The unstoppable rise of the digital investor: the coronavirus crisis will accelerate digitalisation in wealth management and the rise of the self-directed investor.

PERSPECTIVE 4

InvestSuite

‘Digital barriers are being broken. Forever. That behaviour will not change anymore.’

– Steven van Belleghem, Partner & Co-founder of Nexxworks

Self-directed retail trading has been in the hands of online brokers for a long time. There is, however, a significant opportunity for retail banks to offer solutions to self-directed investors, leverage their existing customer base, activate their balance sheets, and avoid losing customers to online brokers.

Dirk Klee, CEO, Wealth Management & Investments, Barclays UK, posted an interesting message on LinkedIn (November 14th, 2020): ‘yesterday saw one of our busiest days on record on Barclays Smart Investor, with trades up to nearly 200 percent as the markets rose in light of the positive news of a Covid-19 vaccine’. However, not all commercial banks have a (decent) platform for self-directed investors.

For a few years now, investing in general has been moving increasingly online, including in an advisory and discretionary capacity, and the pandemic seems to be further accelerating this trend. Online investing will gradually become the new social norm. Recent research from deVere seems to support this: ‘the coronavirus crisis drives a 72% rise in the use of fintech apps’. The current forced lockdowns across the world have put a huge amount of stress on communications between clients and their advisors just at the time when they need to stay in touch the most. Many players will likely rethink and/or adjust their digital strategies, and some will even hasten rollouts.

MAY DAY AND THE START OF SELF-DIRECTED INVESTING BY THE MASSES

Let’s take a step back before we delve into the massive rise in self-directed or do-it-yourself (DIY) investing during the Covid-19 pandemic. May Day in 1975 saw the birth of the discount broker in the US. A new opportunity emerged to serve an entirely new type of client: the independent investor. The founder of Charles Schwab defines independent investors as people who:

1. Are passionate about the markets;
2. Want/love to control their own financial destinies;
3. Love to do their own research;
4. Pick their own stocks; and
5. Do not need or want a broker’s advice.

In 1970, this class of independent investors in the US comprised less than 10% of the market. In 1980, 13% of US households owned stocks, versus only 6% who owned mutual funds. By 2000, however, 50% of households owned mutual funds, with many self-directed investors choosing these funds as their preferred asset class.

The DIY investor invests directly in financial instruments, such as stocks, derivatives, or bonds, without receiving any advice. As soon as advice is offered by a private banker, relationship manager, or an independent financial advisor, investment is no longer self-directed. This is a crucial feature.

By the mid-1990s, more than 20% of the adult US population invested in stocks, compared to less than 5% in Europe. This was made possible thanks to (a) a massive increase in available information, (b) a drastic reduction in cost, and (c) internet access.

The growth of the internet was a key factor. Previously, we have discussed how the growth of the internet contributed to the success of online pioneers such as K. Aufhauser & Co./Ameritrade, Charles Schwab, and E*Trade.

May Day and the internet led to the establishment of online trading giants and ensured that 'the Middle Class join[ed] the Money [C]lass'. The direct investment space in the United States in 2019 occupied 21% of the total brokerage industry, up from 0% in 1995 and 15% in 2008. Some argue that we are now in a third wave, made possible thanks to the mobile revolution, big data, AI, etc.

The drivers behind this ever-increasing growth can be explained by:

1. **Digital experiences increasingly permeating our lives to become a new social norm;**
2. **Customers increasingly engaging with their banks via digital, if not mobile, channels;**
3. **Investors seeking digitally supported/AI-supported tools alongside/as support for humans;**
4. **Direct brokerages outpacing others in digital innovation;**
5. **An increasing demand for transparency;**
6. **The arrival of zero-cost trading; and**
7. **The rise of ETFs.**

And then came Covid-19 in 2020.

A NEW VACCINE!

On November 9th, 2020, the world was surprised by the unexpected announcement from Pfizer, a major US pharmaceutical company, and its German partner BioNTech, that their mRNA-based vaccine candidate against SARS-CoV-2 had demonstrated evidence of efficacy against COVID-19 in participants without prior evidence of SARS-CoV-2 infection. The case split between vaccinated individuals and those who received the placebo indicated a vaccine efficacy rate of above 90%. This is a mindbogglingly high number.

