FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Principles of Investing

I just saw the documentary Bitconned (on Netflix): "In this true-crime documentary, three guys exploit the freewheeling cryptocurrency market to scam millions from investors and bankroll lavish lifestyles." It's interesting and well done, and I recommend it. Most people who invested in the company took huge losses, and I got to thinking about how many different principles of investing they violated. Let's take a look.

What was their philosophy/approach/expectation? Did they think that they would have to take some risk, but if they did their homework, made prudent decisions and were patient, over time they could expect to earn a return that exceeded their cost of capital? No. They thought they could get rich quick.

Did they invest in a company that had been around for at least a decade and had stood the test of time? No, they invested in a brand new company that had never published any audited financial statements. The human brain overvalues novelty, especially since new things have the shortest life expectancy.

Did the company have an established product or service with many customers that is made or provided with existing, proven technology? No, it was a new service that had never been proven to work. They couldn't even get their fake app to work.

Did they invest based on attractive valuation and sentiment metrics? No, they invested based on a story.

Did they do any due diligence on the company? Apparently few of them did. It was relatively easy for a reporter to find out that their CEO did not exist or that their alleged partner Visa had never heard of them.

Did it sound too good to be true? What are the odds that all of the principals had graduated from Harvard?

Were there high barriers to entry with few other competitors, and did the company have an unassailable moat? No. As I've pointed out before, there were at least 4,000 other competing cryptocurrencies. You just needed to be able to put up a website.

Was nobody talking about this company or industry? No, the industry was all the rage among investors and the media, and the company was getting a lot of attention.

Were investors ambivalent about this company? Could they take it or leave it? Were they willing to walk away? Or even better, did the thought of investing in this company make them sick to their stomach? No, they were giddy with excitement and urgently threw money at the company.

This ad by Sam Bankman-Fried's company FTX called "Don't Miss Out," which aired during the Super Bowl in 2022—*five years after* the fraud in this documentary—is reminiscent of the *zeitgeist* of the time and shows just how long fraud can be profitable when the conditions for it are ripe. Beware of companies who use celebrities (who are clueless themselves) to appeal to the dumb masses, as these two companies did.

Did the investment provide any cash flows such as regular dividends? No.

Were there any signs of fraud? Unlike with the established companies in which I invest, these investors could not rely on the Beneish M-score to determine the probability of accounting fraud by management. Many millions of dollars had been invested in the company before anyone began asking serious questions.

Did investors put all of their eggs in one basket? I'm sure many people invested their entire savings in this one company.

People who invested in this company ignored all of the basic and timeless investment principles above because greed shut down their critical thinking. They wanted the get-rich-quick story to be true. Trust me, it takes a lot of time, money and energy to update and analyze a spreadsheet with over 2,300 dividend-paying stocks. Not to mention the decades of education/reading and experience/wisdom that are required to even know how to use that information. It's so much faster, easier and simpler to just invest in something that has had a high recent return (Recency Bias). Who needs a financial advisor when anyone can do this game.

A huge bull market in an industry attracts a legion of fraudsters. The documentary estimates that at the time, about 85% of cryptocurrencies were fraudulent. Yes, these fraudsters are criminals, but in a way, they are also entrepreneurs who are simply meeting a real human demand: the need to speculate in an attempt to get rich quick. Where a demand exists, the market will provide. Cryptocurrency entrepreneurs (fraudulent or not) provided a valuable service to people who wanted to speculate. Unfortunately, these investors had never assimilated the wisdom that if you want to get rich, the surest way is to do so slowly.

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