



## Registered Investment Advisor Firm

©ISSUE IX, VOL. III – *Bud Heng – Registered Adviser (925) 360-6819*

---

SEPTEMBER – 2014

### Answer Forum

Last month I started the Answer Forum and received several great suggestions and requests for topics. Because of the importance of one such question (which several readers raised) I thought I'd devote this month's issue addressing that concern and detailing "investment scams" and "frauds" to help the individual investor protect themselves, especially those that invest on their own and do not use the services of an investment professional.

The Financial Industry Regulatory Authority (FINRA) is not part of the government, but an independent, not-for-profit organization authorized by Congress to protect America's investors by making sure the securities industry operates fairly and honestly.<sup>1</sup>

FINRA's website offers a lot of great tools, "red flags" and advice for the individual investor. One such tool is their **Scam Meter**<sup>2</sup> (use CTRL + Click to access) which consists of 4 questions and can help you determine if an investment opportunity is too good to be true.

Another great tool offered through FINRA is their **Risk Meter**<sup>3</sup> (use CTRL + Click to access) which walks you through 12 questions designed to assess your individual risk of potentially being vulnerable to an investment fraud.

Recognizing investment scams can be difficult because they take many forms and change frequently as new pitches promote their alleged "benefits." But while and how they're pitched to the investing public many frequently

---

<sup>1</sup> FINRA.org

<sup>2</sup> <http://apps.finra.org/meters/1/scammeter.aspx>

<sup>3</sup> <http://apps.finra.org/meters/1/riskmeter.aspx>

---

This publication is intended for informational and educational purposes only. It is not intended nor should it be construed to be an offer of investment advice and any mention of a stock, bond, mutual fund, ETF or other investment vehicle should not be considered an endorsement or recommendation. Investment returns if referenced are based on past performance and should not be considered an indicator of future results. You should carefully assess your own circumstance, conduct your own research or consult your investment advisor before making any investment decision based on any material presented.

change, the schemes generally follow the same characteristics.

Everyone has undoubtedly heard of *pyramid schemes* where swindlers claim they can turn a small investment into large profits within a short period of time. The reality is the participants only make money off the new recruits being brought into the scheme. It's not uncommon for these types of frauds to appear as legitimate multi-level marketing programs. These typically fail when the organizers are unable to recruit enough new victims.

In many similar ways, you have the *Ponzi*<sup>4</sup> *scheme* in which the fraudster attracts money from new investors and uses it to pay purported investment returns to earlier investors. Like the pyramid scheme, a Ponzi scheme requires a steady stream of incoming cash to stay afloat and to pacify the existing "investors." However, unlike pyramid schemes, investors in a Ponzi scheme typically don't have to recruit new investors to earn a share of the scheme's "profits." These schemes tend to collapse and are discovered when the fraudster can no longer attract new investors or when too many investors attempt to withdraw their invested money all at once or over a relatively brief period of time. The economic downturn of 2008-2009 brought many

---

<sup>4</sup> Named after the 1920s era con-artist Charles Ponzi

of these schemes to light.

Perhaps one of the most prevalent schemes that DIY (do-it-yourself or those who do not use the services of a financial professional) investors fall prey to is the *pump-and-dump schemes*. Here the fraudsters (typically an organized effort involving several people) buy shares of a very low-priced stock of a small, thinly traded company and then spreads false information to pump up interest in the stock and increase its stock price by attracting buying demand from investors who think they're getting into the next "best thing."

The fraudster then dumps his shares at the high price and vanishes, leaving you with worthless shares of stock. The most common way these stocks are marketed today is through spam emails, social networking sites or text messages.

The next fraud is known as *advanced-fee fraud* which many readers may think only involves the receipt of a letter or email telling you "you just won or inherited, or we need to get \$10 million out of the country quickly and we need your help" message designed to get you to send or *advance* a fee to get the process started.

The *advanced-fee fraud* I'm referring to involves individual investors that hope to reverse a position that's moved

against them, where they are sitting on positions involving unrealized losses from a low-priced stock, perhaps from being the victim of a *pump-and-dump* scheme.

It generally begins with an offer to buy your worthless stock at a very attractive price. However, for the deal to materialize, you must first send an *advanced-fee* in order to initiate the service. Once they receive the fee, you never hear from them again, you're out the money and you still own your worthless stock.

Technology and the Internet has made the *offshore* scam one of the most attractive schemes because of its appearance and one of the most difficult for U.S. law enforcement and regulators to investigate when it occurs.

Offshore scams can take a multitude of forms, that involve "Regulation S," a rule that exempts U.S. companies from registering securities with the Securities and Exchange Commission (SEC) that are sold exclusively outside the U.S. to foreign or "offshore" investors. The fraudster manipulates these types of offerings by reselling "Reg-S" stock to U.S. investors in violation of the rule.

It's difficult to present clear "red-flag" indicators or warnings to protect the DIY investor, however the most common thread that runs throughout, is the old

adage "if it sounds too good to be true, then it probably is."

The adage will serve as a good guideline, but the difficulty arises when you try to figure out where "good" crosses over into "too good." Investment fraudsters make their living by making sure the products or services they promote appears both good and true, so you need to do your research and ask questions.

Always be leery of "guarantees" in the investment world. Investments carry risk and typically you want to be rewarded for assuming a level of risk. The greater the risk, the greater the reward should be. If you don't or can't get an answer that satisfies you, move on and live to invest another day.

The last *scam* I'll address is the *email phishing scam* where you receive an email that appears legitimate and originating from your brokerage firm or fund custodian. The email will typically highlight an urgent message warning about a security breach, or compliance obligation on behalf of the alleged sender. The email will direct you to "click" on a link telling you it will take you to a site designed to protect you, or other some language suggesting a remedy.

In reality, when you click the link, malware and potentially keystroke tracking software is loaded onto your

---

This publication is intended for informational and educational purposes only. It is not intended nor should it be construed to be an offer of investment advice and any mention of a stock, bond, mutual fund, ETF or other investment vehicle should not be considered an endorsement or recommendation. Investment returns if referenced are based on past performance and should not be considered an indicator of future results. You should carefully assess your own circumstance, conduct your own research or consult your investment advisor before making any investment decision based on any material presented.

system designed to capture your user IDs and passwords. Never click on one of these links, immediately call your financial professional or call the number you have for the custodian of your account(s) and ask them if they in fact sent the email.

Again, thank you for the comments and suggestions, keep them coming.

### [Davis Investment Group](#)

Davis Investment Group is a fee-based Registered Investment Advisor firm servicing the needs of clients across the United States.

Davis Investment Group custodies all client assets at Charles Schwab & Co. Davis Investment Group's home office is located at 714 Marin Street, Suite #C, Vallejo, CA 94590. The telephone number is (707) 648-2024.

If you have questions or would like further information on this month's topics or any other financial or investment related subjects, including Social Security claiming strategies, please contact me directly at (925) 360-6819 or through my email address at:

[Bud@DavisInvestmentGroup.biz](mailto:Bud@DavisInvestmentGroup.biz)

---

This publication is intended for informational and educational purposes only. It is not intended nor should it be construed to be an offer of investment advice and any mention of a stock, bond, mutual fund, ETF or other investment vehicle should not be considered an endorsement or recommendation. Investment returns if referenced are based on past performance and should not be considered an indicator of future results. You should carefully assess your own circumstance, conduct your own research or consult your investment advisor before making any investment decision based on any material presented.