'Today is a great day for science and humanity. The first set of results from our Phase 3 COVID-19 vaccine trial provides the initial evidence of our vaccine's ability to prevent COVID-19', said Dr. Albert Bourla, Chairman and CEO, Pfizer.

Millions of new and existing self-directed investors rushed to the markets to buy stocks. However, many did not succeed in placing orders because the systems of their online platforms were too slow or even down. Consider the situation of millions of customers at some of the UK's largest brokers. The Telegraph (November 9th) reported: 'Hargreaves Lansdown and AJ Bell buckle as investors rush to buy on "busiest day ever"'. Customers of AJ Bell and Hargreaves Lansdown, two of Britain's largest fund shops, were unable to trade due to demand overwhelming the websites and apps'. Investors at Fidelity and many other brokerages experienced similar issues.

What happened that Monday, labelled the 'busiest trading day ever' by Hargreaves, is a symptom of the unstoppable rise of the self-directed investor and the impact of Covid-19 on this phenomenon. The lockdown seems to have addressed one of the key barriers for people wishing to invest directly in the stock market – the availability of time.

AN ENORMOUS INCREASE IN NEW CUSTOMERS FOR ONLINE BROKERS FURTHER DEMONSTRATES THE RISE OF THE SELF-DIRECTED INVESTOR, INCLUDING INDIVIDUALS WHO ARE LESS ACTIVE AND LESS EXPERIENCED.

In mid-April, my doctor – a typical private banking client – asked me to help him open an account with an online broker. He is one of many such investors. In Belgium, Bolero realised a 700% increase in the opening of new accounts in March 2020, and BinckBank realised a ten-fold increase. There was a 400% increase in transactions at Bolero and a 100% increase at both Keytrade and BinckBank. More intriguingly, 70% were 'buy' orders as opposed to requests to sell at BinckBank and Bolero; stocks were the favourites among investors and accounted for 70% or more of all transactions. Clearly, as the coronavirus outbreak has forced almost everyone to stay at home, people have had more time to engage with investments. Indeed, a lack of time is often quoted by would-be self-directed clients as a reason for why they have yet to invest.

The importance of digitisation in wealth management will only increase because of this crisis. I will illustrate that this is the case by highlighting the rise of self-directed investors. They are not the usual suspects, such as day traders or active investors, but rather, 'normal' banking customers who are increasingly intrigued by investing online in mutual funds and trackers, instead of physically going to their bank.

When I was the CEO of Bolero, one of Belgium's online retail trading platforms, we knew that moments of crisis were often (if not always) seen as buying opportunities by self-directed investors. Whether it was Brexit or the unrest in Ukraine, DIY investors were always on the lookout for opportunities of a lifetime. Whether they were right or wrong is irrelevant; what mattered was what they believed. Such is the nature of the self-directed investor. During a crisis and the period shortly after has proven to be a time when online brokers can count on a spectacular inflow of new customers.

One of Europe's largest online brokers, DeGiro, which is owned by German Flatex, AG, reported in May 2020 that they have a waiting list of 30,000 new customers. Consequently, they had to temporarily halt account openings for new applications when they jumped from 500 to 5,000 per day. Since the start of the year, they have also reported an increase of 160,000 new customers.

Increases in self-directed clients can be observed all over the world. Let us take **Japan** as an example. The stability of the yen has caused many people to flock to equities instead of currencies (trading). The Tokyo Stock Exchange's Mothers market has risen more than 70% since hitting a low on March 19th, having been a favourite point of interest for Japanese retail investors. This has led to the Mothers market (listing 320+ start-ups) outperforming the Nikkei 225. According to the *FT,* Japan's five leading brokerages registered over half a million new account openings in April and May. This is twice the average pace in a normal year. Rakuten, a leading broker, welcomed 650,000 new clients in the first half of 2020 (*FT,* October 21st, 2020); SBI, another broker, registered an average of 70,000 per month.

