find a more creative strategy like the Schwab/U.S. Trust merger to provide higher level advice, or if that doesn't work (they don't have the allure of a large branch network or a strong independent advisor base), they will have to create their own advisor network. The marketplace is making it clear it prefers high level personalized advice, thus exposing the internet as more of a communication tool than replacement technology for high level advice. DirectAdvice.com is not the final answer that E*Trade needs to become competitive in the advice it renders; it is just the beginning. We are sure to hear more from E*Trade and their strategy to provide high level advice in the not-so-distant future. ■

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