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Caveat Emptor (“Buyer Beware”)

There is no shortage of investment scams out there, and the predators who target unsuspecting investors are becoming more sophisticated. Learn why investors should always view an advertisement as guilty until proven innocent.

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Caveat Emptor

There is no shortage of aggressive marketing tactics and outright scams in the investment world. One such ploy is known as the "pump and dump." This has been around forever, and probably won't go away anytime soon because it works so well.

Scammers buy up the stock of a small company and then spread false information to the general public. It's either an impeding revolutionary new product, acquisition, medical breakthrough, or any other event that could end up making a lot of money for those who get in right now.

Unsuspecting victims looking for easy money bite. They can't resist learning more, but what hooks them is the warning to act fast before word gets out. Most of us can remember a time when opportunity presented itself only to evaporate due to indecision. It would be a shame to experience that again.

Victims buy up the stock in anticipation of making huge profits, pushing the price higher. Once the stock crosses whatever threshold the scammers target, they sell and lock in profits. Since the thesis for owning the stock is bogus, the stock eventually tanks as the story fails to materialize.

These schemes are highly illegal, but it's also very difficult to catch the assailants. More often than not, the scammers walk away rich while the victims lose their shirts.

It's up to investors to protect themselves from such deviant behavior, so here are ten warning signs that an investment opportunity is most likely a scam.

1. **Guaranteed**: Any time the word "guaranteed" is used in relation to any investment other than U.S. government bonds, run away. No reputable investment firm's compliance team would allow this word to be printed on anything to anyone. Period.

2. **Unsolicited**: Investment opportunities that arrive unsolicited and/or come from an unknown source should be met with heavy skepticism. Do your homework.

3. **Permabears**: The world does not end all that often, so be highly suspicious of anyone making consistently bearish predictions. A good litmus test is to see if the source has ever been bullish and right. If not, watch out.

4. **Before It's Too Late**: Ignore any investment opportunity that pressures you to act quickly. Investment decisions should never, under any circumstances, be rushed. It's usually better to miss out than to move too fast.

5. **By Invitation Only**: Any invitation to a selective opportunity or one that urges you to keep the offer to yourself to prevent too many people from knowing about it is a red flag.

6. **Unrealistic Returns**: If it's too good to be true then it is a scam. Stocks that can triple quickly are often capable of going to zero much faster.
7. **Lack of Information**: If you are unable to find any information about the investment opportunity either online or through other mediums, ignore it.
8. **Protect Against the Next Crisis**: Scammers recognize the emotional toll from recent trauma, so be very skeptical the next time someone tries to warn you about "the next 2008" for a small fee.
9. **Testimonials**: Scams often use testimonials and endorsements. The Securities and Exchange Commission (SEC) generally prohibits the use of these[1], so be skeptical if encountered.
10. **You'll Regret It**: Any attempt to make you feel like you are making a mistake by passing on an opportunity is textbook manipulation.

While many of these may seem obvious, remembering them when presented an opportunity that taps into your emotional core is easier said than done. Let's see why.

Confirming Beliefs

The psychological underpinnings of these scams work so well because they leverage behavioral biases that throw logic out the window and place emotions firmly in the driver's seat.

One such predisposition is "confirmation bias," where an individual seeks out and ascribes more weight to information that confirms an existing belief. For example, if an investor buys a stock, he may view bullish articles on the company to be more accurate than bearish ones simply because they confirm his thesis.

Few biases are more dangerous and harder to overcome than this one. Nobody likes to be told they are wrong, and few possess the mental wherewithal to reverse a longstanding belief after incorporating conflicting information. Warren Buffett said it best when he wrote[2]:

> *"What the human being is best at doing is interpreting all new information so that their prior conclusions remain intact."*

Confirmation bias lures victims by playing into what they already believe. Those who suffer from fear and panic get sold protection. Those susceptible to greed and euphoria get sold opportunity. This works because it circumvents the survival instincts that alert us to danger. Sellers speak the same language and see the world the same way, so an illusion of trust is established.

The sad reality is that human nature does not change all that much. Bad actors know this and will continue to use it to their advantage. What will likely change is the efficacy of these scams due to technology. Unfortunately, it will not be for the better.

It's Getting Creepy

Back in 2012, the New York Times ran an article highlighting Target and their use of their "pregnancy prediction" algorithm[3]. The company used it to score female shoppers based on the items viewed and purchased online. If the algorithm concluded a shopper could be pregnant based on this data, she would begin receiving coupons for pregnancy-related items.

According to the story, the algorithm was so good that it often knew a shopper was pregnant before she did. For example, a shift from buying scented to unscented lotions in specific demographics triggered the website to start showing ads for baby goods, which then subliminally persuaded women to take pregnancy tests to confirm what the website already knew.

While the power of this technology may sound shocking (perhaps creepy to some), what is far more amazing is that this was over eight years ago. Given the pace of technological progress, just imagine how powerful, accessible, and diverse this technology must be today.

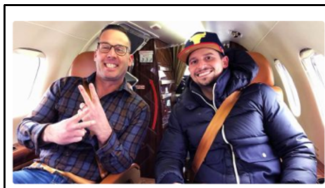
Combine these algorithms with the power of confirmation bias, and it becomes crystal clear why it is getting harder to resist the urge to "Click Here to Learn More!" The same technology that tells Amazon what books to advertise based on recent browsing history is also being used to attract prey with pinpoint accuracy.

The Bottom Line

Gone are the days of casting a wide net via mass-mailings and devoting weeks to cold-calling unsuspecting victims. All a scammer needs to do today is to profile their target, enter it into an online advertising tool, and click "submit." The algorithms do the dirty work for them.

Do you fear for the future of our country and periodically read articles that claim that the U.S. dollar is doomed? If so, you are likely being tracked and served ads that appeal to pessimists. Or do you read about the biotech industry and own volatile micro-cap stocks? If so, the algorithms tag you as a risk-taking optimist and will serve you ads like the one below peddling a $2.8M success story.

This did not come from some sketchy corner of the internet either. It was front and center on Yahoo!, which is one of the most visited websites on the planet[4]. Meaning, these ads are everywhere, there is very little regulatory oversight. It's a virtual wild west.



Sponsored · Raging Bull

California Man Makes $2.8M Trading From Home

Kyle Dennis was $80K in debt when he decided to invest every penny to his name in the stock market — $2.8M later, he owes his success to 1 strategy

The bottom line is to approach all investment advertisements as guilty until proven innocent. Do your due diligence, take your time, and run anything by your financial advisor. A second pair of eyes that is vested in your best interest can act as a second line of defense.

Sincerely,

Mike Sorrentino, CFA

Chief Investment Officer

Sources

1 https://www.sec.gov/investment/im-guidance-2014-04.pdf

2 https://www.goodreads.com/quotes/8956691-what-the-human-being-is-best-at-doing-is-interpreting

3 https://www.nytimes.com/2012/02/19/magazine/shopping-habits.html

4 https://www.alexa.com/topsites

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