Madoff Scandal: What Does This Fraudulent Ripoff Mean For You?

The good news:

Unless you are a member of the Palm Beach Country Club, an investor in funds that invested with Bernard Madoff’s investment firm, Madoff Securities, or a prominent politician, media mogul or owner of a sports franchise, you’re probably gonna be ok in terms of cash.

The bad news:

Bernard L. Madoff was a trusted pinnacle of society and business and he’s turned out to be a crook of massive proportions. He’s taken not only famous wealthy people down in his infamous Ponzi scheme, but has affected a number of charities and foundations as well. This means that potentially, tens of thousands of people are actually out a lot of money.

More bad news:

Shaken confidence makes for bear market behavior. And the Madoff madness is causing extraordinary losses for banks and investment companies that individuals may indeed have entrusted their money. Madoff apparently hoodwinked savvy sophisticated investment professionals.

Consider that:
Banco Santander has said its customers have an exposure of $3.1 billion through its asset manager, Optimal. Most US-based banks haven’t commented on their exposure to Madoff and his firm.

Fairfield Greenwich Group reported Friday that its clients’ investment in Madoff’s firm amounts to $7.5 billion.

For a summary of financial institutions, individual investors and charitable organizations affected, see these reports:

Who's affected by Madoff Ponzi Scheme?

Bernie Madoff's Victims

Take Away Valuable Lessons
No matter how much you may trust your investment advisor, bank or broker, you must be a prudent investor.

This means that need to do your homework and watch out for red flags that signal danger.

The red flags were there all along in the case of Madoff and his firm.

First, he produced a steady 10 percent a year. Unless you’ve been living under a rock for the last 100 years, you’d know that stock market returns vary by minute, let along by year. Madoff’s firm wasn’t managing annuities or bonds for clients…two examples where producing steady returns actually happens and makes sense. The lesson here, if things seem too steady and good to be true, they probably are. Investigate. Which brings me to the next point...

Investment advisors were told that Madoff’s strategy was secret. I say B.S.! Though it makes sense for hedge funds to be wary of revealing their strategies to the general public, reputable advisors and funds not only permit but encourage due diligence and transparency.

Too much secrecy is suspect. Stay away unless you’ve been given full disclosure about your money and what an advisor is doing with it. It’s simply stupid to invest in a “black box” of any kind. I can’t say this strongly enough. Don’t invest in anything you don’t understand.

Besides, Madoff wasn’t a hedge fund manager. Rather, he was an investment manager advising investors inside his own securities firm. Now, let’s turn our attention to the holdings of his securities firm, Madoff Securities.

According to Madoff Securities’ S.E.C. filings, the holdings were too small to support $50 billion in assets. It was reported in the New York Times on Saturday that Madoff’s proponents actually said that Madoff sold all of his shares at the end of each quarter. Come on people. Don’t buy that B.S.

Lastly, I was shocked at the apparent disregard for basic risk management. It’s critical that investors don’t invest more than 5% of their assets in any one investment. The only exception I can think of is backed by academic research and actual positive market returns over a long time horizon. This exception is investing in “whole markets” through index-based mutual funds and ETFs. Join me and other truly trustworthy investing advocates (hint: we don’t have the agenda of wanting to manage your money) like John Bogle and William Bernstein. Learn about the principles of investing that have been proven to work. And leave the scam artists and too good to be true investments to others.