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Caveat Emptor

Bernard Madoff's $50 billion scam teaches valuable lessons

BY ELLEN PARIS

That billionaire Mort Zuckerman could fall victim to Bernard Madoff leaves average investors shaking in their boots. Brian Shea, vice president and regional manager of Wells Fargo's Wealth Management Group, knows this firsthand. "This has hit a vein here," he says. "It's no surprise that we're hearing from local clients that know someone hit hard by Madoff. Your money must be well diversified. We talk about that all the time, but we're seeing so many investors who gave Madoff practically everything."

No matter what entity you invest with, review your portfolio closely and often. More importantly, entrusting all your money to a single investment adviser — no matter how trusted — is risky business.

Due diligence was lacking among Madoff's clients. Those involved claim he had an aura about him that precluded asking questions. "He was known to be evasive in communication and give black-box kinds of answers," says Shea, who's based in Palm Desert. Investors have the right to demand to speak directly to the person managing their money and making investment decisions — including direct portfolio and fund managers.

"There needs to be total transparency with money managers and quarterly meetings directly with them and not their intermediaries," Shea says.

Check the backgrounds of people managing your money. Request client names, both past and present, and talk to their competitors.

In an essay published in *The Wall Street Journal*, psychologist and author Stephen Greenspan explored the reasons why wealthy people fall for shysters like Madoff. Greenspan, who himself lost money to Madoff, wrote, "The Madoff scam had social feedback pressures that were very strong. Newspaper reports described how wealthy retirees in Florida joined Mr. Madoff's country club for the sole reason of having an opportunity to meet him socially and be invited to invest directly with him."

Marc Beauchamp, a former NASDAQ spokesperson during Madoff's tenure there, views it this way: "Madoff is a prime example of affinity fraud pure and simple, with unsuspecting victims believing something that was too good to be true." Affinity fraud is a scam that targets members of a specific demographic group. "In Madoff's case, his victims were wealthy and many were Jewish," Beauchamp notes.

The first mistake Madoff investors made was entrusting hefty sums of money to an individual. "Anytime you deal with a sole proprietor or small shop, you can't do the necessary due diligence you can do with a large firm," says Jim Estes, associate professor of finance at Cal State San Bernardino. Madoff's credibility was based on his wide network of friendships. It was difficult to identify the clearing broker, critical to ascertain when investing with a small company. You also want to see monthly and proxy statements directly from the funds in which you invest. "With computers and the various software programs available today, anyone who sets out to create fraud can," Estes warns. "They can produce all kinds of bogus statements."

Before giving your money to anyone, check with the Financial Industry Regulatory Authority (www.finra.org) to ensure they are licensed and to see what arbitration and mediation history they have. FINRA is the largest independent regulator for securities firms doing business in the United States. It oversees nearly 5,000 brokerage firms, about 172,000 branch offices, and approximately 665,000 registered securities representatives.

An SEC rule that loosened regulation for private brokerage firms such as Madoff's has not been extended into 2009. Haddon Libby, chief financial officer of El Paseo Bank who spent years in private banking, considers that a positive move. "This is important that the SEC is fixing this rule, because the more you have people really looking over people's shoulders, the better," he says. Libby also points to "making sure your money is held by well-respected and recognizable custodians like Schwab, LPL, Bank of New York Mellon, or Fidelity."

Most importantly, Madoff boasted to have only two down months in 20 years. Realistically, nobody can claim that kind of record. Who you invest with goes back to one simple guideline: Caveat emptor (buyer beware).

Rethinking for Retirement

Are you tweaking your investment strategy for the long term?

BY ELLEN PARIS

A City of Palm Springs employee for almost 17 years, Phil Kaplan walked out of City Hall in September deciding the time was right to retire. He owned a classic Alexander house in Vista Las Palmas and had a healthy amount saved for retirement between personal retirement investments and work-related deferred compensation investments. A nice monthly pension check added to his security. Kaplan is one of the lucky ones. According to Bloomberg.com, the global financial markets lost $30.1 trillion in value in 2008.

"In July, I decided to adjust my retirement investing strategy because I just didn't want the risk," Kaplan says. "I sold my three mutual funds and went into stable, value-fixed income." Currently that's throwing off about a 4 percent return. "I wasn't trying to outsmart the market; I was just being conservative," Kaplan recalls.

