INVESTMENT FRAUD

How Financial "Experts" Rip You Off
And What To Do About It

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Introduction

"It's not the return on my principal that worries me; it's the return of my principal."
Will Rogers

Every year, investors just like you lose hundreds of millions of dollars to investment fraud. Con artists scam the rich, the poor, the naïve, and the experienced. Nobody is immune. Investment fraud steals from widows, young couples, senior citizens, and highly paid professionals. If you have money and are willing to invest, then you are a potential target for investment fraud.

This may sound alarmist but it's not. Even I was surprised at how common investment fraud was when I began working with the public as a financial coach. I helped many clients save five figure and six figure sums applying the exact information you are about to read in this book.

The truth is investment fraud preys on financial ignorance, and the antidote to ignorance is education. An educated consumer is the con man's greatest fear. The front line of defense against investment fraud is your own due diligence[2] and skepticism when evaluating investments.

It may be an old, worn cliché, but, "An ounce of prevention is worth a pound of cure" is actually timeless wisdom. In fact, it is an essential truth in the world of investment fraud.

My goal with this book is to provide you with the necessary education so that you know how to prevent investment fraud from ever reaching your portfolio. Forewarned is forearmed!

Are You Vulnerable To Investment Fraud?

"Happiness is the perpetual possession of being well deceived."
Jonathan Swift

Let's begin with a little test.

Not everyone has the same risk of becoming the next fraud victim. Certain situations and habits make you more prone to fraud while others increase your safety.

Below is a simple test to help you assess your own risk profile for financial fraud so that you know what preventative measures are most relevant to your personal situation and style.

1. Are you excited by investments claiming high returns (25%, 50%, or even 250%) with little or no risk, or do these claims make you cautious?

Investment fraud is often sold on the basis of above-market[3] returns with little or no risk to lure unsuspecting investors. If high returns excite you, then you're in danger because this characteristic should make you wary, not interested. High returns are a reason to double your due diligence efforts and dig deeper—not invest blindly. Guarantees and low-risk claims should also raise a red flag about possible fraud. Novice investors are enticed by such claims, but sophisticated investors become cautious because they defy business common sense.

2. It's the securities regulator's job to make investing safe and protect me from fraud. True or false?

False: The first line of defense against investment fraud is a skeptical, educated investor. Securities regulators are here to help, but it's impossible for them to catch all investment fraud before it reaches your portfolio. You are self-responsible. You must do your own due diligence. If you invest, then you will eventually run into fraud; therefore, you must learn to protect yourself. You cannot rely on regulators as proven by all the financial fraud that currently exists despite existing regulation.

3. If a church leader, book club member, or friend-of-a-friend

introduced me to an investment, then I would be more inclined to trust that person. True or false?

False: Affinity fraud is a favorite tactic of the con man because people are naturally more inclined to trust people who are like them and share common interests. For that reason, the investment fraud perpetrator enrolls trusted individuals in organizations who are not investment experts. High-level church members and social leaders are favorite targets. This person honestly believes in the investment but is deceived. Just because a source is trusted personally or professionally in other fields does not necessarily qualify him as an investment expert. Good people make mistakes by getting involved with lousy investments. Always do your due diligence—never invest based on trust.

4. I have proof the investment is not a fraud. My buddy Bob got paid off handsomely in cold, hard cash. The proof of the pudding is in the eating. True or false?

False: The con man will often pay the first investors handsomely as a cheap source of marketing leverage. He knows Bob will boast about his great investment at cocktail parties and social events thus selling his friends and family into the fraud. Soon the fraud promoter's phone will be ringing with greedy callers wanting in on the great investment Bob told them about. Just because one person got paid does not make the investment legitimate.

5. It can't be investment fraud. I saw it advertised in reputable magazines, papers, and other media sources. True or false?

False: The media may be legitimate, but that doesn't necessarily mean the advertising is. Not all advertising is thoroughly screened thus allowing legitimate publications to be used as implied endorsements for investment fraud. Just because an investment ad is published in a reputable magazine or newspaper does not make the investment legitimate.

6. I've seen a bunch of information on the Net and in discussion groups during the last few days. This company is hot. The penny[4] stock has already jumped, proving all these people are right. True or false?

False again: These are the tell-tale signs of a potential "pump and dump" investment fraud. A fraud promoter can post throughout the Internet under various aliases to create bogus discussion and the appearance of mass involvement. The increased demand caused by publicity can lead to impressive price spikes in thinly-traded penny stocks that are easily controlled by the investment fraud promoter. The stock's rise serves to further stimulate demand from trend followers thus allowing the con man to offload his stock to unwary and inexperienced speculators.

7. My insurance salesman or accountant seems really excited about this investment. He's never steered me wrong with his regular services. I guess it's okay to trust him on this, too. True or false?

False: Trusted professionals are a favorite sales vehicle for investment fraud. They already have your confidence, but they typically aren't experienced investors with full compliance departments and due diligence skills. They are offered high commissions to promote what they honestly believe to be a good deal. Unfortunately, they are often self-deceived and operating outside their field of expertise. You must do your own due diligence.

8. The brochures are impressive, the company address is prestigious, the name sounds official, and the salesman is nice, knowledgeable, and very service oriented. I guess I can trust that the investment isn't fraudulent. True or false?

