

>: How to Rob an Individual Investor

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Editor's Note: Dylan is taking a much deserved vacation. Please enjoy this article, which was originally published almost exactly a year ago.

THE RICH HAVE BEEN DOING IT TO THE POOR SINCE THE BEGINNING OF TIME.

Fortunately for us, it's a heck of a lot more blatant (and therefore easier to spot) on Wall Street than it is in many places.

Some call it a "hustle". Others call it a "con job". Whatever your pet name for it is, one thing is certain: if you don't see it coming, you'll likely wind up much poorer as a result and very, very sorry you ever ran into it.

On Wall Street, as opposed to Main Street, the con takes a couple of different shapes. One is the famous and well discussed "bucket-shop hustle".

Now, many people automatically think of small, dingy firms "akin to a boiler room" when they hear the name "bucket-shop". But those firms are responsible for a small fraction of the damage done to individual investors. To this very day, the most harmful "bucket-shop" practices are engaged in by many of the largest brokerage firms in the world.

It goes a little something like this: you get a call from a well-intentioned broker who has the "deal of a lifetime" for you. After getting you all worked up into a lather, you're convinced that it's something you should purchase. What you don't know is that the broker who just convinced you to buy shares of XYZ was secretly selling them for one of the firm's largest customers. Before you know it, you're left holding shares of a stock or bond that have decreased in value by as much as 90%.

Although these kinds of shenanigans continue to this very day, the last really blatant example was during the height of the dot com crash in the late 1990s.

The "commission cartwheel" is another variation of the same hustle. The only thing that changes is that, instead of asking you to buy a stock that somebody else is selling, you're asked to purchase shares in a stock that gives the salesman an extraordinarily large commission.

What's particularly damaging about this little hustle is that it comes in forms that most people couldn't imagine.

Sure, some folks expect to get hustled when buying shares of a stock. But oftentimes, people practicing the "commission cartwheel" hide their hustle behind otherwise innocent sounding securities such as bonds and mutual funds. Yikes!

And of course, let's not forget the traditional classic, the "pump and dump". In its older incarnations, investors get called to buy a stock that is secretly being liquidated by the owners of the firms (as opposed to large clients of the firm).

For example, you get a call to own shares of XYZ for \$2 per share. What you don't know is that the firm calling you had an investment banking relationship with the company and is selling the shares allotted to them at sometimes pennies per share. So every time you purchase 1,000 shares of stock, you are really making the firm an "investment banking" profit of \$1,998 if the bank owns the shares at \$0.02 each.

These days, the classic "pump and dump" has taken on a new and much hipper flavor with the use of email. This new and improved "electronic pump and dump" does largely the same thing, but via email instead of phone calls.

I can't tell you how many friends of mine "largely smart and successful people" shoot me the occasional email asking my opinion on a stock they've just been given the greatest tip about.

I don't even respond any longer if the symbol ends in the letters ".PK" denoting a pink sheet security. If they don't know to beware of those types of advertisements at this point (after years and years of my warnings), then nothing I can say will change that.

Last but not least, there is another classic Wall Street hustle that I've failed to mention so far. Of all the hustles I've discussed, it is by far the sleekest and smoothest. In fact, it's such a smooth and silky hustle that it isn't even illegal! But make no mistake about it "it's just as dangerous (if not more so) than the rest of them.

We'll refer to it as the "IPO "Icicle" and it goes a little something like this:

When a specific industry group has a great run "say 5 or 10 years of excellent business conditions" the founders plan to sell their stock at the very top of the market.

For example, right now "for the first time in history" private equity firms of all stripes are planning to go public. This is largely a result of the

success (or the illusion thereof) of Blackstone's recent IPO.

Why on earth would these otherwise greedy private equity mavens want to suddenly sell shares to the investing public? Is it that they've grown a conscience and want small investors across America to make some great money owning their shares?

Of course not!

What they're saying to themselves is that we're at the top of a bubble in private equity. With low interest rates, a business-friendly administration and a low tax environment, things are simply never going to get this good ever again.

So they're cashing out now. Right at the peak of the private equity bubble, when small investors who don't understand the cyclical nature of things are at their most fascinated by the billions of dollars they're making.

This is by far the most dangerous of all hustles because it comes gift-wrapped by some of the biggest names in business whom you read about each day in The Wall Street Journal (Steve Schwarzman from Blackstone, Henry Kravis from KKR) and seems perfectly legitimate. And on the surface, it is; it's not like they've planned a criminal enterprise with you as the victim.

But that's just what makes it so darn dangerous. They know that you're buying their stock from them at the top of a bubble. And yes, they're definitely taking advantage of that. But that's really what Wall Street is all about, isn't it: smart investors taking advantage of less informed investors?

So consider this as fulfilling my job to inform you. Indeed, folks, trust me on this: you want to avoid these private equity firms like the plague right now.

I'm not saying they're not fundamentally good businesses.

What I'm saying is that buying shares in these companies now would be like buying into the Florida real estate market a year or so ago: a bad idea, by any stretch of the imagination.

For those of you sitting around right now in the middle of summer looking for things to buy, beware.

Mark my words when I say the private equity firms aren't the profit pond you want to be fishing in.



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