It is interesting to note the underlying hypothesis in relation to this (i.e. the coronavirus crisis) is rewriting the fundamentals of business in Japan and that 'the pandemic is giving these small innovative companies (typically listed on the Mothers market) their big break'. The Mothers market is seen as the 'new Japan'. The *FT* columnist Leo Lewis described the phenomenon in his May 27th article in the following manner: 'Coronavirus spawns new generation of Japanese stock pickers'. He highlighted the huge growth in demand arising from the need for self-preservation (people wanting masks, antiseptic gargle, hand sanitisers, etc.) and a change in behaviour. However, he correctly argued an important factor that has, so far, been overlooked in the country – that the lockdown has redirected many retail investors' and novices' attention towards the stock market. Lewis found that the most striking decision made by Japanese people who are normally housebound is that they have started trading equities. **This is a major departure from their behaviour in the past.** The *FT* article points out that since the 1980s bubble, the Japanese have been **net sellers of equity** for the past 30 years; these new investors appear to be contrarian by instinct. Mid-November, the Nikkei 225 (Japan's highest stock index) closed at its highest point since 1991. It has taken the index 30 years to recover to this point; even more astonishing is the fact that the index still needs to increase by 50 per cent to hit an all-time high.

Chinese equities appreciated to their most successful weeks in five years as legions of retail investors rushed in. Some of these new investors reported gains of more than 40% since the March reports in the *FT* (July 12th, 2020). Interestingly enough, investors perceive that the Chinese government believes in a long bull run, an idea supported by the state media. This brings up memories of another bull run in 2015 when prices, spurred by the state, rose and then collapsed, said the *FT*. Chaoping Zhu, JP Morgan's global market strategist, points to the fact that household deposits have been rising and people have struggled to find a good place to put that money. Nevertheless, many observers note that this rally is not really supported by underlying fundamentals. The *FT* reports that in mid-July, the Chinese securities regulator published a list of 258 platforms that were illegally offering margin finance. This enters dangerous territory – the official amount of borrowed money in the Chinese market has risen to its highest level since 2015 (when the markets collapsed) but remains below the 2015 peak level. The excitement for stocks has been driven up by social media channels like WeChat and Weibo.

Moving on from China to gamblers in the US, is there another behavioural change in the making? The pandemic has brought many of the biggest professional sporting activities to a halt, resulting in gamblers not able to place bets. Where do they go? The stock market seems to be an obvious answer for these punters. According to an *FT* article by Richard Henderson (May 20th, 2020), this shift has helped to upwardly propel US stocks by 30% after the depths they reached in May. This may not be as much of an increase as the Japanese Mothers market, but it is still a remarkable rebound. 'People are staying home, there are no sports to bet on, so people are "trading for fun"', says Rich Repetto, a senior analyst at Sandler, in the *FT* article. Charles Schwab, E*TRADE, and Interactive Brokers have reached new records in terms of the inflow of new customers by collectively adding 780,000 new customers in two months. That number is almost two-and-a-half times higher than the entire Belgian market of unique self-directed retail investors.

Users of Robinhood, the stock trading fintech app, have, according to the *FT* (May 30th, 2020), more than doubled their positions in the Russell 3000 Index. More intriguing is the fact that the ten most popular stocks held by their users include vulnerable companies like American Airlines and Carnival, the cruise operator that was hit by the coronavirus. These retail investors speculate upon a spectacular rebound at some point in time and do not want to miss what could be a run of a lifetime. This is exactly what (partly) happened after Pfizer made the new vaccine announcement in November.

The early online brokers were not left behind. E*TRADE, bought by Morgan Stanley for $13 billion ($13 bn) earlier in 2020, added $32 bn of retail funds between January and October 2020. E*TRADE brings more than 5 million customers to Morgan Stanley.

Conclusion: Online brokers worldwide experienced a massive inflow of new clients. Meanwhile, the Belgian financial newspaper *De Tijd* reported in their April 4th/5th weekend edition that retail banks in the country did not notice a significant difference in terms of new clients or transactions. Like many other banks, they are not yet seriously engaged in online investing.

A WHALE SNAPPING UP US STOCK OPTIONS

As of April 2020, there has been an almost inexplicable rally in (primarily) tech stocks worldwide. Most experts judged this to be a risky situation, as the market capitalisations and underlying fundamentals of these companies are widely divergent. As discussed earlier, much of the rally was attributed to a massive inflow of (new) retail investors all over the world, underpinned by an ultra-loose monetary policy from central banks, a world of quasi-permanent low yields on fixed-income instruments, and massive government spending.

