How To Protect Yourself From Investment Fraud

Zacks
INVESTMENT MANAGEMENT

Investor fear is at all time highs. With stories circulating, and investigations of Ponzi schemes by Madoff, Stanford and others all over the news, it is understandable that many investors are cautious and suspicious of whom they hire to manage their wealth.

The conundrum many savvy investors are now facing is that they can see the large opportunity currently available in the stock market. However, they are also in great need of an investment manager who can help them achieve their financial goals in a risk controlled fashion. So, we decided there was no better time to provide investors with a simple and effective way to ensure they can identify, and don't fall prey to, a Ponzi scheme.

Always make sure the custodian of your assets is separate from the individual who is making the investment decisions on your behalf.

Every investment Ponzi scheme has always had one consistent factor: the investment manager and the custodian were the same entity. A combined structure provides an investment manager an easy avenue to quietly embezzle money.

Separating these functions provides you, and your hard earned assets, protection. Here the investment manager cannot transfer your money without your written permission. The manager will make ***investment*** decisions on your behalf, but they will be unable to move your money around on their own.

What if the custodian goes bankrupt?

When you have your money invested in equities, you actually own the underlying companies. If either the investment manager or the custodian goes bankrupt, your investments are still perfectly safe. Your only risk in this situation is the fluctuating value of your portfolio holdings in the market.

Let's look at a recent example of this scenario: Lehman Brothers completely failed in September of 2008. Individuals who had securities in custodial accounts were still in good standing.

Does this limit your investment options?

There are certain managers who commingle assets (such as hedge funds and certain limited partnerships). Following our model of keeping client assets separated may prevent you from investing in some of these products (and please note that some of them are perfectly legitimate firms). However, if one of your primary concerns is ensuring that you do not fall victim to a schemer like Madoff, then this separation tactic is the best way to protect yourself.

If it's so easy to avoid these schemes by simply separating the manager and the custodian, then why did so many "sophisticated" investors fall prey to Madoff?

The simple answer to that question is Greed. Institutional and individual investors alike were drawn to Madoff because he was seemingly offering the ideal solution: low-risk consistent, market beating investment returns; a portfolio that appeared to produce 1% per month regardless of what happened in the market.

Greed can be hypnotic, and investors seeking the impossible were sold just that. Madoff, as well as other fraudulent investors, know how to present their story in a believable and compelling fashion. Had these unfortunate investors followed our simple rule of separating the custodian and the investment manager, they would be in a much better situation today.

ZACKS CAN HELP.

FOR MORE INFORMATION on how Zacks can help you and your investments,
please contact your investment consultant or call us at 800-245-2934.
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