INVESTMENT 101

When A Great Investment Opportunity Becomes Your Greatest Nightmare

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If you aspire towards financial freedom or have an interest for investments, chances are, that you will be heading down to the investment fair this weekend at Suntec City.

I will say one thing about investment fairs. They are a great place to learn new things and about products. It is a great training ground for people in the sales line. Investment fairs are places where many people with hopes and goals of financial freedom seek out instruments to help them achieve that goal. However, it is also a place where nightmares are born and where some people have their dreams of financial freedom stolen from them. In this short post, I hope to encourage potential investors to have the right mindset when deciding how to deploy their hard earned money and to be vigilantly sceptical.

In the world of investments, many instruments and asset classes are available from property to equities and commodities like gold, oil, wine or even land and plantations. Now, there are also crypto-currencies such as BitCoin and LiteCoin. The bottom line being pushed by vendors of these instruments is that you can make a return better than placing your money in the bank. Every salesperson you speak to at such fairs will have a story crafted about the background of the asset, the potential returns and the assurance that your money will be safe. Some will go as far as to say that their high return investments are risk-free.

As we all know, not all of these investments end up with happy stories. Just ask anyone who invested in EcoHouse, Gold Guaranty, CTL, Sunshine Empire, Edgeworth, Profitable plots, Suisse International and the list goes on and on. I have personally met a few of these in previous investment fairs; they definitely seemed legitimate enough back then. I made my own mistakes and learnt a very expensive lesson from a wine investment scheme from a vendor I met in 2012.

To be fair, there are good operators of these alternative investments who truly look after their client's interests and help people achieve their wealth creation goals. But they are few and far between.

So then, how can investors distinguish between good or bad operators? Actually, a better question would be, what are the factors an investor should be considering before making a decision to invest. Being in the investment advisory profession, I could go into the typical textbook answer of knowing oneself, being aware of one's own risk tolerance and to never invest money that you cannot afford to lose. (But you probably see enough of that on Yahoo anyway).

Instead, let me go briefly into 3 main factors that we at RunningStream use to assess investment opportunities, and hopefully, through that help you to catch a glimpse of how you should assess the opportunities being presented to you.

Ownership

This is perhaps the most important factor for investors to consider. Is the investment product secured to the investor? What will happen to the investment product if the vendor goes bankrupt or dissolves?

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The purpose of ownership is control. Or what we term as enforcement of that ownership. Without the ability to enforce, the ownership is but a toothless tiger.

For example, in a property investment, if you make a direct investment into a property with a title. You have the rights of ownership and to rent, sell or improve the property as you wish. In a country with established laws and systems, there is both the letter of the law and strong enforcement to ensure that the owner's rights are preserved.

However, in structured investments where investors are debtors or shareholders, ownership then becomes a tricky affair. In emerging markets such as those in Asia, ownership and enforcement of the ownership rights can be challenging.

In fact, there are developed countries where our rights as foreigners can be difficult to enforce practically as well. An example can include the ability to easily take companies to court over contractual breaches as a foreigner. Often, without the ability to enforce, the title is not worth the piece of paper it is written on.

The structure of a product also affects how secured it is. Usually, when an investment scheme fails, it is usually not because of the underlying asset, but because of the way the investment structure is constructed.

Some vendors like to say that an investment is risk-free because an insurance company has undertaken the risk of the investment and will guarantee the capital. However, insurance companies can be registered for as little as a few thousand dollars in some places. That provides no security. As for "guaranteed returns" the guarantee is only as good as the company promising it.

Profits

Everyone invests because of the returns. And many are often lured by promises of high guaranteed returns. An investment that promises 15% return will always generate more interest than a property delivering a consistent 6% return.

It is important for investors to understand the different measurement of returns. We commonly use ROA (Return on Asset) and ROC (Return on Capital) to measure returns. For example, an S$120k product may return 10% yield without any leverage. Both the ROA and ROC will be 10% since the asset price is the capital injected. But another product might only return 4% yield, requires also S$120k but the asset is leveraged to S$500k. The ROA is then 5% but the ROC is over 16%!

But one of the key things here that we always emphasize to investors is to look beyond the yield. Because to be honest, we have not known of any successful investor who has gotten rich through yield or dividend. It is always about capital growth.

But we are always constantly amazed by folks who would invest on yield alone, disregarding growth. Not that it is wrong, but is it the right strategy for you?

Always remember that stories can be crafted and data can be managed to suit a salesman's story. If you do not have the information, you are not in a position to negotiate. Fortunately today, we are living in a 4G world and there is no reason why you cannot use your smartphone to perform basic due diligence and find misrepresentations.

Another important point is to find out where the returns will be coming from. Investors need to be aware of the insidious presence of Ponzi schemes and not fall prey to them.

To quote Wikipedia: "A Ponzi scheme is a fraudulent investment operation where the operator, individual or organization, pays returns to its investors from new capital paid to the operator by new investors, rather than from profit earned by the operator. Operators of Ponzi schemes usually entice new investors by offering higher returns than other investments, in the form of short-term returns that are usually abnormally high or unusually consistent."

Here's the thing about investment scams. An investment product usually is not a scam until after the fact. By then, it would be too late for the investors.

Management

Let me focus on the property for the purpose of discussing management here. Property is an asset class that requires professional management especially when you are buying beyond your shores. The managers must be professional, easily replaceable and accessible.

Culture, laws and regulations are also important as they lay the foundation for ease of management. Without such, as a foreign property investor, you are a sitting duck.

The investor also needs to consider if he has the resources, experience and knowledge to manage the investment property. One of the most important resources would be time and effort. For example, property management is a professional and regulated practice in Australia. Therefore, there are strict service guidelines and standards to adhere to result in manageability. Countries where rental practices are unproven and tenant delinquencies are high, the effort is often not worth the returns.

Do be aware of managed investments and always verify claims by the sales folks. For us, a red flag goes up when we hear the words "fully managed".

Conclusion

Working here at RunningStream, we often meet people who share with us their heartbreaking experiences. It is a rather sad feeling hearing these cases knowing that there is not much they can do when an investment goes south as most vendors would have covered themselves well.

Investment is something that you defend from the start. And is not defensible when it goes sour. Especially when it involves elderly investors, where their losses cannot be easily regenerated.

It is my hope that people take away some tips to protect their hard-earned money.

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