

THE H. KENT BAKER INVESTMENTS SERIES

**THE SAVVY INVESTOR'S
GUIDE TO AVOIDING
PITFALLS, FRAUDS,
AND SCAMS**

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AND SCAMS**

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INVESTOR IN PEOPLE

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There is no greater agony than bearing an untold story inside you.

—Maya Angelou

We have seen the pain experienced by investors who have made costly mistakes and have become unsuspecting victims of clever fraudsters and scammers. We felt that we had a story to tell that could help others avoid experiencing similar anguish. That's why we wrote *The Savvy Investor's Guide to Avoiding Pitfalls, Frauds, and Scams*. However, we couldn't have told our story without the help of many others. We thank our partners at Emerald Publishing for their many contributions, especially Charlotte Maiorana (Senior Editor) and Charlie Wilson (Associate Editor). We also appreciate the research support provided by our respective institutions – the Kogod School of Business at American University, the College of Business & Public Policy at the University of Alaska Anchorage and the Aalto University Business School. Finally, we dedicate this book to our families: Linda and Rory Baker, Anna Nofsinger, and Marika Puttonen.

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INTRODUCTION TO THE SAVVY INVESTOR'S GUIDE TO AVOIDING PITFALLS, FRAUDS, AND SCAMS

The only impossible journey is the one you never begin.

—Tony Robbins, American author,
entrepreneur, philanthropist, and life coach

You work hard for your money. Having your money work hard for you through investments is an appealing way to build wealth. However, as an investor, you face many obstacles. Some are self-inflicted. Others result from unscrupulous individuals trying to take your hard-earned money. The investment industry has many landmines that you should avoid. There are two important things you must do to be a savvy investor: make good investment decisions and avoid making costly mistakes. Most investment books focus on making good investment choices. But one bad mistake can ruin the results of many good investments. This book is unique in that it focuses on avoiding those detrimental missteps.

*Once you stop
learning, you start
dying.*

Albert Einstein

Your journey begins with obtaining a proper financial education. However, you should be aware that this education can be flawed or misleading if obtained in the wrong places. *The Savvy Investor's Guide to Avoiding Pitfalls, Frauds, and Scams* can help you increase your investing knowledge and result in handsome payoffs.

Using a novel question and answer format, this book begins by identifying many of the biggest pitfalls facing investors. These roadblocks can cost you a bundle. Although common sense should separate savvy investors from uninformed investors, common sense is not as common as you might think. You have two major paths to avoiding these pitfalls – a smart path and a dumb path. With the smart path, you learn from other's mistakes in order to sidestep these pitfalls in the future. With the dumb path, you make your own mistakes and become a student of hard knocks. Although you could use your losses and mistakes to learn how to dodge them next time, you could also learn the wrong lessons. Thus, why make errors in the first place if you can avoid doing so? Given that the dumb path can be expensive and painful, learning vicariously from the mistakes of others is clearly a better route to take when possible.

Nonetheless, some investors repeatedly succumb to the same pitfalls because they haven't learned the right lessons from their previous losses and errors. They continue to operate using unsound principles that separate them from achieving

You can't believe everything people tell you – not even if those people are your own brain.

Jefferson Smith

financial security and greater wealth. As the late American humorist Sam Levenson once noted, "You must learn from the mistakes of others. You can't possibly live long enough to make them all yourself."

Fortunately, circumventing most of these pitfalls starts with awareness, followed by taking deliberate actions to evade financial landmines. If you're unaware of investor pitfalls, you probably can't do anything about them. Savvy investors exhibit patience, discipline, and the ability to remain calm and levelheaded when others are freaking out. They keep their emotions in check and follow sound investment plans and strategies.

The Savvy Investor's Guide to Avoiding Pitfalls, Frauds, and Scams guides you along the following path. Chapter 1 exposes common investing pitfalls whereas Chapters 2 and 3 highlight pitfalls specifically related to investing in common stocks and mutual funds, respectively. If you're looking for someone to blame for the less than stellar performance of your investment portfolio, you may want to look in the mirror. You may be your own worst enemy by having self-inflicted biases. Your investment decisions aren't always rational, despite thinking that you're acting logically. Chapter 4 examines some psychological biases that investors frequently make. Another insidious trap is falling for investment frauds and scams, which is the focus of Chapters 5 and 6. Regrettably, an endless array of dishonest people wants to profit from your gullibility. You lose so they can gain. Savvy investors, however, learn to avoid harmful pitfalls and to steer clear of damaging frauds and scams. The bottom line is that a lack of knowledge and failure to take preventative measures about these matters can have devastating results.

This book provides useful insights about widespread investing pitfalls and cons that can put you well on your way to becoming a savvy investor. Achieving financial security and building wealth is more than simply a destination, it is also a journey to be enjoyed when you avoid the rocky path of losses and learn how to experience a smoother ride to gains. Making money is much more pleasant than losing it. By becoming

a savvy investor, you can avoid making major mistakes, thus earning better returns, and ultimately enhancing the quality of your life. As the ancient Chinese philosopher Lao Tzu once wrote, “A journey of a thousand miles begins with a single step.” Let the journey begin.

