



Value for Money Investing by Gordon Stockman, CA, CFP

Ponzi, a four letter word to many.

As is true in all downturns, the rotten apples are quickly exposed as all the good apples are removed from the barrel. When the barrel is almost full and apples are being added, no one notices the bad ones. Reverse the trend and remove apples and it is not long before you discover a bad one, and then more and more.

Ponzi schemes are named after the fraudster Charles Ponzi, who went from anonymity to being a well-known Boston millionaire within six months in 1920. A Ponzi scheme is a fraudulent investment operation that pays returns to separate investors from their own money or from money paid by subsequent investors, rather than from any actual profit earned. The Ponzi scheme usually offers returns that other investments cannot guarantee in order to entice new investors, in the form of short-term returns that are either abnormally high or unusually consistent.*

The US news has been full of news in this area. Surely we have all heard of Bernie Madoff due to the staggering sum that was involved of over \$50 Billion. More recently, here in Canada, similar frauds have been uncovered. Earl Jones of Pointe Claire, Quebec and Milowe Brost / Gary Sorenson of Calgary to name two.

So, how do I avoid being a victim?

First, trust no one completely. I know that sounds harsh, but the key is the word completely. All individuals are fallible. Some more than others and you will never be able to truly ascertain your advisor's state of mind or depth of morals. Of course, you will need to trust your advisor to accomplish what you set out to accomplish. Value his advice highly and trust his knowledge and his concern for you implicitly, but do not abdicate your responsibility to question and verify what he does. A serious professional will see this as a prudent move on your part, a thief will be less enthusiastic.

Second, trust institutions, not entrepreneurs. A key characteristic of all the noted frauds was that people gave BOTH their money and faith to the same individual. You need to trust your advisor to be successful. However, it is not necessary for you to entrust your funds as well. Seek a third party to hold your assets and provide custodial services. A manager is able to make investment decisions without direct access to the assets. Your custodian will ensure that funds are only released to you. The advisor is limited to decision making, not access.

Third, since you can never trust any individual completely, if you choose to ignore the use of a third party custodian, diversify your risk. It is almost always right to let one manager direct your assets, it is almost always wrong to let one individual control all your assets. Of the people that took the risk with Madoff, surely the most damaged by the fraud were those that had given everything to him. Losing part of your investment portfolio to fraud will certainly make your retirement less perfect, but losing all of your investments could destroy your life.

Fourth, if it is too good to be true, it is. Why do we ignore this simple piece of advice? How are we so easily manipulated? Remember the fraudster is pushing all the right buttons and setting you up to be taken in. All actions are intended for you to be blinded, so there should be no mystery that you are. Early investors may be close associates, family or friends. The initial promises are met timely and as promised. If you were promised 10% in a month and you were given back 110% of your original investment, what do you do? You invest it again AND you tell everyone about how shrewd you are. Soon others follow and they also are managed well and big returns are presented. Not long after, no one wants to go through the re-investment steps and just wants reports on how they are doing. Those reports will be GREAT! Madoff purportedly even turned money away. This built up an aura of exclusivity, driving the desire to get in even higher.

Fifth, make sure you receive an independent report of your assets. One common link to all these frauds is that the only person telling you where your money is and how it was doing was the same person you wrote the cheque to. Seek third party verification on an ongoing basis. If your manager provides you with a performance report, compare it with the custodian's report, to see that all assets are accounted for. Verify that the investments presented exist. Look beyond the report.

Lastly, always seek out an independent opinion. When asked, I may not be able to even give a complete answer, since I may or may not have heard the pitch or seen the investment circular or prospectus (or heard the verbal promises,) but I can at least make sure that you are asking the right questions and giving consideration to the right things. Have you considered the use of a custodian? I will remind you that high returns are always tied to high risk. If it was low risk, the bank with billions to invest would already be there and they would not need your money. Is the decision driven by trust or by facts that can be checked?

Why is it that we probably all know some Latin? Could it be because "Caveat emptor" or "Let the buyer beware" always applies!

*With excerpts from Wikipedia

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COSTS DO MATTER

START VALUE	RETURN OF %7	RETURN OF %8	YOUR SAVINGS
\$100,000	\$386,000	\$466,000	\$80,000
\$250,000	\$967,000	\$1,165,000	\$198,000
\$700,000	\$2,700,000	\$3,262,000	\$562,000

Look at the chart and determine how much more you could keep in your pocket after a 20-year period, if you could reduce the overall fees in your portfolio by just 1%

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Gordon is the Vice President – Financial Planning at Efficient Wealth Management Inc. a leader in cost efficient financial planning. He teaches at George Brown College in their Financial Services and Accounting area. He is also a frequent guest on television and has written numerous articles on investing and financial planning.