

Chasing yield

The reason that the Bernie Madoff investment fraud continued for so long is that he didn't promise investors that they would get rich quick. He promised steady returns without risk. An offer of a 25% return in one year should set off alarm bells for most investors. Offers that downplay the risk of loss should also.

Recent stock market volatility and the Federal Reserve's policy of low interest rates have driven more and more investors to unconventional assets, styled "alternative investments" or "exotic investments." According to one estimate, Americans have some \$712 billion in complex investments that claim to provide higher returns without the volatility of the stock markets. Savers are looking for a stable source of income, something that was not so very hard to do years ago. Some of these alternative or exotic investments have soured, leading to action by securities regulators. Among exotics mentioned in a recent *New York Times* article:

- Part ownership in a fleet of luxury cars;
- An interest in a company supposed to produce a bilingual television show, "Hacienda Heights"; and
- Interests in nontradeable real estate investment trusts (REITs). In fact, Massachusetts regulators fined a major brokerage firm for selling these securities to investors who were not sophisticated enough to understand them. The firm promised to reform its sales process.

Be an informed investor

The Securities and Exchange Commission (SEC) offers a wide variety of resources to those who are willing to investigate before they invest. For example, offers of the sale of securities must be registered with the SEC, and important details about them may be found in the SEC's EDGAR database or by calling its toll-free investor assistance line at (800) 732-0330. The SEC also provides information on the background and qualifications of investment professionals.

Commonsense financial advice also may be had from the SEC investor bulletins, available at its Web site. For example:

- *Paying off high-interest debt may be the best investment strategy.* Eliminating credit card interest rates that easily may exceed 20% annually has no risk and provide an immediate, above-market return.
- *It can be costly to ignore the fees associated with buying, owning and selling an investment product.* One of the usual characteristics of "alternative investments" is a high commission for the broker who sells it. High costs make it very difficult to achieve high net returns. Surrender fees also must be taken into account.
- *Active trading and some other very common investing behaviors actually undermine investment performance.* A large body of academic research supports this assertion.
- *Research shows that con artists are experts at the art of persuasion, often using a variety of influence tactics tailored to the vulnerability of their victims.* The SEC cites tactics such as phantom riches, source credibility, social consensus, reciprocity and scarcity as techniques to watch out for.
- *The key to avoiding investment fraud, including scams that target specific groups, is using independent information to evaluate financial opportunities.* Such information needs to come from outside one's family or social community.

We can help

For a second opinion on your investment ideas, call on us.

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Any developments occurring after January 1, 2014, are not reflected in this article.