He is holding onto the funds in his Roth IRA, which has taken about a 40 percent hit over the past year. "I don't need that money right now," he says. "And since they are good, solid funds, I figure I'll hold onto them and maybe in four to five years they will recover. If I sell them now, then I definitely lose out." For now, Kaplan is on the sidelines. "If I do invest, it would be in a few stocks that pay dividends and make products that people really need."

Rethinking retirement investing strategy is painful when you tally up hefty losses. But make no mistake; it's necessary. Though many of us simply want to pull the covers over our heads for the next 18 months or so, we can't. A stringent portfolio evaluation and possible asset reallocation should be at the top of your to-do list as tax time approaches.

Here's a suggestion worth considering from Greg Owens, a certified financial planner at Alaska Trust Co. "For high net worth individuals, this is a great time to offload underperforming stocks to the next generation as a gift. This and many other estate-planning strategies are extremely advantageous when stock prices and interest rates are low. If your stocks are low, you can transfer them to a child or grandchild (either outright or in trust); and when the stocks begin to perform and increase in value over the next few years, all of that growth happens out of the donor's estate. The next generation can benefit with the increased value and have it in their estates." Anyone is entitled to give an annual gift of up to $13,000 to any one person, with a lifetime gift exemption of $1 million.

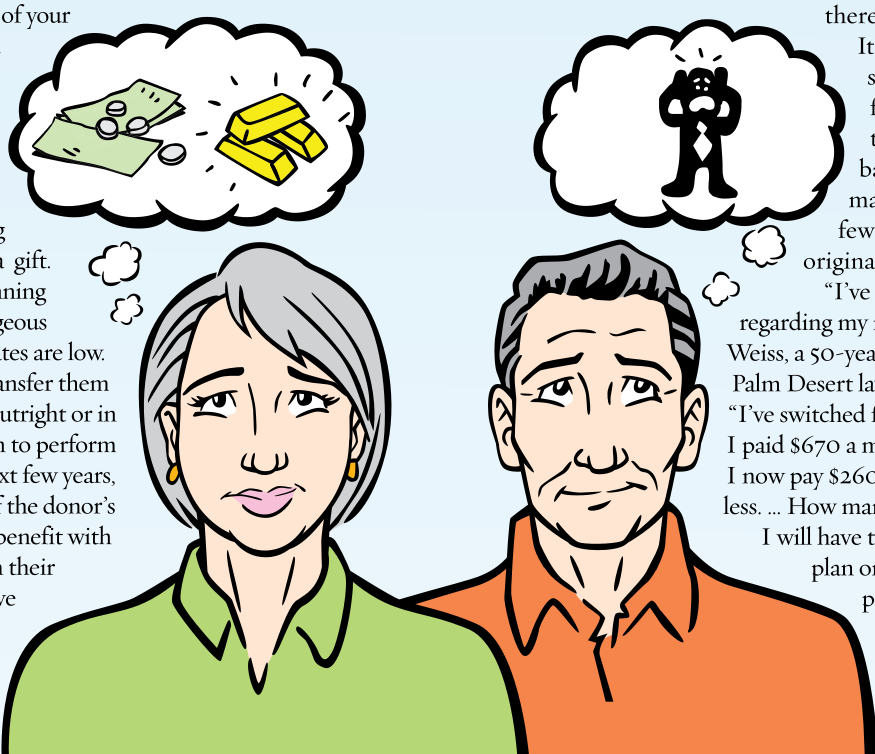
If you bailed out of your stock portfolio before the fall, you can play the waiting game. That's what San Diego attorney and investment consultant Todd Williams, president of TW Consulting Inc., is doing. Heavily invested in certificates of deposits and cash equivalents, he's unconcerned about the miniscule return he's earning. "I am cautiously bargain-hunting in stocks and real estate," Williams says. He is only looking at properties with attractive debt-servicing opportunities and ones best poised for the upswing when it happens. In markets like Florida and Nevada where prices have fallen as much as 50 percent, his strategy could work both short and long term.

To weather the perfect economic storm we are experiencing, Jim Casey, president and CEO of Integrated Wealth Management with offices in Palm Springs and Beverly Hills, recalls that his clients in active retirement "can withstand this because of the amount of cash and fixed-income vehicles they had on hand at the beginning of 2008." Casey saw people burned using equities as income. His lesson on the balance between fixed income, cash, and equities is one that makes sense no matter where you are in retirement planning.

