Want to be a stock market millionaire?

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“Don’t let your eyes deceive you”
-Janet Jackson

We all dream of a better life. Thus, it is normal for human beings to pay attention towards an institution or individual that would pledge to assist them in striving towards their aspirations. The pledge would awaken the inner desire for abnormal returns that would pave the way towards a hassle-free life and blind us from reality. We will be too busy dreaming about what they promise instead of inferring into the credibility of the information and the risk involvement of blindly following such institutions/individuals.

Perhaps our readers would have come across the concept of becoming a stock market millionaire on electronic and print media recently. Have you ever pondered upon the statement?

As you are aware, equity is a form of investment. We have also heard of how millionaires (Warren Buffet) were created through the equity market. Yet, these advertisements definitely overstate the true essence of investment. They have failed to create an impartial view on investment. For example, they have not taken to account the risk-return tradeoff that is an inherent factor in any form of investment.

Are you vigilant enough to be critical over the sandcastles they would build before you? It is important to recall a few vital points before you respond to advertisements of this nature.

A stock market does not give guaranteed returns

A person who understands market dynamics would know that the market usually generates impressive returns in the long run. During the last 30 years, it has generated relatively higher returns when compared to the return on treasury bills. Yet, investors should be realistic about the returns. Further on, guaranteed returns cannot be expected as prices are determined by the demand and supply for the stock. Demand and supply varies due to a myriad of factors.

If someone pledges to beat the market or claims to reveal cutting-edge information, you should be very vigilant. Never fail to ask questions.

Purchase shares through a registered stockbroker firm

You can invest money through a licensed stockbroker. The Securities and Exchange Commission Act of 1987 (as amended) defines a stockbroker as an individual or body corporate engaged in the business of buying or selling securities on behalf of investors in return for a commission. They are expected to obtain a licence from the Securities and Exchange Commission (SEC) of Sri Lanka. They are continuously monitored and regulated by the SEC. Currently there are 36 licensed stockbroking firms, out of which eight deal with debt. The list could be obtained from the Colombo Stock Exchange (CSE) or the SEC websites. The stockbroking firm will open an account for you at the Central Depositary System (CDS). They will assign you a licensed investment advisor to assist you in your investments. These individuals are given a licence to act as an investment advisor after they successfully complete a set of exams held by the SEC. Further on, the licence will be renewed annually. These steps are taken to ensure that the service provided by the industry is of a very good standard.

Unfortunately, certain incidents can occur where individuals may attempt to impersonate as an investment advisor. Verify if he is attached to a stockbroking firm and if he is licensed by the SEC.

Clearly identify the role of an agent

Stockbroker firms are allowed to expand their business through an agent. According to Section 6 of Stockbroker Rules, the stockbroker firm can appoint a corporate that deals with financial services or an individual as an agent. The primary role of an agent is limited to introducing ‘new clients’ to the stockbroker firm. They are not expected to impersonate as a stockbroker. It is prohibited for them to make representations to the public as an investment advisor or offer investment advice. Remember that the account opening at the CDS should be done through the stockbroking firm.

You might come across flamboyant individuals who would impersonate as skilled and experienced market makers. However, impressive they might sound, never fail to do a background check on the individual. Ask for details about the stockbroker firm he works for, his licence to act as an investment advisor and other credentials. You may also contact the CSE/SEC for further details.

It is important to restate that agents are employed by stockbroking firms to expand the investor base. Taking the market out of Colombo is important for its development. Yet, this cannot be done according to the whims of individuals. It requires national policies and a well-structured regulatory framework. This would entail expanding the CSE branch network, improving infrastructure, etc. Educating investors is also another vital factor but should be undertaken with utmost responsibility.

Clients should be given impartial advice

Stockbroker firms and employees of such firms who deal with clients should disclose, to the best of its ability, all circumstances and risks that could reasonably be expected to affect a client’s decision. If requested, a stockbroker firm and employees of such firm who deal with clients should provide all information on a security available in the automated trading system (ATS).

Their approach should be impartial and transparent. If you get promises about fixed returns, unusually high rate of return or even if they persuade you for quick investments, you should think twice. Some might not touch on the risk involvement and talk simply about unusual profits; these will definitely be red lights.

