

GOOD LIVING: FINANCIAL PLANNING FOR THE HEALTHY, WEALTHY AND WISE.

Invest wisely

If it sounds too good to be true, it probably is

In almost every inappropriate investment decision, says Montreal-based investment advisor Mark Pretorian, there is a similar pattern at work. "The issue boils down to complexity. The investment premise is generally based on some sort of relatively simple and convincing theory, but invariably, the actual application is very complicated."

As a result, he says, the investor usually loses control of how the funds are used. "It feels like a good opportunity, but you don't understand exactly how it works. The person presenting the investment has built some credibility, but has made the investment opportunity extremely complex. The client often no longer understands the time-frame of the investment or how returns will be generated and distributed, and has to rely on trust."

While a trust-based relationship with a competent and qualified advisor can be an important element of effective financial planning, unfounded trust is the basis of most investment fraud, ranging from "phishing," in which a faux financial institution asks e-mail recipients to confirm their financial information, to fraudulent investments that promise extraordinary returns.

Surprisingly, victims of such fraud are often relatively knowledgeable people who respond to the promise of high returns and inside information, says Tom Hamza, president of Investor Education Fund. The perpetrators will go as far as setting up faux businesses with letterhead, telephone lines and Internet presence, and building seemingly impressive social networks.

Fraud avoidance begins, he says, with a healthy dose of wariness. "Be skeptical of anybody who calls you without any prior solicitation by you. If someone contacts you out of the blue and questions you about your finances, you should be very careful. You wouldn't let someone that you don't know hold your jewels or drive your car – but many people forget that healthy caution when it comes to allowing access to their cash and investments."

"If you're offered an unsolicited deal that promises to make you a lot of money, it's the first signal that you should be looking for a problem – amazing investment opportunities simply don't come calling on the phone. There are thousands of professionals, with years of professional experience in finance and investing, who would get a call if such a get-rich-quick product existed. Not you."

High-return, low-risk investments do not exist, says



PHOTO: CHRISTINNE MUSCHI

While a trust-based relationship with a competent and qualified advisor can be an important element of effective financial planning, unfounded trust is the basis of most investment fraud. "Once a loss is incurred, it may be difficult to make up for it," says investment advisor Mark Pretorian.

Hamza. "That is completely against the laws of finance. Double-digit annual returns with low risk are not possible. Of course, there have been some famous investment return opportunities throughout history, just as there are lottery winners in our midst. They're famous because they are exceptions – the odds are overwhelmingly stacked against investors who believe they will be able to consistently pick stocks that provide this sort of return. People often assume that high risk just means having a more exciting time earning a lot of money – but the truth is that it means assuming a much higher probability of losing some or all of their money."

Hamza agrees that too much complexity is never good when investment is involved. "Avoid advisors who hide behind technical talk. If you're being offered a product that you don't really understand, you owe it to yourself to keep asking the simple, seemingly dumb questions until you do understand. An advisor's job is to help make things less murky."

The risk of fraud and market risk (the risk of losing money when a traded security drops in value) are only two of the factors that investors must consider. "Often when we meet clients for the first time, their portfolio is split between two polar opposites: very risky mutual funds or stocks on one side and GICs on the other," says Pretorian. "It's like putting your head in the oven and your feet in the freezer and hoping to achieve a comfortable body temperature. Every investment should align with the risk management and return objectives that your

financial plan dictates."

People who engage in high-risk investing or who overlook the possibility of fraud because they're dazzled by promises of high returns frequently misunderstand the

opportunity costs of their mistakes, he says. "Often, they're taking on unnecessary risk – their goals are more often than not within their reach without exposing their capital. Once a loss is incurred, however, it

may be difficult to make up for it. Then it comes down to a very difficult choice. Will you work for a couple of extra years – or take on even more risk in the hope of making up for the losses?" ■

Do your homework

The antidote to inappropriate investment decisions, says investment advisor Mark Pretorian, was best expressed by famed investment guru Warren Buffett. "You really have to invest in something you understand. Purchase a share in a company in the same way you would if you were buying the entire company. You have to do your due diligence. I know everyone has heard this a thousand times before, but it's essential: the investor really has to do their homework."

Another essential element in guarding against unwise investment is working with an experienced, accredited investment advisor to determine an appropriate risk management framework and to invest within it. "Investors sometimes see risk as something they can prescribe for themselves. It's similar to the patient who demands a prescription for antibiotics from his doctor to treat a cold. It's the doctor's job to advise him that antibiotics aren't an effective treatment for viral illnesses. Likewise, it is the financial advisor's job to advise clients against inappropriately risky investments."

Investor Education combating fraud

The experience of any type of fraud is traumatic, but few experiences are more devastating than being defrauded by someone you feel you know and can trust.

At the Investor Education Fund, efforts are underway to arm Canadians against this particularly malevolent type of fraud. "Everything depends on trust," says Tom Hamza, president of Investor Education Fund. "Fraudsters can squirrel their way into somebody's trust through a social or religious network. A faith-based community in British Columbia recently had a horrible experience where that was exactly what happened."

The Investor Education Fund has launched programs to combat trust-based fraud. "We're working to ensure that this can't happen again within that community, and we're spreading the word to other groups as well. This is a growing phenomenon – and it's all based on the fundamental issue of gaining people's trust. Wherever your trust is going to be down, that's where you're going to be most vulnerable."

For more information, please visit investored.ca.

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