On Saturday, September 5th, front-page headlines in financial newspapers included: 'Softbank behind the tech stock rally on Nasdaq'. The *FT* (September 5th/6th, 2020) had the fitting title, 'Softbank unmasked as Nasdaq Whale that stoked huge tech rally'. What happened was that – unknown to most observers during the past months – Softbank had bought a huge amount of options, including billions of dollars' worth of US equity derivatives; a dangerous bet, according to industry experts.

UNDERLYING DRIVERS

The thesis that a new generation of online self-directed investors has been/is being created during the coronavirus crisis is echoed by Steven DeSanctis, an equity analyst for Jefferies, who stated in an interview with *FT* (May 30th, 2020), ‘this is similar to the frothy buying behaviour of retail investors during the dotcom boom’.

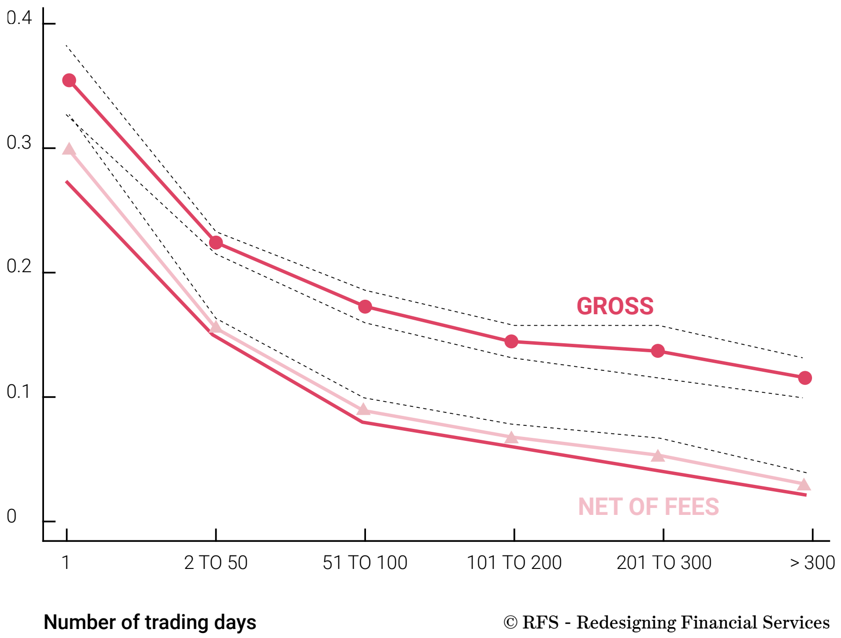
Given the changing social norms and the continuing attractiveness of exchange-traded funds (ETFs) that offer a fully-fledged investment-only option, which consists of a discretionary or advisory online offer, the number of investment platforms for self-directed investors may surge in the coming months and years to keep up with so many new players.

The possibility of trading in fractional shares and trackers is another driver behind the booming online trading by younger investors, who typically have less money. Stocks like Amazon or Tesla are appealing, but their price (per stock) is often too high for those who are younger or first-time investors. Fractional share trading offers a solution for this.

Nevertheless, most industry experts are of the opinion that the rally in stocks we witnessed in April–June 2020 is out of sync with the underlying economic reality and fundamentals. The *FT* labelled its Big Read commentary on June 13th as ‘The rise of the retail bro’. A boisterous US sports blogger, Dave Portnoy, became the poster child of this new type of retail investor, posting messages like ‘Let’s get fucking nuts’ and ‘I am ready! Are you ready?!’.

Redesign for Financial Services, a think tank based in Zurich, made an interesting analysis of day trading: most of us will not make a profit.

FRACTION OF DAY TRADERS WITH POSITIVE PROFIT



AN INCREASING APPETITE FOR ETFS

The rise of ETFs is unstoppable. Whether their performance is better or worse than that of mutual funds is another matter, but why they appeal to retail investors is obvious. Their low costs, decent performance, the ease of investing in them online, their transparency, and – normally – the fact that they are liquid (as they say on the stock markets) are all the reasons investors are drawn to them. The attractiveness of ETFs is further supported by the rise of automated advice or robo-advice. While B2C robo-advisors did not disrupt the market as predicted, more and more financial institutions are launching automated advisory services. Often, online brokers, such as Charles Schwab and Fidelity in the US, Keytrade in Belgium, and Nordnet and Avanza in Nordic countries, were among the first to add robo-advisory services to their banking and brokerage businesses. In Belgium, Bolero's robo-advisor, Matti, helped to realise a 700% increase in ETF transactions.