COMMON INVESTING PITFALLS THAT CAN SEPARATE YOU FROM FINANCIAL SECURITY AND SUCCESS

*In the markets there is nothing wrong with being wrong,
but there is enormous wrong with remaining wrong.*

*—Martin Zweig, American Stock Investor,
Investment Advisor, and Financial Analyst*

Everyone is susceptible to making mistakes and succumbing to life's perils. Investors are no exception, especially retail investors. A *retail investor* is a person who buys for his or her own account rather than for an organization. Retail investors generally trade in much smaller amounts than institutional investors like mutual funds and pension funds. Today, most of the world has gone to a do-it-yourself model in which you must select your own retirement assets and portfolio strategy, which can easily lead to making mistakes. Although falling prey to investing traps can provide life lessons, the repercussions of such errors can range from minor to disastrous. In fact, investors often learn more from their losses than from their gains. Given the choice, you probably would prefer to

Wisdom comes from making mistakes, having the courage to face them, and make adjustments moving forward based upon the knowledge acquired through those experiences.

Ken Poirot

learn from the costly mistakes of others instead of making them yourself.

The purpose of this chapter is to help you become aware of common investing pitfalls that affect investors in general, especially novice investors. Being aware of these pitfalls is the first step to avoid making them. You can boost your chances of

investment success by becoming a savvy investor who is aware of these widespread errors and taking steps to elude them.

PITFALL 1. FAILING TO LEARN ABOUT INVESTING: HOW CAN A LACK OF INVESTING KNOWLEDGE COST YOU A FORTUNE DURING YOUR LIFETIME?

Investing in yourself is a key component to your financial success. If you want to invest in something with a low risk and a high return, invest in yourself. Why? When you learn about investing, you're making an investment in your future. Thus, building financial intelligence can help you avoid pitfalls and roadblocks, and subsequently build your wealth. Keep in mind that you must learn before you can earn. If you don't do so,

The most important investment you can make is in yourself.

Warren Buffett

you'll end up making costly mistakes and experiencing difficulties that you can easily avoid. Having only a little knowledge about investing can be dangerous and costly.

You can learn about investing in two main ways. One approach is to obtain formal education about investing, which can make you a living. Another path is through self-education such as by reading books, articles, and blogs, as well as searching the internet for specific investing topics. Both approaches to investing involve a learning curve that requires honing and developing skills. By becoming a savvy investor, you can increase your wealth by avoiding pitfalls and making more informed decisions. Your mind will be around much longer than a vacation or a fancy car, so invest in yourself. When investing, you need to have a clear understanding of what you're doing with your money. You must also do your homework to succeed. If you aren't inclined to understand how to invest your money, you're better off leaving this task to a trusted advisor or professional money manager.

Although investing is not rocket science, you need to have sufficient knowledge and the ability to match your investment objectives, preferences, and risk profile with the most appropriate mix of investments. If you want to be a savvy investor, you should invest in your investing knowledge and develop the temperament for investing. Don't hop on the emotional roller coaster. Keeping your emotions in check and tuning out the noise when others are freaking out helps separate you from those who are buying and selling out at the worst times. For example, during the financial crisis of 2007–2008, many investors left the market due to its volatility and parked their money in cash or short-term investments such as certificates of deposit (CDs) and money

You will come to know that what appears today to be a sacrifice will prove to be the greatest investment that you will ever make.

Gordon B. Hinkley

market accounts. They waited on the sidelines fearing to invest in stocks. If they were savvy investors, they would've realized that periods of substantial market recover often follow some of the worst short-term fluctuations and losses. Hence, they missed out on the longest running bull market since World War II.

PITFALL 2. UNDERESTIMATING YOUR ABILITIES: IS BEING A SAVVY INVESTOR ONLY RESERVED FOR RICH, SOPHISTICATED, OR PROFESSIONAL INVESTORS?

The answer to this question is a resounding “no.” Investing isn't an exclusive club. Anyone can do it and do it well. You don't need to be a professional investor to earn good returns. In fact, most professional money managers don't outperform the benchmarks to which they're compared. According to a research report from Standard and Poor's (<https://us.spindices.com/documents/spiva/spiva-us-year-end-2016.pdf>), over the 15-year period ending December 2016, 92.15% of large-cap, 95.4% of mid-cap, and 93.21% of small-cap managers trailed their respective benchmarks. Thus, even professionals have difficulty beating the market. *Market capitalization*, also known as *market cap*, is calculated by multiplying a company's outstanding shares by its stock price per share. Analysts typically group publicly traded companies into three different market cap categories: large cap (\$10 billion or above), mid cap (\$2 billion to less than \$10 billion), and small cap (less than \$2 billion).

Given this fact, how can the “average Joe” or “average Jane” expect to do well as an investor? The answer is simple: follow some basic investing principles, avoid the investing pitfalls, frauds, and scams discussed in this book, keep your