"Every year no matter what the market is doing, you review your portfolio and current income needs," Casey advises. "Never let the amount between equities and fixed-income investments get unbalanced, regardless the market climate."

If you are in your 50s and your portfolio has taken a dramatic drop, now is not the time for a major reallocation. Your losses are there in indelible red ink. It's more important to stay in and reposition for growth once the market comes back. Consider that may mean working a few years more than originally planned.

"I've changed several things regarding my retirement," says Rick Weiss, a 50-year-old semi-retired Palm Desert lawyer and avid golfer. "I've switched from a golf club where I paid $670 a month to one where I now pay $260 in dues. I dine out less. … How many extra years that I will have to work that I didn't plan on is what is most painful to me." ■

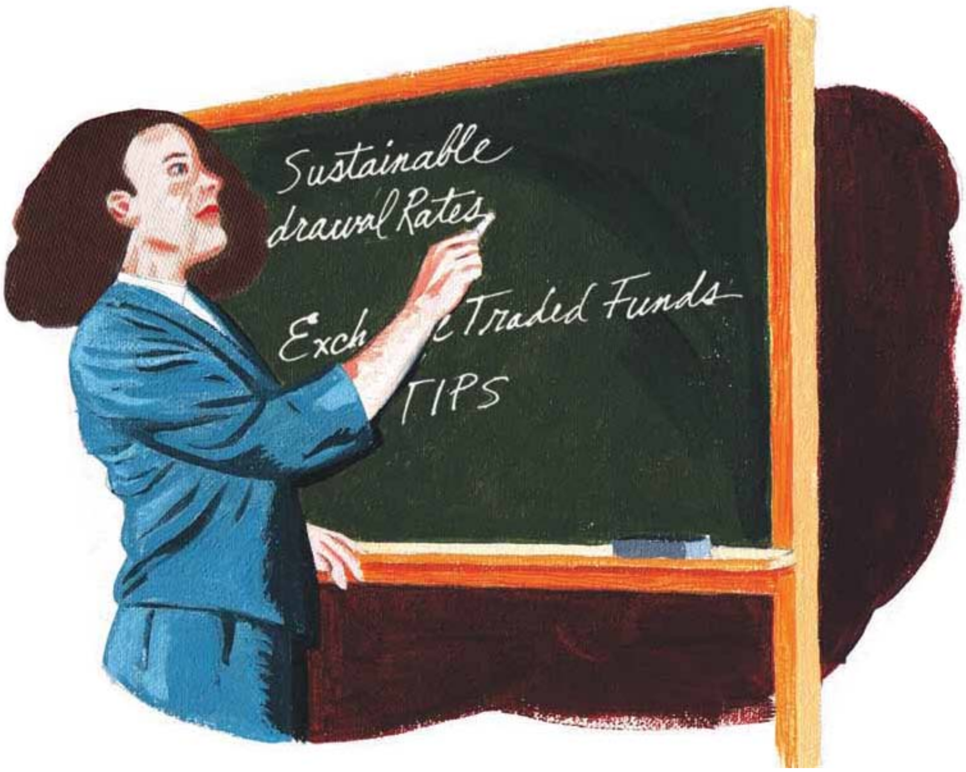


SHANE O'BRIEN/ISTOCKPHOTO.COM

The New Financial Literacy

As the economy changed during the past year, so has the language.

BY ELLEN PARIS



As an investor, you must speak the language CNBC pundits spout hourly. More importantly is understanding what your wealth advisers and financial planners are saying.

"Some of the hot issues that you're hearing about today include sustainable withdrawal rates," says Bill Baldwin, an attorney, president of Boston-based Pillar Financial Advisors, and national chair of the 2,000-member National Association of Personal Financial Advisors. "How much can you withdraw from your portfolio annually for personal spending? That's a tough question to answer during volatile markets. One has to balance that issue against the need to invest because of living longer." He points to a 4 to 4.5 percent annual withdrawal rate as the industry standard for safety.

