

Is Your Money Safe? Avoid Madoff Type Scams

We know you are wondering if your assets have any exposure to the Bernard Madoff's \$50 billion securities fraud.

The answer is: *No*

Mr. Madoff sat at the helm of several businesses that were under his powerful influence including an unregistered investment management company, a brokerage company, and an advisory business. Due to the influence that he held and the interaction of the companies, he had the legal authority to direct funds as he saw fit with essentially no oversight.

Savant is different. Savant is an SEC (Securities and Exchange Commission) Registered Investment Advisor having only limited authority. Savant does not and never has had direct access to your assets. We are obliged to follow the trading limitation that you have outlined for us. We are authorized to trade but cannot move your money around without permission.

With that as a start, we think that it is important to offer some sage advice to help guide you through this very clumsy time in the markets. We hope to help you understand the difference between Mr. Madoff's sad and illegal legacy and that of legitimate investment advisors.

"Trust! But verify!" One of our more recent presidents offered this valuable piece of advice. At the end of the cold war, the Soviet leaders said that they were dismantling their nuclear arsenal, and in exchange for this action, the U.S. would similarly disarm. President Reagan often said "Trust! But verify!" Reagan was not the originator of this phrase, but he certainly followed it well. There is no doubt that we were better off reducing the number of weapons, but it was important to be certain that both sides lived up to their promises.

"Trust! But verify!" is still good advice. Mr. Madoff's clients appear to have trusted but not to have verified. The result is that they did not really know what Mr. Madoff was doing

with their money. Madoff engaged in two activities. The first was a Ponzi scheme named after Charles Ponzi who bilked hundreds of New England investors back in the 1920s. In a Ponzi scheme, the scheme's promoter takes in money from an investor by promising very large returns. In order to pay the first investor, the promoter takes in money from a second investor and pays a part of that money to the first investor. With this action, the first investor is thrilled. He just received a large and fast return on his investment. Then, through his false enthusiasm, he unintentionally becomes a shield for the promoter. As the scheme continues, the promoter uses the endorsement of the first group of investors to take in more investors. As long as the promoter has a steady stream of new investors, he can pay fake returns to the old investors. However, inevitably, the house of cards falls.

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Madoff's tactics."*

The second leg of this scheme was that Madoff's investments were managed under the guise of a hedge fund. **Hedge funds are funds in which individual investors provide investment capital to a manager who is not regulated by the SEC - the federal regulator of investment businesses.** The investors, called "qualified" investors, must at a minimum have an annual income of \$250,000 or an investable net worth in excess of \$1 million not including their house. As far as the qualifications are concerned, these folks or institutions are generally able to afford the investment even if it lost everything. The SEC rules exempt the registration of hedge funds that limit themselves to investing for accredited and presumably sophisticated investors.

This exemption allows investors to give the unregulated investment manager a tremendous amount of freedom. Hedge funds enjoy an unusually opaque investment environment.

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Specifically, *a hedge fund can do pretty much anything the investment manager wants to do* with the money that he is given to invest. They even have the advantage of borrowing large sums of money (leverage) in order to engage in speculative activities. They have no restrictions as to things in which they invest, and (this is the best part) they can only collect investment dollars from clients who can afford to lose the investment.

Madoff's hedge funds are completely different from the standard investment vehicles used by Savant. We prefer institutional, regulated mutual funds. Mutual funds are publicly visible and are regulated by the SEC under the Investment Company Act of 1940. They have stringent reporting requirements. Their pro-forma activities are published in both prospectuses and reported in audited semi-annual reviews. While mutual funds do not guarantee returns, their strategies and their returns are openly visible, studied, regulated, and reported. They typically offer daily published pricing and liquidity.

So, if we go back to the *"Trust! But verify!"* commentary, everything that you do with your investments should be visible and transparent. The investments should be comprised of public and marketable securities operated under the watchful eye of state and federal regulators, and for that matter, under the watchful eye of the insurers who are at risk if the rules are not followed.

The Savant strategy is the polar opposite of Mr. Madoff's tactics:

- Savant believes that if an investment strategy is not readily visible, justifiable, and understandable, then investors are better off without it. Savant utilizes highly liquid and visible investments including institutional mutual funds, exchange-traded funds and listed securities. Mutual funds are public vehicles which reduces the potential for illegal activities.
- Assets should be held at legitimate, reputable custodians that send monthly statements and offer daily online

access. Most of our clients hold assets at one of our three main custodians: Charles Schwab, TD Ameritrade, and Fidelity. We have several minor custodians that serve the remaining clients. The custodians engage a set of checks and balances over activities, fees, and other charges submitted by the Registered Investment Advisor for your account. Bank custodians are regulated by the FDIC (Federal Deposit Insurance Corp.), state and federal banking regulators. Broker custodians are regulated by FINRA (Financial Industry Regulatory Authority), the SEC and SIPC (Security Investors Protection Corp.).

- Our clients' custodians provide fidelity and errors & omissions insurance against most human or machine originated mistakes. They also provide SIPC and supplemental insurance coverage to protect you in the unlikely case of insolvency.
- Limited authority is a good thing. Savant instructs the custodian to buy and sell on your behalf according to your direction as stated in your Investment Policy Statement. Savant has very limited ability to buy/sell assets for the client account. This eliminates surprises.
- *Above all*, your investment advisor should be a fiduciary. He or she should be schooled in the area of fiduciary duties and operate pursuant to a published code of ethics. It is evident that Madoff was unethical and illegal. He stole from his investors and broke the law.
- A non-regulated company presents added risk. Registered Investment Advisors such as Savant are regulated by the SEC.

Savant always acts in your best interest. We encourage questions about your investment strategy. We follow guidelines placed upon us by you and the regulatory agencies. Though almost all of registered investment advisors act in the best interests of their clients, the few bad apples taint the credibility of the whole investment industry. We encourage you to *"trust and verify."* Should you have questions or concerns, we encourage you to contact your advisor.