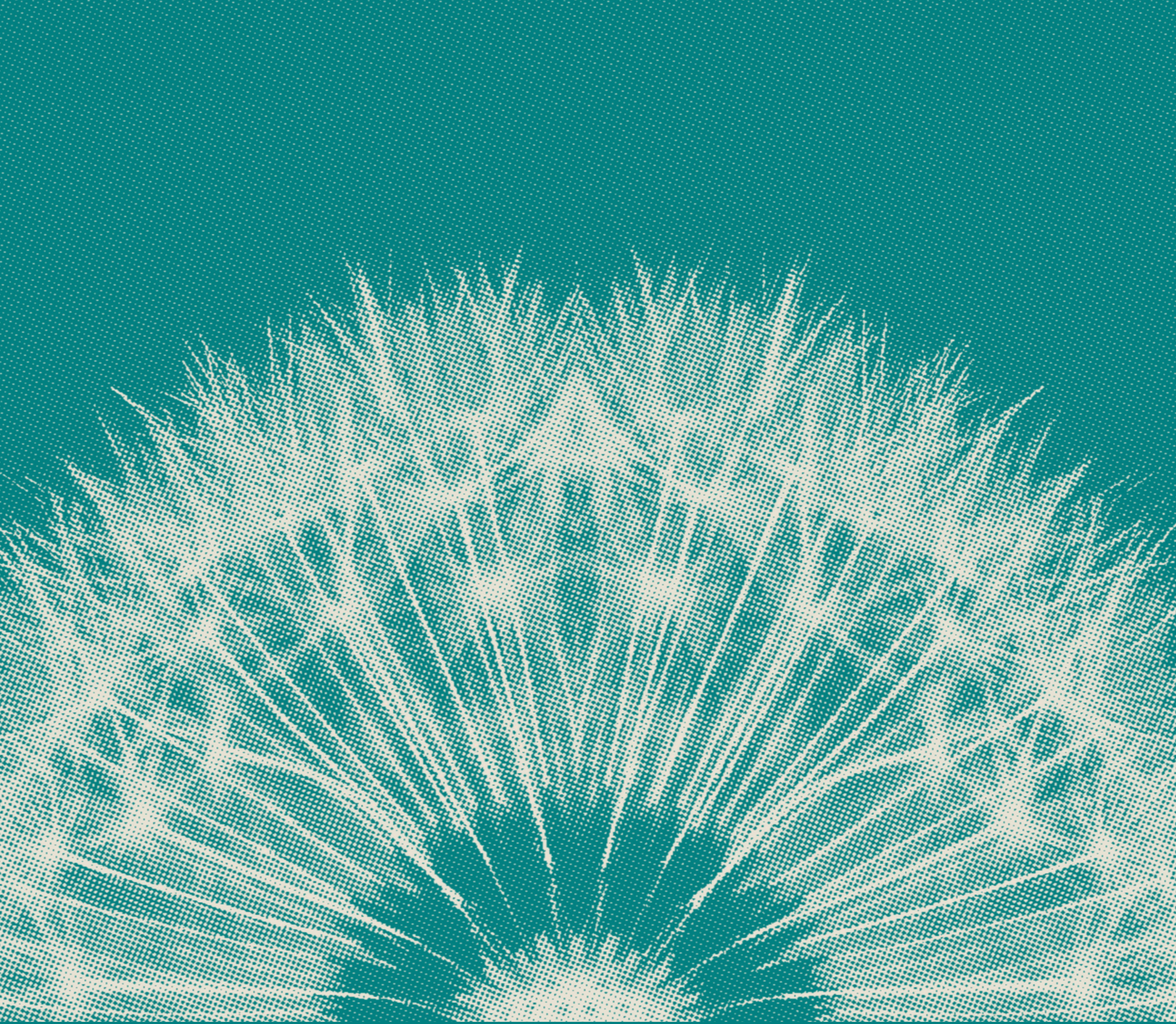

Nitrogen

Trading Automation vs. Traditional Rebalancing

NITROGEN WHITE PAPER

Introduction

As advisors build out their core client services, they're faced with an important question: Which services should we insource, and which ones can we outsource?

According to recent research, it's a question that will come up more often if advisory firms continue on their current trajectory. In 2013, the typical firm provided about nine different services to clients, but today most firms provide up to sixteen routine services.[1]

The insourcing decision can look different for each firm, and for each type of service they offer. Advisors who want to find an immediate way to recover inefficient time should start with trading and rebalancing.

