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NEWSLETTER

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Note from Theo and Warren: How to spot an investment scam

Those who have never been conned by an investment scam are always amazed by the apparent stupidity of people who have. The victims of these scams often suffer enormous guilt and embarrassment in addition to their financial losses, and sometimes this cocktail of emotions has tragic consequences.

You can use these pointers to help identify a potential investment scam, but remember that there's no single factor that can be used to differentiate a scam from a legitimate investment: it's usually a combination of factors. Most importantly, remember that effective scams use seemingly legitimate structures to mask their efforts to rob people of their money, so it's more difficult to spot a scam than you might think.

Here are some warning signs:

- Guaranteed returns, especially when the return is above 15% per year. The stock market is the best performing investment over the long term, so you could reasonably expect shares to generate a return of 15% per year, but not in a smooth, straight line. You will experience losses and gains and when you look back after 10 or 15 years, you will find that your return was probably 15% per year on average. Any investment that guarantees you a return that is higher than this amount, especially if the return is a stable, fixed amount, might be a scam. Think of Bernie Madoff as the great example of this type of return.

- Dr Simon Marais, Chairman of Allan Gray, says that scammers always have the best dressed salesmen. The better they are dressed, the more you should investigate the proposed "investment".

- If the investment has an element of exclusivity or is only available for a limited time, be wary. Scammers try to create hype around their investment and a sense of urgency on the part of investors. They will often tell you that the investment is currently closed to new investors and then contact you a few days later to say there is an opening but you have to invest immediately. This prevents you from doing a proper due diligence, which is their objective.

- If they tell you that you can invest, but if you take some or all your money out, you can never come back again.

- Complex products that seemingly have a secret methodology. When you start asking questions about how the underlying investment works and they tell you that it is a trade secret and cannot be shared, beware! You need to understand what you are buying. If all the layers are stripped away, what do you actually own?

- Everyone at church, Shul, bowls club, etc. is invested, and you are the only odd one out. Some of the world's most intelligent people have been caught in scams because they have invested when their friends invested. They all thought that the other person had done the research and therefore there was no need to do their own.

- They create a sense of obligation to invest or they give you something so that you feel indebted and therefore invest your money with them.

- Is the investment company you are investing with actually registered with a regulatory body eg. the FSB, SA Reserve Bank or the Johannesburg Stock Exchange?

- Theo and Warren

You are your portfolio

In our last newsletter I wrote about 'human capital': the actuarial present value of your future labour income: an expectation on the size and shape of an individual's future expected earnings. And I reminded you that your total wealth is represented by financial and human capital.

Human capital comes with its own risks, and there's one you cannot diversify out: your mortality. A higher mortality risk does not lead to higher return. So, if you have a family that you care about, and which is truly dependent on you, then the purpose of life assurance is to hedge out the mortality risk as it applies to your human capital.

Therefore, life assurance should first be an expense (and the inclusion of an investment component is an unnecessary complication). Second, it should decline as you age (which is just as well, since it just becomes more expensive anyway).

An addendum to this is that even single people should be sure to hedge their human capital against, for example, the event of disability. Because the flipside of mortality risk, is the risk of longevity. This is the risk of outliving one's savings, and this can be hedged out with the purchase of annuities at the time of retirement.

This is of course an act of faith, and highlights the real tragedy of overcharging by South African life companies, because it undermines the willingness of people to save this way. It does, however, highlight that retirement annuities do remain valid tools as part of one's retirement planning portfolio.

Another point that this whole process of life-cycle modeling throws out, is the fact that most households are ridiculously under-invested in equities. This is not just a display of drum-beating by greedy product peddlers, although their agendas are obviously clear. Academic economists have long sought to understand how levels of household consumption could be weighed up against the obviously wide equity risk premium available to stock market investors. The rather sad answer is that most households never save enough to be able to participate effectively in equity markets.

Large borrowings at a young age effectively act as a counterweight to some of the most valuable human capital. Some of this is productive in the form of property investment, but others, such as swanky cars to keep up with the Joneses, completely lack economic logic. It is a very different matter for commercial businesses to use debt, since they get a tax deduction.

In conclusion, investors should seek to invest financial assets to diversify total wealth, which includes human capital. Those with stable jobs or high levels of employability should add equity assets to their portfolios as soon as possible. After all, the rainy day that most people are saving for usually turns out to be retirement.

- Warwick Lucas, Galileo Asset Managers

The Science of the Perfect Nap

There's a lot to be said for taking a nap – it's like a reboot for your brain. In fact, sleep experts say that the Mediterranean cultures have it right with their daily siesta: we could all do with an afternoon sleep.

Most of us can't afford a long sleep, but a quick nap can have a huge effect on your productivity. However, it's as much as an art as a science – here's what you need to know.

According to a growing body of research, napping is a clever thing to do. It can help to refresh your mind, make you more creative, boost your intelligence, and even help you live a longer, healthier life.

Some companies – like Google and Apple – are allowing employees to take 15-minute naps on the job, because the payoff in mental efficiency, productivity, company morale and production, is far beyond that small investment in time.

Sleep experts say a 10- to 20-minute power nap gives you a quick burst of alertness. For cognitive memory processing, however, a 60-minute nap may do more good. Be aware, a 60-minute nap has a downside: you may feel a little groggy when you wake up.

And a final tip: if you find yourself dreaming during your power naps, it may be a sign you're sleep deprived and need to get to bed earlier as a routine.