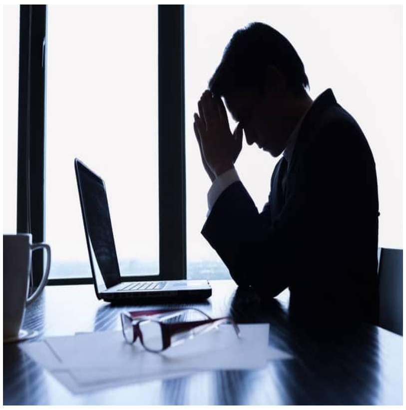

New Investors: Avoid These 3 Common Investment Scams

Description

There are tonnes of ways to lose money investing. Poor stock picks, panic selling, or having an options trade go south can cause you to incur some deep, painful losses.

However, most of these are preventable through good investing behaviour, discipline, and strategy. Sticking to an investment policy statement, keeping your holdings diversified, and maintaining a long-term perspective can mitigate these risks.

That being said, there are more nefarious ways that you can lose your money in the markets. Crooks, con men, or swindlers have always existed, and when there is money to be made, you will encounter them.

Today, I'll be going over three common investment scams with the goal of teaching you how to recognize and avoid falling into these schemes. Let's get started!

The rug pull

The rug pull is a rather specific scam prevalent in the cryptocurrency industry due to the lower amount of regulation there. In a rug-pull scheme, the "developers" will create a new cryptocurrency token and list it on a decentralized exchange (DEX), pegged against **Bitcoin** or **Ethereum**.

Then these "developers" will promote their new token to investors, trying to drum up hype on social media. Investors who fall for this scam will swap their Bitcoin or Ethereum for the listed token, driving the price of the token up, and attracting more and more unsuspecting investors.

Once enough investors have swapped their Bitcoin or Ethereum for the listed token, the "developers" will withdraw all of it from the liquidity pool, causing the price of their new token to crash, often to $0. This leaves the investors with nothing, while the "developers" (now scammers) make off with the Bitcoin or Ethereum.

You can spot and avoid rug pulls by avoiding the social media hype. Staying off **Twitter**, Telegram, and Reddit will help you avoid echo chambers and confirmation bias and reduce the fear of missing out (FOMO). Instead, before you invest in an alternative cryptocurrency, examine the developer's whitepaper and background closely.

The pump and dump

The humble pump-and-dump scheme has been around for decades but has recently made a resurgence thanks to social media and online brokerages. In a pump and dump, scammers will attempt to boost (the pump) the price of a thinly traded stock (with bad liquidity) up via false recommendations and promotions.

Investors who fall for the hype and see the increased volume will buy in a frenzy, causing the price to shoot up even higher, attracting more investors. This occurs until the scammers sell their positions all at once (the dump), causing the price to crater and leaving investors with some high losses they will likely never recover from.

Pump and dumps can occur with any stocks but are most common with penny stocks due to a lower amounts of regulation and enforcement. Penny stocks generally have fewer shares outstanding, lower volume, and less disclosure information, making them ripe targets for scammers.

You can avoid pump and dumps by sticking to non-over-the-counter (OTC) stocks that trade on reputable exchanges, disregarding spam stock promotion emails/messages, and taking stock message board/forum posts with a grain of salt. Always carefully read the audited financial reports of any stock you're considering purchasing.

The Ponzi scheme

If you see opportunities on the internet called "high-yield investment programs" or anything promising high daily/weekly/monthly returns for an initial deposit, it is likely a Ponzi scheme. A Ponzi scheme works by paying initial investors with later investors' money — "robbing Peter to pay Paul."

A typical Ponzi scheme promises investors fantastic profits for little risk. Investors may be asked to deposit some money, say $10,000 to earn 2% weekly. These investors may get the returns advertised, but those returns are not legitimate. In fact, the returns paid out are simply deposits from investors who buy in later on.

As the Ponzi scheme progresses, it becomes increasingly more difficult to meet investor withdrawals, especially if the scammer cannot find more investors. At a certain point, the Ponzi scheme runs out of money, and the scammer will pocket the remaining funds and flee, leaving investors holding the bag.

You can avoid Ponzi schemes by staying realistic, understanding what levels of returns are feasible versus impossible. Generally, with high returns come high risk. With average long-term stock market returns at 10% annually, and the risk-free 10-year US treasury rate at 2.05%, getting 2% a week with little risk is pure fantasy.

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