The average advisor spends 5.5 hours a week on investment management, which includes trading tasks.[2] If that number could just be cut in half, advisors would gain more than ten hours a month for retention and business development-related activities instead.

As a quick caveat, the question of insourcing or outsourcing rebalancing tasks isn't relevant for advisors who have already decided to fully put their investment management services in the hands of a TAMP. Firms like Brinker Capital, SEI, Envestnet | PMC, and AssetMark provide a proven model for growth-minded advisors who want to focus on finding and onboarding new clients.

Many TAMP-affiliated advisors use and love Nitrogen for client engagement, portfolio analytics, proposals, and of course, the Risk Number®.

According to our data, about 26% of our advisors use a TAMP for investment management.

For this white paper, we are interested in what trading looks like for those advisors who choose to insource their portfolio management, and how they can create a more efficient process for serving their clients.

Once an advisor has decided to keep this part of client service inside their firm, choosing how to manage time becomes essential. If a firm manages trading within their four walls, making the right decision at the right time becomes critical—especially considering that 45% of advisors' clients have said that better investment performance is their chief concern.[3]

Based on what we've found at Nitrogen...

70% of the advisors who insource their portfolio management are manually loading trades into their custodial platform. We lovingly call these the "yellow legal pad" advisors, because whether or not they're actually using a pen and paper, they're working out trades by hand and entering them by hand as well. It's such a common method of trade entry simply because it has always been done before.

The other **30%** of advisors try to use rebalancing software, but they may not entirely trust it. After programming complicated tolerance bands and rebalancing schedules, they're still working in a glorified spreadsheet to pray that trades come out correctly on the other side.

From here, advisors have two choices. First, they can choose to staff out a trade desk and fully manage portfolios manually every step of the way with expensive software that takes months to onboard and learn.

The second option is more optimal. Advisors can add technology to scale their efforts and automate much of the rebalancing and trading needs to keep clients aligned with their Risk Number®.

The Nitrogen Approach to Trading is Advisor-Driven

Nitrogen gives advisors the power to drive alignment between clients and their portfolios and also to make allocation decisions in those portfolios to further drive that alignment.

Once a portfolio is aligned with its owner's risk tolerance and risk capacity, advisors need a way to easily implement their allocation decisions over time and keep portfolios on track with a couple of clicks.

That's where Autopilot comes in. With trading automation by your side, implementing portfolios you've built in Nitrogen is no longer a pain in the assets.

Over the next few pages, we'll define how trading automation with Autopilot helps free up valuable time and help advisors provide more value to their clients when compared to traditional trading and rebalancing systems.

The 5 Differences Between Rebalancing Technology and Trading Automation

Trading automation is a new way of thinking about managing accounts, implementing decisions, and keeping things on track in the long run. Here are the five key ways it differs from traditional rebalancing technology.

- **Leverage an Intelligent Inbox Design**

  Trading and rebalancing systems are descendants of the tool in every advisor's arsenal: the spreadsheet. As such, they were initially architected to replace a spreadsheet, and interfaces aren't optimized for surfacing decisions to review and approve.

  Trading automation is built like an intelligent inbox that allows advisors to click or swipe to make smart investment decisions for their clients with at-a-glance information that's easy to read. It's a much more powerful model than a rebalancer, allowing advisors the ability to review and approve trades to make decisions efficiently and rapidly. Whether you're approving trades or snoozing actions to address them later, you're quickly working your way toward the wonderful feeling of "inbox zero."

- **Focus on What Matters**

  Rebalancing software surfaces on the mechanics of trading and focuses advisors into the minute details of trades. The problem is that advisors are rarely dealing with 10 trades at a time—it's often more like 1,000.

  Trading automation pulls the advisor up a level, away from the mechanics, and into the client fiduciary decisions layer. It intelligently surfaces the right information to allow advisors to make the right decisions in client portfolios at the right time. This is where advisors ideally should live within their technology, because they want to be driving the car, not tinkering with its engine.

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- **Avoid Unnecessary Trades**

  Rebalancing technology lives by a set of rules, and those rules are often focused squarely on allocations. When a model is assigned an account, the software looks at the existing tickers compared to the tickers in the model, and if they don't match, it does whatever is necessary to get the account aligned with the model. This is a fine strategy in theory, but in practice, it can produce undesirable trade costs and tax ramifications.