Exchange-traded funds have gained popularity as a vehicle for index investing. Buy them in any asset class ranging from broad to narrow. They are easy to sell and buy, so they work for portfolio rebalancing. However, James Casey, president and CEO of Palm Springs-based Integrated Wealth Management, cautions, "ETFs are in vogue right now. But just because it's an ETF doesn't mean it's a good one."

A recent study by Transamerica Center for Retirement suggests there is a significant gender gap in financial literacy: "Women did not start saving for retirement until age 40 or later. And while 34 percent said their retirement savings are invested in a relatively equal mix of stocks and bonds, an additional 31 percent were not aware of how their savings are invested." That kind of financial illiteracy — no matter the gender — comes at a costly price.

Casey points to a key issue in today's world of investing: transparency. Bernard Madoff shocked us with the enormous losses that occurred due to lack of transparency. Don't be a victim. "We need transparency. Ignorance is not bliss when it comes to your money. Ask hard-hitting questions about fees, the security of the underlying custodian, and who the underlying company is supported by," Casey says. "More important than ever is who is on the board."

Brian Shea, regional manager for Wells Fargo's Wealth Management Group, agrees with Casey on the importance of transparency. "It's a simple concept that comes down to do you really know what your money is invested in?" Even if you're just buying mutual funds, then determine what the fund owns, what it is buying, and who's behind these investments."

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New products include Treasury inflation-protected securities, also known as TIPS. According to TreasuryDirect®, "TIPS are securities whose principal is tied to the Consumer Price Index. With inflation, the principal increases. With deflation, it decreases. When the security matures, the U.S. Treasury pays the original or adjusted principal, whichever is greater."

"How much can you withdraw from your portfolio annually for personal spending? That's a tough question to answer during volatile markets. One has to balance that issue against the need to invest because of living longer."

— Bill Baldwin

A new question asked by wealth advisers is, "What's your number?" Shea explains: "That means what amount of liquid assets do you need and want to have available to you. It goes right back to depth of the financial crisis." Shea cites foreign currency buying as a vehicle for forward-thinking investors.

In the halcyon days of Wall Street, many investors were happy to let advisers and brokers handle it all. That's no longer a strategic way to do business. "One investing concept people need to pay attention to today is managing return in a low-interest-rate environment," says Dave Wilson, vice president and managing director of Northern Trust's Rancho Mirage office. "Understanding the difference between yield to call, yield to maturity, and current yield is key today."

It's a new world. The best thing you can do is educate yourself. Of course, one adage holds true: "Caveat emptor," advises Haddon Libby, chief financial officer of El Paseo Bank. ■

Visit www.palmspringslife.com for financial literacy resources.

WEALTH

LUXURY in Another Land

Resort housing deals lie beyond U.S. borders — just be cautious

Estrella Del Mar

CLUB ACQUISITION

BY ELLEN PARIS

Rita Pacheco often travels between La Quinta and her 5,000-square-foot oceanfront home on the Mexican Riviera in Mazatlan.

"I go every other month and stay for a month. Between my computer and Skype, I can do business from there," says Pacheco, who manages vacation properties she owns in the desert. She says her five children thought she had flipped out when she announced she was building a home in Mexico. Now they fight to use it. While there, Pacheco plays golf, participates in a book club, and socializes with other residents who are "like family" to her. She's into the property for about a million dollars, but wouldn't take less than $2 million (though she has no plans to sell).

Pacheco bought her second home in Estrella Del Mar, a private luxury golf and beach resort built by Palm Springs developer Pat Butler. She had looked at two homes under construction, but then decided to purchase an oceanfront lot and build her dream house.

"I had always wanted a home on the beach," she says. "I knew there wasn't any place in California where I would ever be able to own a home like this."

That's why more American buyers are going outside the United States for that second or third dream home. Value coupled with a luxury lifestyle in a posh community — whether in Mexico, Italy, the Caribbean, or Central America — is becoming more popular, especially with today's attractive pricing.

"There is great value proposition out there today when you look at beachfront property in Mexico versus the United States," notes Butler, president and CEO of Club Acquisition, the developer of Estrella Del Mar. Butler points to construction costs of $350 per square foot for top-quality materials that would run about $1,600 to $2,000 per square foot for oceanfront property in San Diego. A two-bedroom, 1,443-square-foot condo in Phase III of Estrella Del Mar runs $439,000; lots start at $89,900.