INTEGRIS WEALTH MANAGEMENT

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PROTECTING YOURSELF FROM CHARLES PONZI

December 2008

We ask your indulgence for sending you this eNewsletter so soon after our last one, but sometimes events provide us with an important teachable moment. This is one such occasion.

The financial markets are down significantly, and as we discussed in our newsletter last week, disciplined investors will recoup their losses as markets recover. But there is a type of portfolio loss from which investors do not recover, and that is loss though fraud.

Recent headlines tell the tale of Bernard Madoff, a prominent and well-respected broker and money manager in New York, who ran a Ponzi scheme resulting in losses estimated at as much as $50 billion. Yes, that is BILLION! Mr. Madoff created a sense of exclusivity that resulted in people feeling lucky for the privilege of investing with him. If you invested your money with him, you were in the club!

In 2007, Monterey Peninsula had its own Ponzi scheme, courtesy of local resident Jay Zubick. Mr Zubick invited friends, acquaintances, and parents of his children's friends to participate in his fund, telling them he was doing them a favor because of their relationship with him. They were grateful, not realizing that some portion of the money they invested was being used to support Mr Zubick's lavish lifestyle.

And earlier this year, the collapse of Cedar Funding resulted in painful losses for many area residents. While Cedar Funding's problems probably started as gross mismanagement and later morphed into (alleged) fraud, the result was the same – losses that investors will never recover.

Why do these kinds of losses happen time and time again? We can blame the perpetrators certainly, but that will not protect us from them. We have to protect ourselves. How do we do that when even highly sophisticated investors were duped by Mr Madoff?

We propose that you adhere to four rules that will either prevent this from happening to you, or at least greatly reduce the impact on your hard earned wealth – IF you follow them religiously.

Rule 1 – Avoid investment opportunities that do not employ an independent custodian. Custodians, like Schwab for Integris clients, hold the money and provide independent reporting.

If the custodian and money manager are different people, the custodian can prevent the money manager from diverting your money to himself. This was a key problem with Zubick..

In addition, an independent custodian provides independent reports. Both Mr Zubick and Mr Madoff created phony reports showing that everything was fine, when in fact there were ever diminishing assets.

Rule 2 – Be wary of anything that is too good to be true. You have heard this before, and we ignore it at our peril. Cedar Funding promised 10-12% returns and implied these returns were virtually risk free. There is an adage that goes something like "every deal has a chump, if you can't figure out who the chump is, it's you". Remember this rule and believe it.

Rule 3 – Be wary of accepting special favors. The social mores of accepting favors is that there is a cost – reciprocity if you will. The cost in these situations is that you are not allowed to ask too many questions lest you appear ungrateful. The Ponzi scheme perpetrator is counting on you not looking too closely.

Rule 4 – Diversify. If you really want to invest in something that has no independent reporting, sounds too good to be true, and / or involves special favors, then at least invest no more than what you can afford to lose. The saddest stories about Cedar Funding and Mr Madoff were those about people who put ALL of their life savings into that single investment.

There will no doubt be countless more Cedars, Madoffs, and Zubicks. However, if you stick to these rules, and don't let greed, social pressure, or the fear or being left behind tempt you, you can just read about it in the paper instead of being a victim.

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