  Trading automation looks at more than simple allocations with an intelligent logic that includes an account's Risk Number. If the Risk Number of the existing portfolio is in tolerance with where the client wants to be, then trading automation can intelligently hold off on generating unnecessary trades and incurring additional costs and taxes simply because the allocations may not precisely match.

  With trading automation, you don't need to trade from a Risk 55 to a Risk 55, unless you really want to.

- **Scale with Models or Get Surgical**

  Rebalancing software is built on a rigid model portfolio architecture, where the baseline expectation is that every account must be assigned to a model.4 Models are a great way to scale portfolio solutions. Still, the truth of everyday life is that there are very few advisors who have 100% of their client accounts assigned to a model. Recent

Broadridge research has shown that while 85% of advisors use model portfolios, 54% of total advised assets are in a model. Additionally, as portfolios grow larger, fewer advisors believe a model is appropriate.

73%
say model portfolios were more appropriate for smaller portfolios, those of less than $500,000.

46%
prefer models for portfolios between $500,000 and $999,000.

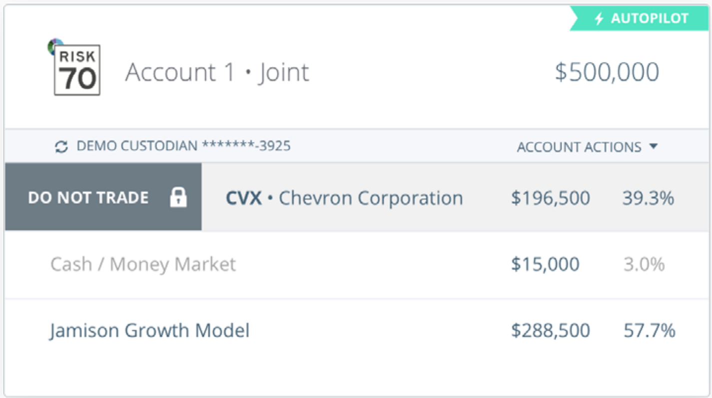
31%
prefer models for portfolios of more than $1 million.

As an advisory firm grows, the tendency is to create a custom model for each account. What does that look like? It looks like an unorganized mess of countless copies of models. That strategy quickly undermines the scalability promised by rebalancing technology in the first place.

Trading automation provides more flexibility by looking intelligently at how advisors add value to clients. While models may be used for as many clients as desired, an advisor may also need to lock certain legacy positions or blend models together. For other clients, merely turning a client's current holdings into an account-level target might be more appropriate than a model. In the real world, advisors sometimes need to operate for scale, and other times, they need to ace with precision like a surgeon. Trading automation makes either approach as simple as the other.

Trading Automation: Easy to Learn and Implement with Autopilot

Nitrogen helps advisors empower clients to invest fearlessly by delivering tools that help them align a client's portfolio with their Risk Number. Autopilot takes the relationship a step further by enabling advisors to implement their Risk Number-influenced portfolio recommendations and keep everything on track. From start to finish, trading automation happens in three acts.



Act I: Set a Target for Accounts

This part feels incredibly familiar because it takes place right where advisors are already building portfolios in Nitrogen. Using the rich set of analytics at your fingertips, you can build the right portfolio for your client. If you'd like to scale your practice with models, you can subscribe to them from one of the leading strategists available in the Partner Store, rebrand and edit them if you'd like, or build models from scratch. Either way, these accounts live on the Portfolio Analytics screen you know and love. Enabling Autopilot is as simple as clicking a button. Here, you can lock legacy positions with a click or swipe, and add satellite allocations if tweaks are needed.

