A Late Night Call

The call came late Friday evening, well after hours, and the voice was one of anguish. “I think I’m in terrible trouble, Ted.”

David was a long time business acquaintance, five years retired, in good health, and a man of significant means, but the tone of his voice bespoke trouble. Only hours before our conversation, David discovered he and his trust we victims of Bernard Madoff and his massive Ponzi scheme. Madoff, former NASDAQ chairman, though his investment company had apparently stolen an estimated $50 billion in client money over the years by admittedly falsifying client statements and using moneys from new clients to provide for withdrawals by longer term ones. (Kind of like the government does with the social security system....).

“How could he do this? How could this even happen with the SEC (Securities Exchange Commission) looking over his shoulder?” David questioned. “What should I have known or questioned that I didn’t.”

My friend’s questions were good ones. Unfortunately, I had few answers. And my standard punch list of advice on investment due diligence seemed a little late in the offering. The money lost was, in all probability, unrecoverable; gone.

Tens of thousands of investors annually are bilked for hundreds of millions of dollars by purveyors of garden variety investment scams. There favorite targets are sadly too often those who can least afford the losses; the elderly, the financially unsophisticated, the gullible, and the desperate. Even investors with years of experience make bad investments and are sometimes taken by the Ken Lays and Jeffrey Skillings of the world (read Enron). And yes even seasoned professionals with years of experience can be fooled by clever promoters. It is important to remember that almost all investments have exposure to potential influence or manipulation. Even good companies can have dishonest or self serving executives, funds can have illicit managers, and real estate values can be influenced by crooked appraisers, brokers, and financiers.

To insulate yourself from entities promoting potentially toxic investments I recommend a few standard precautions:

1. Don't invest in something you don't understand. If the ‘salesman’ promoting it can’t explain exactly what you are buying, including the risks and historical returns, the volatility, liquidity, etc. its always best to pass. Adapt a posture of ‘constructive skepticism’ ask questions, and sleep on it before investing your hard earned money. Don’t be intimidated by ‘one time offers’ or ‘last chance to make your fortune deals’. Trust me, if it’s worth doing, it will still be worth doing tomorrow.

2. Ask for professional references. Do some ‘snooping’. Use the internet to check out the investment and its purveyor. Learn all you can about the product, investment, or service. Check with the better business bureau and any agency or regulatory body with which the sales entity might be registered to determine if it has any pending violations.

3. Ask for an audited performance history on an investment or audited financials on a company and be sure the auditor is a recognized and reputable entity. Don't take no for an answer. Be particularly wary of unsolicited phone calls, no name or unfamiliar organizations, and out of area promoters.

4. Remember truly, there is no such thing as a free lunch. Be extra guarded when someone offers you double digit returns with low volatility and/or low risks. Those virtues do not co-exist in the known investment universe with any consistency.

5. Insist on full disclosure and get it in writing. It is not impolite to ask the hard questions: How long have you been doing this? How much of this investment do you have in your own portfolio, and can you show me your personal statements? How do you get paid, and how much, if I invest? With what regulatory agencies are you registered?

6. Diversify. I discovered my friend Dave had over forty percent of his money with Mr. Madoff's investment company. That's simply too much exposure to one fund or company. I frequently recommend that associates have no more than ten percent of their net worth in any one asset (and less than twenty percent in their personal residence). Today's environment reminds us that even good investments, with great management, and excellent histories can suffer unparalleled losses.

7. Finally, remember, no one cares more about your money than you do! You are the one ultimately enriched or impoverished by its management. Seek good financial counsel. Wise and experienced counsel is invaluable, but seldom cheap. And in all cases be sure that those chosen to advise you are rewarded on a fee only basis or based on helping you make sound and profitable investment decisions, and not incentivized by commissions to sell you something.

8. If you are dealing with an advisor or portfolio manager never make out investment checks to the person managing your money. All funds should be held in a custodial account at a reputable broker or clearing firm. Funds should never be held in your independent advisors name and all statements should come directly to you from your brokerage or clearing firm and itemize all your positions.

For as long as humanity values money, there will be those persons or entities influence by persons prone to marginalize truth and integrity for financial gain. For the prudent investor that means that the all too over used Latin expression 'caveat emptor' remains the watch word.