The 2009 Risk Reward Predictions (Continued from page 3)

Stock Markets

Again there is no reason for much optimism. The lack of trust that is compounded by recent public failures will continue to represent a drag on the markets for the foreseeable future. We do not expect a significant rebound during 2009 with markets rising by perhaps only 5% over the entire year.

Bond Markets

The place where you will not want to be in 2009 is in our opinion fixed rate securities. Since interest rates are approaching their bottom you can expect to see fixed rate securities starting to fall. During 2009 a fall in value of perhaps 20% is to be expected on a global basis.

Commodities

As you will have noted we are not very optimistic about assets in general. Some of the brighter spots will be in physical commodities, particularly foodstuffs, which will retain current prices and could experience a small level of growth. Not spectacular but at least they may represent a safe haven in times of stress.

Ponzi Schemes

In the light of current news Ponzi schemes are back in the news.

The question you may be wondering is what actually a Ponzi scheme is and who was Charles Ponzi?

A Ponzi scheme is a technique used by fraudsters where the operator of the scheme promises high return to investors in short periods but makes no actual investments at all. Instead, the operator will use money from future investors to show previous investors that a profit has been made, paying out sums that actually have not been earned. The scheme is completely reliant upon money coming in from new investors to continue to pay out the returns to existing investors. Effectively the investors who withdraw their funds are actually defrauding the new investors. If the flow of money from new investors ceases, so does that Ponzi scheme.

The scheme is named after Charles Ponzi who in 1919 conducted a scheme involving the buying and selling of international mail coupons. He promised investors a 40% return in just ninety days. The prospect of high returns within a relatively short period of time is all a part of the attraction that comes with Ponzi schemes. Ponzi was able to take in $1 million within just a three-hour period in 1921. It emerged that he had only in fact purchased $30 worth of mail coupons.

A Ponzi scheme is different to a Pyramid scheme in two significant ways.

Firstly, a Pyramid involves payments being made to an investor on the next level up. In a Ponzi scheme, money is paid directly to the operator of the scheme. Furthermore, the latter can only be sustained by current investors continuously recruiting new investors. A Ponzi scheme does not require new investors necessarily, provided that the operator of it can persuade an existing investor to reinvest his 'profits'. It is only when the investor withdraws funds that the scheme actually fails.

So the question is how can you identify a potential Ponzi scheme? In the typical scheme returns are higher than the market and normally higher than could be realistically expected from the nature of the activity being conducted. The seller of the investment vehicle is highly credible and normally well connected, such that the regulatory structure either does not apply or loosely applies to the fund.

Finally always remember that if something looks too good to be true then it normally is too good to be true!