Now that Interest Rates are Falling

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As we approach the September meeting of the Federal Reserve Board, virtually all Fed watchers expect a 25-basis point reduction in the Fed funds rate. Recent indications that inflation continues to decline and weakness in the availability of jobs are encouraging the Fed to take a less hawkish approach to managing the economy. We have noticed a rush into interest rate-sensitive securities such as real estate investment trusts (REITs) and preferred stocks as investors seek to lock in high yields before rates begin to come down. Even the bond market is doing well in anticipation of not one, but potentially more, interest rate cuts through the end of this year. The losers in this scenario seem to be investors attempting to maximize their interest income to support their living standards.

Such a trend allows the interest rate tricksters to come out of the woodwork. One of our first experiences with investors being pulled into high-interest rate investment frauds was way back in 1974-75 when Tom worked in a bank where the interest rate on savings was about 5%. One of the bank's employees came to him, bragging that he had deposited money in an offshore bank account that yielded 15%. Tom warned the guy of the risks in offshore accounts, especially when the interest rate is unusually high relative to more secure investments. Not long after that discussion, Tom asked what happened. He said he lost all his money! Surprised? If it sounds too good to be true, it probably is.

Jason Zweig, a regular columnist for the Wall Street Journal, recently penned an article about hucksters coming out of the woodwork when interest rates are declining. Zweig personally tracked down the timeline and outcome of what started as an online scam. He was notably surprised, and dare we say shocked, about the ease of promising a return greater than 17% for a 10-year term deposit. The charlatan also claimed that the deposit was insured by Lloyd's of London for up to $10 million! Digging further, the author found out that the firm had no clients and no assets under management. In other words, it was just a massive scam that could have attracted more than a few unknowing investors who would fall for this "investment" just because of advertised super-high yields. Remember Bernie Madoff, the largest Ponzi scheme executor in history, siphoning off almost $65 billion from innocent investors? He got away with that scam for at least 17 years.

Our point in revisiting these stories is to ensure investors are aware of similar scams that make outlandish promises. Before you fall for such a pitch, please spend a little time pursuing due diligence on any offer and the firm (or individual) making the offer. You may even go so far as contacting the Securities and Exchange Commission to report your findings. You could be saving the next yield-hungry investor from making a bad choice. As Jason Zweig concludes: "If it sounds too good to be true, it definitely is."