TWO MISUNDERSTANDINGS

I believe many people misjudge the trading desire of the wealthy. At Bolero, the biggest clients actually came via KBC's private banking and wealth management division. Other wealth managers and private banks experienced a similar rise in demand; the *Financial Times (FT)* (September 12th/13th, 2020) quoted Hervé Ordioni, CEO of Edmond de Rothschild Monaco: 'We had to deal with six times as much trading volume as normal. It was massive'.

A second misunderstanding is related to the zero-commission phenomenon. Robinhood, who pioneered this in the US, caused a shockwave. Perhaps the largest industry shock after May Day in the 1970s was when fixed price agreements were abolished and Charles Schwab took advantage and became the industry giant it is today. But do we see the same happening in Europe? Clearly not. In most markets, the market leaders are exactly the same, and few have adjusted their prices! That did not prevent them from signing on a massive number of new customers. Let us be careful before announcing the death of transaction commissions.

SIGNS OF A NEW SOCIAL NORM: JUST EAT TAKEAWAY, AMAZON, DELIVEROO, NETFLIX – A NEW VIRUS CALLED 'DIGITAL TECHNOLOGY'

The stock market took a beating, and stock prices are likely to remain volatile for the time being. Amidst this, investors are again trying to make up their minds whether or not this presents a once-in-a-lifetime buying opportunity. In any case, stocks like Just Eat Takeaway, Amazon, and Deliveroo are performing much better and/or are already recuperating. Furthermore, Netflix has already seen an unsurprising record number of viewers in recent weeks. While they have long been used by start-ups and tech companies, the world at large is becoming more accustomed to apps like Zoom, Google Hangouts, Miro, and Slack. Will this lead to a new way of working? Will business travel be reduced forever? Retailers around the globe are suffering, and many will go into bankruptcy if they are not saved by government bailouts. The 'relatively good' stock market performance of companies like Amazon is a sign of the times – a sign that the coronavirus crisis will only further accelerate the wave of digitalisation across industries.

'What the "new normal" looks like after this crisis is not clear yet, but we do expect enduring changes in consumer behaviour – with consumers being even more health- and environmentally-aware, and digital becoming even more paramount and consumer pathways migrating even faster from offline towards online', says Sarah Willersdorf, Head of Luxury at Boston Consulting Group in the *FT Weekend* (April 11th/12th, 2020).

Meanwhile, in an article for *Forbes* (March 30th, 2020), Simon Chandler, a London-based tech journalist, described how the long-term effect of COVID-19 will facilitate the spread of another virus known as 'digital technology'.

THE IMPORTANCE OF COMMUNICATION

Imagine you are on a plane and it is heading towards turbulence. Most of us are reassured by the announcement of the captain or flight attendant that the aircraft will enter said turbulence, and they will state the well-known platitude, 'Ladies and gentlemen, we are entering turbulence. Please fasten your seatbelts'. While going through turbulence remains unpleasant, it is not surprising (because of the warning and mental preparedness), and people feel taken care of. This is exactly what investors need in turbulent times. How many of them picked up the phone to try to reach someone in the full heat of the outbreak? How many got through? How many felt they received timely and relevant communication?

Recent research from FactSet confirms this. They found that weekly or daily reporting is becoming more desirable among various investor demographics. Out of the survey respondents under 35, 30% expect managers to be evaluating risk profiles on a weekly basis, while 16% expect daily reviews. Roughly 40% of those with more than USD 10 million in investable assets expect at least weekly reassessments of their risk profiles. This shift also appears to be part of a wider move toward delivering a better client experience.

In mid-2018, I was invited to a private banking and wealth management gathering in Zurich, which had a trends and digitalisation theme. I offered to take a look at the fashion industry for inspiration. Both the industry and its wealth management counterpart are arguably targeting the same types of clients. Both are – or were – seen as businesses that require human interaction and cannot be online, unlike for a customer buying (cheap) stuff on Amazon. The fashion industry has moved on since then. There are high-end, purely internet-based luxury companies, but all major brands also have now moved online. What is relevant in this context is the communication and connection aspect.

