Stock Market Perspective: Scams and Dubious Claims

Normally this section is devoted to discussion of an aspect of stock market movements or factors that produce the movement. This issue I will broaden the type of education I try to provide to discuss some misleading and even outright fraudulent pitches that you may encounter. Of course, I think readers of this newsletter are too savvy to fall for them, but you may know some others such as elderly friends or relatives who may be victims or potential victims. Many of the scams are designed to entrap and are pitched to the older segment of the population. Before I get into details, here is a little bit of motivation.

If it sounds too good to be true, it almost certainly is not true. Knowing the "tricks" they use is a good first line of defense.

When I am asked where I live, I often say in Arlington, Virginia, which is just across the Potomac from Washington where your tax dollars go to die. That usually brings a mild chuckle and sometimes a comment about how the government works or does not work. Those tax dollars do produce some very tangible benefits to residents of this area. In particular, we are blessed with a collection of world class museums that are located close to each other and are free to enter.[2] There are also benefits from being close to the working parts of the government. In September, I attended a conference at the offices of the Securities and Exchange Commission (SEC) on protecting "senior" investors against fraud. Since I qualified as a senior, I also was invited to a "free lunch."[3]

The second annual "Seniors Summit" was a joint effort of the SEC, the North American Securities Administrators Association (NASAA, the organization of state securities regulators), the Financial Industry Regulatory Authority (FINRA, which is a new entity formed by merging the regulatory arms of the New York Stock Exchange and the National Association of Securities Dealers), and the AARP. The presentations talked about common problems and what steps to combat them that investors, professionals such as myself, and government agencies can take and are taking. Spreading the word is one of the steps.

▶**Some common abusive practices**:

- *Free lunches and dinners:* I get invitations to several of these every month, and I suspect most of you do also (but not because I have given your name to anyone). They always promise that nothing will be sold at the event and there is no obligation on your part. Technically this is true, but you can be certain that there will be at least one, and likely several more follow up phone calls and other contacts. Many of these are legitimate and they will "take no" on the first or second call.[4]

[2] On the down side, every so often one has to wait 10 or 15 minutes until the motorcade of a high government official passes. At least twice I have been delayed by the President's.

[3] As the old saw goes, there is no such thing. In this case, I had to attend a couple of hours of informative presentations. Even better, the presentation during the lunch was quite valuable and the most informative of the day. In that sense, the lunch was better than free.

[4] After hearing him at a very basic lunch, I engaged a local attorney to draw up living trusts and related documents. Lured by a dinner at one of Washington's best restaurants, I attended a presentation by a local broker on managed investing. His presentation and those of the investment managers were unimpressive, but the one by an estate planning attorney was quite good. If I had not already engaged the services of the one who made the lunch presentation, I would have given strong consideration to the one at the dinner. The broker lost any chance of further contact when he called me during most people's normal dinner time since that says his

As part of the process, you will provide a lot of contact and other information. Unfortunately, there are those who will use it improperly or fraudulently. They may try some psychological ploys, which are discussed later. Another abuse is selling products that are not appropriate for the investor. A popular one is an "equity indexed annuity" that may have a guaranteed return of principal. These are complex products that almost certainly have lucrative commissions for the sponsors of the meal. There is a good article about them in Martha Hamilton's Financial Futures column in the Sunday, October 7 *Washington Post*. If you don't mind typing, it is at "http://www.washingtonpost.com/wp-dyn/content/article/2007/10/06/AR2007100600106.html?sub=AR" and you may need to register to view it.[5]

- *So-called "Senior Specialists":* I have received offers about how one can "earn" an impressive sounding designation. In many cases the requirements are minimal, and in the worst ones only a fee is paid to a fake organization for the associated title. Sadly, this detracts from the legitimate professional organizations such as the Financial Planning Association that issues the Certified Financial Planner designation after five challenging exams are passed. Just because someone has a title conveying expertise, whether legitimate or not, does not mean he or she will act in your best interests.
- *Affinity Fraud:* You are contacted because you are a member of an identifiable group and the trust you may have in a supposed fellow member is abused.

need to sell is more important to him than my desire for a peaceful meal.

[5] If you are interested in this type of investment, there are several available with no loads or commissions and relatively low expenses. I can provide information.

- *Ponzi and Pyramid Schemes:* These are well known, but a newer variant often used for older investors is a fraudulent charitable gift annuity. Many legitimate organizations offer them, so one must really know about the supposed charity. You should be skeptical about any charity or organization that you do not first contact yourself.
- *Oil and Gas Scams:* These are particularly tempting with energy prices heading higher. Often they are Ponzi schemes. If you are tempted, thorough research is your best defense. As a rule, the greater the "promised" returns, the more likely it is a scam.
- *Cold Calls Touting Great Investments:* While some of these may be legitimate, I think it is best to end them as soon as possible because the risk is too great. Once I establish that I have never done any business with the caller's company, I simply say "I don't respond to cold calls" and hang up.

There are many more abuses and frauds, but the above are some of the lowlights. For example, I know you are all savvy enough to delete immediately e-mails touting a very low priced stock that is certain to double, triple, or even more in the near future, which are "pump and dump" schemes.

