Investing Behavior

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# Investing Behavior

One is never rational when it comes to investing and money. Investor behavior is sometimes very strange and therefore there is a whole field of study. Different theories help one understand their standing and behavioral patterns as an investor. According to Questioning Rationality Theory, investors behave rationally and use all the investment information. On the other hand, according to the Investors Regret Theory, investors react emotionally and try to avoid the feeling of regret in the end (Michenaud & Solnik, 2008). Humans also reflect some mental accounting behaviors by placing different events in different compartments of mind. In the absence of better information, investors consider that market price is the best price and base their decisions on the current market views, referred to as Investor Anchoring Behaviors. Some of the investors are preservers, who place great focus on preserving wealth, while some investors lack interest and have little aptitude for investing (“The 4 behavioral investor types,” n.d.). Such investors follow mates’ investment decisions. Some of the investors are independent and trust their own choices while accumulators are also confident in what they are doing.

According to a survey regarding investor behavior, the score for risk-tolerance was 32, which is above average. The test reflects my own behavior as an average risk taker (Grable & Lytton, 1999). The instrument suggests that I should invest in securities having low to moderate risk, such as life insurance, treasury securities, (from highly rated carriers), savings bonds, fixed and indexed annuities, insured municipal bonds, utility stocks, income mutual funds, and preferred stocks. In addition, I have good knowledge of investment tools and techniques and therefore I can evaluate the potential risks and returns on my investments before taking any decisions. With time, I believe my risk assessment skills will increase and I will be more confident about my investment decisions.

# Recognizing Fraud

A pyramid scheme is an unsustainable business model where a few top level managers hire new members and these new members who are promised increased payments on bringing other members to the scheme. When recruiting multiplies it becomes impossible for the new people to recruit more and hence this business model becomes impossible to sustain. In addition, this business model relies on fees from new recruits and not on the sale of products and services. The pyramid scheme relies heavily on the cash from new recruits, but in reality, the prospective member pool declines eventually. Owing to the money making model this scheme adopts, it eventually collapses. It also resembles Multi-Level Marketing operations (MLMs), but they involve the sale of tangible goods (Nat & Keep, 2002).

I have never been vulnerable to such a scheme and never got an invite to participate in any investment scheme that could be declared a pyramid scheme. It is not easy to detect a pyramid scheme because the companies reinforce that their business model is based on selling tangible goods and hiring other distributors, referring them to be multi-level marketing firms. Just because a company claims that it sells a product doesn't necessarily mean is legit, and it does not clearly indicate the fraudulent scheme. Certain tips can help one to save themselves from falling in pyramid schemes trap, such as being alert of money investing schemes that require to bring more investors. The independent verification of the legitimacy of schemes is also essential. In addition, such companies excite people by claiming that they are providing them a business opportunity. The victims of these schemes are urban poor people who are attracted to the large returns on smaller investments. Such schemes target poor and vulnerable persons who come up with savings to invest. Pyramids also affect all the segments of society.



# Famous Scandals

Madoff fraud is known to be one of the biggest financial frauds in history (Clauss, Roncalli, & Weisang, 2009). The Madoff fraud was spotted by an American fund manager Harry Markopolos. He blew the whistle against the $65bn (£43bn) Ponzi Scheme of Bernard Madoff that imploded by the end of 2008. He was able to detect the fraud in five minutes and went to the Boston office of the Securities and Exchange Commission to blow the whistle against Bernie Madoff. Based on mathematical modeling and the constant rising trends of profitability, he was able to identify the fraudulent scheme. There were thousands of victims of the Bernie Madoff’s fraud including the families, businesses and financial institutions as well. One of the biggest victims of Madoff’s fraud was Austria's Bank Medici. Some of the other victims of this fraud include New York University, Credit Suisse, BNP Paribas, Henry Kaufman, Town of Fairfield, Conn., pension fund, Fortis Bank Netherlands, Rosenman Family LLC, Fairfield Greenwich Group, Chais Family Foundation, Lawrence Velvel, Mass. School of Law dean, Grupo Santander SA, Rye Investment Management, HSBC Holdings, Kevin Bacon and Kyra Sedgwick, owner of Philadelphia Eagles, Norman Braman, etc.

Madoff defends himself in the video and the interviews by claiming that he is not the kind of person as portrayed in the media. He argued that everyone was greedy and he just went along them. He was defending his actions and blames that others who appear to be innocent are not blameless in reality. It was not only him but the investors and the regulatory agencies as well that led to the success of this fraudulent scheme. His investment securities were examined for at least eight times by the SEC and other regulatory agencies who often got suspicious of fraud. In addition, Madoff's business practices were declared as unusual by the regulatory agencies. However, despite various warnings, the fraud went undetected. SEC has the sole purpose of protecting the investors against frauds and illegal financial practices. In the case of Madoff fraud, it was the negligence on the end of SEC that made thousands of people vulnerable to biggest financial fraud and therefore SEC faced criticism (Van De Bunt, 2010).

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