Private banks and wealth managers target (rich) millennials. This segment of the population is increasingly used to connecting with brands through social media, in particular via Instagram. They expect to be engaged with, as that is their social norm. Nevertheless, how are they and other older clients being taken care of during these times of 'social distancing'? Brands like Loewe (an LVMH company) are rolling out new types of content via Instagram; for instance, they have instigated a series of digital events called 'Loewe en Casa', whereby artisans demonstrate their practices via workshops and participate in live interviews. Sara Willersdorf (Head of Luxury at BCG) believes that the increased focus on connection and community building will remain as stores start to reopen. What is more, Adam Wray writes in the *FT Weekend* that brands that were able to forge genuine connections with customers at the nadir of the pandemic will stand to benefit.

Leading on from this, how well has the wealth management and private banking sector, which is traditionally focused on face-to-face interactions, 'connected and communicated in a timely manner' during the crisis?

'Private banking relationship managers saw digitalisation in the past as a threat. Now it is the only way to do the job', writes Anna Zakrzewski from the Boston Consulting Group in its influential wealth management report.

A NEW SOCIAL NORM FOR ADVISORY AND DISCRETIONARY MANAGEMENT

Ever since May Day 1975, online brokers have been the masters of the universe when it comes to online investing for self-directed investors. The arrival of the internet in the 1990s accelerated this belief significantly as online investing became the new norm. People only rarely went to brokerages or banks to place orders, and so it became a thing of the past. The iPhone was the catalyst for another new social norm, moving our lives increasingly online and seeing to it that we became mobile. Ordering books, food, DVDs, travel, and even luxury items and very expensive fashion clothing became part of our daily lives. Experiences provided by the likes of Amazon, Spotify, Deliveroo, and Net-a-Porter are drastically altering our lifestyles. This was not necessarily for the better, but now there is no escape.

The deVere research, which shows a 72% increase in the use of fintech apps, is indeed another indication that the long-term legacy of the coronavirus will be an increasingly digital and online society, even more so than before. It is fascinating that different aspects of financial services became a part of this new social norm in a series of waves, for example, mobile services. Online brokerages, along with payments and lending, were the first, and players like Ant Financial in China have completely taken over the (mobile) payments market. In Western Europe, banks typically have a decent mobile presence when it comes to basic services, which is less obvious and easy for their competitors to disrupt.

Bankers have shrugged off the threat of B2C robo-advisors, and rightly so. Bank competitors that started by offering basic banking services but who are now adding an increasing number of investment services are a different kind of animal. For example, Nubank now has more than 15 million customers and counting. Yet, the real threat may come from FAANG companies partnering with giants like Blackrock or Vanguard and complementing each. Here, the cooperation between Ant Financial and Vanguard needs to be considered. In April 2020, they announced they had joined up with a robo-advisor, which can recommend a portfolio selected from 6,000 mutual funds. Users can then access the service through payment apps like Alipay and Ant Fortune. Ant Financial's wealth management platform, Ant Fortune, has teamed up with more than 80 asset management firms to deploy its artificial intelligence-powered capability to offer tailor-made wealth management services.

CONCLUSION

First, retail and even private banks, should consider producing an (mobile) offering to address the needs of their current and potential clients who have an appetite for self-investing. Yes, this may cannibalise other products, but these types of customers exist and have requirements that may lead them elsewhere. It has happened to stock trading, and it may happen again to mutual fund investing, which is currently accelerated by an appetite to invest in funds and trackers online, meaning that going to a branch is no longer a necessity.

Second, the transformation journeys of wealth managers and private banks towards digitalisation will only hasten further. This means that advisory and discretionary advice will also move online at a greater rate, either fully available via the internet or in a hybrid format. Those who are forward-looking will step up their game and further invest in the back end (via solutions relating to core banking platform providers), middleware, and 'front'. The latter will involve providing mobile solutions to their clients and advisors and changing communications in a fundamental manner. In addition, the core (i.e. the construction of funds and portfolios) will progressively utilise scientific developments such as algorithms and machine learning, combined with elemental investing skills. Daniel Kahneman did say, 'Whatever you can have an algorithm let decide, let it. We humans have way too many biases'.

Finally, we observe more and more online brokers launching robo advisory solutions as well. The percentage of online brokers with robo advisory solutions is now already much higher than other financial institutions offering a similar service.