False again: The con man's job is to create a trustworthy facade so you feel confident enough to invest. Your job is to look behind the image to determine if there is any real substance—or if it is nothing more than investment fraud. Approach all investments with skepticism and find out if there is any real beef between the buns. You must do your due diligence because looks can be deceiving.

9. I just couldn't hang up on him. I felt uncomfortable saying "no" when he spent so much time on the phone with me.

Strangers who call you on the phone or knock on your door seeking money are interrupting your day. It's rude. You owe them nothing—least of all your money. Good manners should be reserved for people who deserve them. If you're lonely and need companionship, don't mistakenly believe it will come from strangers whose only real interest is your money. If money or investing ever enters the conversation, then hang up on them. You must be willing to say “no” when appropriate.

10. Investing is too complicated. I don’t understand it. I would prefer someone take care of that stuff for me.

You can delegate authority for your investing, but you can never delegate responsibility. Why? Because you can’t make a person care more about your pocketbook than his own. This unfortunate reality makes constant vigilance a necessary part of being an investor. You must educate yourself about investing and watch over your portfolio. Anything less is an invitation to investment fraud. It’s unfortunate, but that’s the reality.

Insist on regular financial statements and watch for excessive or unauthorized trading. Watch out for anyone who encourages you to leave your nest egg in their hands. Be forthright in demanding explanations for anything that seems amiss or unusual. Nobody cares about your money as much as you do. You are solely responsible, regardless of who you hire to help you. In the end, it is always your decision.

11. I would ask more questions except it makes me feel so dumb. I should already know this investment stuff.

Con men prey on your fears. None of us wants to look dumb. The con man can make the flimsiest scam look real through manipulative persuasion tactics. You must be willing to ask apparently dumb questions to pierce the veneer. My experience when asking “dumb” questions is that it usually reveals more about the salesperson’s lack of knowledge than my own. Besides, you have nothing to lose by asking perfectly legitimate due diligence questions. It’s only the questions you don’t ask that cause you risk. After all, if you think asking questions will make you feel dumb, then just wait until you lose money to an investment fraud because you weren’t willing to ask the questions in the first place. That’s *really* dumb.

12. I’m an inexperienced investor who has sudden business success or received a windfall life insurance settlement or inheritance.

You are a favorite target for investment fraud. Con artists love to target elderly widows and young, successful business people because they often have more money than investment experience. In circumstances like this, it’s wise to pay by the hour for a neutral, third party to educate and support you in analyzing your investments until you gain sufficient experience to do it on your own. Warning: an investment advisor compensated by commission has conflicts of interest; whereas, when you pay for services by the hour the conflicts of interest are reduced. My experience with financial coaching clients is the small cost is more than offset by improved investment results and avoiding the obvious mistakes. Nothing is more financially dangerous than managing $100,000 with $1,000 worth of investment experience.

13. I like to make my investment decisions on the fly. Immediate decisions are okay by me because over-analyzing stifles me. If the story is compelling or the relationship feels right, then that's good enough for me.

Investing isn't about relationship, story, or feeling good—it's about business and positive mathematical expectation. Don't confuse the issues. Investment fraud depends on people making decisions based on surface level impressions. For that reason, you must probe the depth to find the truth. It isn't always fun, but it's necessary. The more you look into an investment decision before committing money, the less likely you'll be victimized by fraud. You must do your due diligence to get past the veneer because story, relationship, and feelings have nothing to do with investing.

14. I believe there is some truth to conspiracy theories about the government and the "big boys" having access to elite investments that are secreted away from the average investor.

Prime bank and offshore investment fraud are often designed to appeal to conspiracy theorists. You are sold on finally having access to the "secret investments of the rich" as the reason high returns and low risk are plausible. Unfortunately, no secret investments of the rich exist, and the government is not conspiring against your investment plans. It makes no sense. The more you profit, the more they can tax your profits. Conspiracy theories are just marketing hype designed to extract money from people who believe such things.

15. I'm more excited to own 10,000 shares of a 10-cent stock than to own a paltry 10 shares of a $100 stock.

Inexperienced investors in search of the next eBay, Microsoft, or Google in its infancy prefer many shares of dubious value over owning fewer shares representing real value. They want a big killing and aren't dissuaded by the nearly impossible odds confronting this strategy. The 10-cent stock appeals to the gambler's mentality, but beware of penny stocks because the risk of investment fraud is higher. New issues and penny stocks require specialized investment skills and due diligence capabilities that few readers possess.

Investment Fraud Test Summary

If your attitudes and beliefs were congruent with even one of the above statements, then you're at risk of becoming a victim of investment fraud. Defend yourself by educating yourself. Con men prey on inexperienced and trusting investors. There are three things you can do to reduce the chances that you become a victim of investment fraud.

1. Educate yourself so you recognize the symptoms of investment fraud before it costs you money (this is fully explained in the next chapter).

2. Approach all new investments with a healthy dose of skepticism.

3. Always perform thorough due diligence before risking a dime. (Again, this is fully explained later in the book.)

In the following chapters I show you the many ways financial "experts" rip you off and what you can do to protect yourself.