▶**Persuasion Tactics:** The presentation during lunch by the Washington State AARP covered the most common psychological persuasion tricks and ploys used by fraudsters. Recognizing them is important, particularly because research has shown that victims of investment fraud typically are financially knowledgeable, but susceptible to these tactics.

- *Phantom Dreams:* They paint a picture of something you desperately want but won't get unless you "invest" with them. Usually this happens over several calls or personal visits.

- *Social Proof:* Convincing you that others are doing it, so it must be good. This may be combined with scarcity.
- *Source Credibility:* They claim to be affiliated with established organizations or experts. For example, they may say the oil exploration scientist has been in the business for many years and has worked for Exxon all over the world.
- *Scarcity:* The claim is that what they are offering is so good and so desirable that there are only a few interests left and you must act right away or you will be shut out. Right!
- *Fear and Intimidation:* When all else fails, they may turn nasty and abusive and resort to bullying tactics.

Even more disgusting is that it is common to go after prior victims with the pitch that they can help them get back their losses. In other words, those who are suckers once are likely to be repeat victims.

▶**What You Can Do:** Being informed, somewhat skeptical, and careful is the best defense. Educating others who may be susceptible may prevent someone else falling into a trap. The SEC has an Office of Investor Education and Advocacy that issues various publications. One that covers many of the topics discussed here is "Seniors Protect Yourself Against Investment Fraud" that is a valuable guide regardless of one's age. It has an extensive list of web sites and regulatory agency contacts and can be obtained for free by calling 800-732-0330. The web sites of the sponsoring organizations (finra.org, nasaa.org) also have many educational materials.

If you have questions about a potential investment, particularly one that seems "too good to be true", I am willing to help you research and evaluate it. Just call me or send me an e-mail. If you say I want to check with my financial advisor, you may get pressure ("don't you trust me?") to sign up right away. Keep in mind that if you are told you must act at once, it is almost certain that your correct action is to say no and hang up the phone or get the scum out of your house.

If you are victimized, you definitely should report it to a state agency or the SEC to try to keep the crooks from victimizing others. However, your chances of getting back anything you lost are extremely slim.

▶**Dubious Claims:** These days I get several snail mails a week promising me incredible returns if I just subscribe to a publication or buy and use their software. The frequency of these seems to be rising. (I don't keep track.) I think that is tied to the rising markets we have had. Several years ago when the markets were falling, I received hardly any.

I don't think these are fraudulent although the ones that cost several thousand dollars do make me suspicious of whether they will really honor the virtually ubiquitous "money back guarantee" if not satisfied. (None of them offer to cover any losses from following their advice, which would be a meaningful guarantee if real.)

Although they may not be nearly as bad as what is discussed above, there is usually reason to be highly skeptical. Reading the fine print is always a good idea. Here are a couple of examples, which could qualify for my Gibberish section if I had one this issue.

- "Options Hotline" has a typical money back guarantee. Its level of hype goes to extreme levels by claiming "Why I'm Paying Every Trader $250" on the cover page and inside "I'll Even Give You $250, Just to Help You Get Started…" Sound to good to be true? Of course it is. The $250 is a "discount" from the "normal" subscription price that I doubt anyone has ever paid. Like other flyers of this ilk there is a seemingly endless stream of examples of incredible profits in very short times. Reading the fine print at the bottom of the last page reveals "gains are based on all triggered picks, *assuming exit point at peak option value."* (Italics added by me for emphasis.) In other words, the amount that could have been made if one had sold at the very top every time. I would have thrown it in the recycle bin right away if I did not think it could be potential newsletter material. I urge my readers to recycle these without bothering to read them. If someone really thought he or she could turn "an initial $5,000 investment into over $216,164…in a single year of trading", why bother sending out all the mailings trying to get people to pay several hundred dollars a year for the service? I think you know the answer.

- The almost six hundred page novel[6] *Paradigm* by Robert Taylor, published last year, is based on a supposed discovery that stock market movements can be accurately predicted by the changing effects of the gravitational pulls of the sun and moon. These in turn can be measured by the changes in the ocean tides. The author claims the "Taylor Effect" is not fiction. Although the trading method calls for more frequent trading, he presents a table in an appendix showing the years from 1920 to 2020 when his system says stocks should make lows and the years when they should make highs. To evaluate this (using the Dow Jones Industrial Average) he says to "use the following provision: The lowest price in a year market with a 'Low' will be below the highest price in the preceding year marked with a 'High.' The 'Highest' price in a year marked with a 'High' will be above the lowest price in the preceding year marked with a 'Low.'" In other words, he assumes he can buy at the low point of a year and sell at the high point of a subsequent year and then buy again at the low point of a later year. He does not indicate how he would be able to do that without a time machine, and there were none in the novel. For what it's worth (not very much), the table showed a high in 2004 and another in 2009 with a low last year. By his provision, that was correct: sell at 10,737 in 2004, buy at 10,667 in 2006, a whopping gain of under a percent with perfect timing! Needless to say, I am not going to act on his projections.

[6] My main interest was in the stock trading system in the novel. I can't recommend it as a good read. Although it has a similar flavor to Dan Brown's *DaVinci Code*, I did not find it nearly as compelling and have stopped about two-thirds of the way through well after the main plot turned from development of the trading system to trying to avoid being bumped off by the bad guys.