A recommendation cannot be considered reliable simply because it is claimed to be “independent”

It is undoubted that independent research caries great weight when selecting stocks. Yet, have you ever questioned if these research recommendations are truly independent? Never accept recommendations at face value. There might be a relationship that is not apparent. For example, the owner of the research firm might be related to the CEO of the company that is recommended. Focus more on the reasons provided for the recommendations given to you instead of the independent nature.

Don’t get carried away by individuals/institutions that try to draw relationships with state

institutions or eminent people

It is seen how impersonators attempt to relate their products and services with big names to increase credibility. There might be instances where the names of top regulators in the industry or names of eminent and learned individuals are used to sell products/services.

In such situations it is natural for the public to accept it without a reasonable doubt. Investing in capital markets requires investors to inculcate an investigative mindset. ‘Why’ and ‘how’ are two important questions that you should always ask before accepting the advice given.

Most of the times these people will tend to overly talk about these big names. This would be a good point for you to start on.

Deadly price of sandcastles

You invest to maximize returns. An investor who is overly keen on the rate of return would tend to question the risk factor. You may wonder why you should not work with these people or institutions if they could keep to their word. Is it a chance worth taking? No.

It is this incorrect mindset that might bring about misfortune not only to you but to the market in general. It is important to stress that the possibility of them delivering what they promise is highly questionable. The Sakvithi scam that occurred in the banking sector is a classic example. People were blinded by the high interest and overly relied on him as he was in a respected profession (teaching). What was the end result? Investors lost their life savings.

Remember that it takes two to tango. Similarly, incorrect market practices could be mitigated if investors behave with responsibility. It is the duty of our investor community to be more vigilant. Clearly perceive the undue risk involvement. If vigilant decisions are not taken and they follow incorrect market practices, it is a futile initiative to turn towards the SEC/CSE for relief.

It is timely to reflect further on such situations in order to understand the risk involvement and the nature of these incorrect practices. Given in the box is a case reported in U.S.A.

Maximize returns in stock market

The key towards maximizing returns in the market is to be an informed investor. This will enable you to differentiate between a reliable investment opportunity and a hoax. It is equally important for you to play by the rules. The Securities and Exchange Commission Act No.36 1987 (as amended) clearly stipulated the rules pertaining to regulating the capital market. Further on, the CSE has imposed rules regarding share trading, stockbrokers, listing, etc. The SEC, together with the CSE, expects market stakeholders to comply with these rules when investing in the market. This will increase credibility, transparency and confidence in the market that is vital for a robust market. If market stakeholders fail to adhere to these rules, the SEC will be compelled to take stringent measures to uphold its fiduciary duty of safeguarding the interest of the investors.

U.S. Securities and Exchange Commission
Litigation Release No. 23163 /
December 19, 2014
Securities and Exchange Commission
v. Premier Links, Inc., et al., Civil Action
No. 14-cv-7375-CBA

SEC charges Staten Island-based firm with operating boiler room scheme targeting seniors

On December 18, 2014, the Securities and Exchange Commission (SEC) charged a Staten Island, N.Y.-based firm, its former president and two sales representatives involved in a fraudulent boiler room scheme targeting seniors to invest in speculative start-up companies.

The SEC alleges that Dwayne Malloy, Chris Damon and Theirry Ruffin treated vulnerable older investors as their personal ATM machines. They cold-called names from a list they maintained at Premier Links Inc. and used high-pressure sales tactics to convince seniors to invest in companies purportedly on the brink of conducting Initial Public Offerings (IPOs). They never disclosed to the investors that only a small fraction of the money would be transmitted to the promoted companies, and Premier Links diverted investor funds to other entities controlled by the sales representatives or other associates.

According to the SEC's complaint filed in U.S. District Court for the Eastern District of New York, Premier Links has never been registered with the SEC as a broker-dealer as required under the federal securities laws to conduct this type of business with investors. Premier Links, Malloy, Damon, and Ruffin fraudulently obtained at least US $ 9 million from more than 300 investors across the country by building a relationship of purported trust and confidence with them. In one particularly egregious example, Damon and Malloy spent months earning the trust of an elderly veteran in order to defraud him of US $ 300,000. In many instances, investors were provided with misleading account statements showing the shares they purportedly purchased as being held for safekeeping in their Premier Links accounts while awaiting the promised IPOs. Yet, transfer agent records for the relevant companies indicate that shares were never purchased for these investors. Investor money was simply stolen instead.