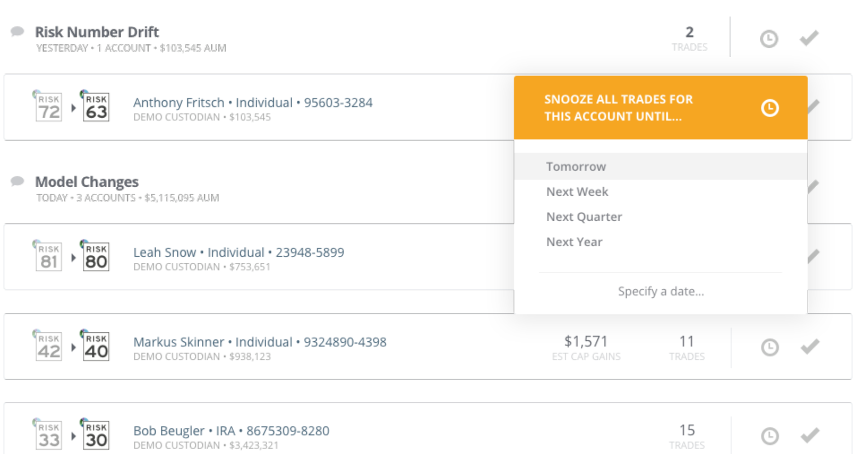
You'll see a comparison of the current portfolio's Risk Number and the new Risk Number once Autopilot makes its recommended trades.

That trade list is exactly what we'll cover in Act II.

Act II: Make Fiduciary Decisions with an Intelligent Trading Inbox

Trade lists generated by Autopilot will live in the Trading Inbox, along with any important actions the system wants to bring to your attention. Autopilot puts these decisions in front of you so you can take action (or snooze the recommendation to address later) with just a click. Here are some of the more common reasons accounts may need attention:

- **Autopilot Activated**: Whether an account is new and needs to be traded after it's been opened/funded, or a current account in Nitrogen needs to be traded for the first time using Autopilot, this is where we'll execute the trades needed to start things offon the right foot.
- **Cash Management**: When clients make contributions to an account, or you request an account be rebalanced to raise cash, Autopilot will calculate the necessary trades required to spend the cash deposited, or raise the cash requested.
- **Target Updated**: Make a change to the holdings in a client's account? Autopilot captures how to get from point A to point B and queues up trades for your approval.
- **Model Updated**: Are you subscribed to models in the Nitrogen Partner Store? When you tap into the free research in the Nitrogen platform, you get to accept, edit, or ignore an asset manager's changes to a model portfolio. Making a change to your models will prompt some trade decisions in your dashboard as well.
- **Risk Number Drift**: Gone are the days of making unnecessary trades based on target asset allocations. Nitrogen analyzes all Autopilot-enabled accounts every night for the movement that matters: Risk Number drift. If an account moves more than six Risk Numbers off of target, Autopilot will surface some approvals to get it back into alignment.



Once you get a trade list in traditional rebalancing software, it's not the end of your work—it's only the beginning. Most advisors make adjustments and hand-picked changes at this stage. But when you have 300 trades to review, your efficiency is toast.

The trades that Autopilot surfaces aren't designed for manipulation, they're designed for action. With intelligent trading logic that accounts for estimated taxable gains and trade minimums automatically, the details have been ironed out for you so you can check the changes and critical information like taxable gains, and then get on with your day and back in front of clients instead of behind your computer screen.

Once your review is done, sending trades to a custodian is as simple as adding an order to your cart, just like you would on any e-commerce site, like Amazon.

Connected Trading
powered by FLYER

Act III: Connected Trading

The last step of the trading process should be simple. All you have to do is get your trades to your custodian.

But with traditional rebalancing technology, it's not that simple. You've got to manually download a file, manually upload it, check its formatting, and hope that the trades come out correctly on the other side. It's a hassle, and it's prone to error!

Connect Trading, powered by Flyer, isn't prone to human error in the way that rebalancing tools are. Once you've got your trades in your cart, you click a button to fulfill your orders, and we'll take care of the rest through a FIX connection with every major custodian.

One of the best features of Connected Trading is that we automatically block and allocate trades to help you fulfill your fiduciary duty and get the best price for all your clients.

While your trades are processing, you can monitor their progress until you get to celebrate with the animation that lets you know they've been processed.

About Nitrogen

Nitrogen revolutionized how financial advisors and wealth management firms grow with the launch of Riskalyze in 2011. Today, Nitrogen is the growth platform for wealth management firms, helping advisors turn leads into meetings, meetings into valued clients, and clients into referral champions. The company invented the Risk Number®, built on top of a Nobel Prize-winning academic framework, and is the champion of the Fearless Investing Movement — tens of thousands of financial advisors committed to our mission of empowering the world to invest fearlessly. To learn more, visit NitrogenWealth.com.