EXAGGERATED RETURNS:
HOW TRADING NEWSLETTERS & SERVICES CAN MAKE SUCH OUTRAGEOUS CLAIMS AND HOW HOW TO SPOT THEM

By Joshua Wilson, CMT, AIF
Chief Investment Officer, WorthPointe

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Exaggerated Returns: How Trading Newsletters & Services Can Make Such Outrageous Claims, and How to Spot Them

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THIS PAPER IS FOR ANYONE WHO:

- Has tried to use the internet to research ways to learn to trade and has run into newsletters and services that seem too good to be true.
- Anyone who has ever tried to learn to trade or invest by themselves, or be “self-directed,” as we call it.

WHAT YOU’LL LEARN:

- Deceptive ways that investments returns are calculated
- How these firms stay in business despite their record
- What the “red flags” are, and how to detect them
- Why real advisors who owes you an fiduciary duty at all times can not market in these ways
- Why the fiduciary standard disallows certain types of communication that may seem “normal” in the largely unregulated world of “Infotainment” and “Fake news.”

HAVE YOU EVER RUN ACROSS A “SERVICE” OR NEWSLETTER THAT PROMISES TO EASILY GUIDE YOU TO AMAZING INVESTMENT RETURNS?

Chances are, you have. As people have become more savvy, the stock jockeys are increasingly moving to make wild promises about options trading. Options *do* offer powerful potential to reduce the risk in a portfolio and/or bolster its growth/income generating potential — but there are no “diet pills” that make trading them easy. Though the salespeople for these services would have you believe it is easy, the truth is, options trading is *much* more complicated than stock trading. Since it still sounds exotic to most people, the allure of lucrative returns is especially enticing.

SO, ARE THEY TOO GOOD TO BE TRUE?

In summary, yes, they probably are. Let's look at a couple of ways investors are misled. For my examples, I'll assume we are working with an account that is $100,000, all in cash.

AGGREGATE RETURNS: “20% IN A MONTH!” OR “AVERAGE PROFITS OF 20%!”

The confusion comes from using “aggregate returns.” This means they add the returns of each individual trade together and divide by the number of trades.

- *Example 1:* They made one trade in January, and it had a return of +20%. So, they report they made 20%.
- *Example 2:* They made four trades in February. They report they made 12.5%, after averaging the returns of all four trades together.

The problem with this is that we all *assume* the account was up ~$20,000 in January — but it *wasn’t*. In other words, they aren’t looking at returns the way everyone else looks at returns, which is based on total investment/account value! Let’s look at the examples again, but this time peek under the hood at what was *really* going on so we can understand why these results are so misleading.

- *Example 1:* They boast that you can *“never lose more than 5%!”* All that means is they have a rule that says they will never put more than 5% of your account at risk for a single trade. Since you have a $100,000 portfolio, they would never lose more than $5,000 in a single trade. Is that the first thing that came to mind when you read you could never lose more than 5%? I doubt it.

If they can never lose more than $5,000 in a single trade, and they only made one trade in January, which gained 20%, how much did they really make? Easy. What is 20% of the capital they risked? $5,000. The trade made $1,000, which is 20% of $5,000.

The problem is that any reasonable person reading this would assume they mean 20% on the entire value of the portfolio — $100,000 — meaning the portfolio would’ve been up $20,000 on the month. Instead, it’s only up $1,000, which is just 1% of $100,000.

Now let's look at example 2 again.

- *Example 2:* Remember, they got to 12.5% by averaging the returns from all the trades and dividing them by the number of trades (four). So, we have to look at every trade individually.
    - Trade 1: Risked 5% ($5,000), lost it all for a -100% return.
    - Trade 2: Risked 5%, lost it all again.
    - Trade 3: Risked 5%, lost half of it (-$2,500) for a -50% return.
    - Trade 4: Risked 5%, but tripled it (+$15,000) for a +300% return!

Now, you see how they report a 12.5% return (-100 - 100 - 50 + 300 = 50 / 4 = 12.5%). But what actually happened in the account? Remember, we lost -$5,000 on each of the first two trades, and -$2,500 on the third trade (a total of -$12,500). On the fourth trade, we get a +300% return on our $5,000 in risk — meaning we made +$15,000. Once we subtract the -$12,500 we lost on the first three trades from the +$15,000 we made on the fourth, we are left with +$2,500 for the month. If we figure returns based on total investment, like we should, that's 2.5% ($100,000 / $2,500 = 2.5%). A far cry from 12.5%, right? The fact is, you aren't putting all of your portfolio in just one trade at a time!

In these first two examples, I assumed each trade was exposed to the maximum possible loss ($5,000) allowed by their rules. In my third example, I'm *not* going to assume every trade risks the maximum. This one will really blow your mind!

- *Example 3:* Made four trades and reported a +15% return.
    - Trade 1: Risked 1% ($1,000), made +100%.
    - Trade 2: Risked 2% ($2,000), made +50%.
    - Trade 3: Risked 5% ($5,000), lost -100%.
    - Trade 4: Risked 3% ($3,000), made +10%.

Now, you see how they report a 15% return (+100 + 50 - 100 +10 = 60 / 4 = 15%). But what actually happened in the account?

- Trade 1: Made 100% on the $1,000 risked = +$1,000
- Trade 2: Made 50% on the $2,000 risked = +$1,000
- Trade 3: Lost 100% of the $5,000 risked = -$5,000
- Trade 4: Made 10% on the $3,000 risked = +$300
    - Total = -$2,700

You read that right. They reported a +15% return even though they lost $2,700!

What's more, they could even report they had a 75% "trade accuracy" (or whatever they decide to call it) this month since three out of four trades were profitable!

CUMULATIVE RETURNS: "240% RETURN IN THE LAST YEAR!" OR "SINCE INCEPTION"

Let's look at another way newsletters and services can confuse investors. This time, the confusion here comes from "cumulative returns." With cumulative returns, they simply add the returns of all trades together.

Rather than run through a long example over the course of a year or longer, for the sake of simplicity, I'm going to use example 3 again. This time, however, I will calculate *cumulative returns.* In example 3, we had four trades (+100%, +50%, -100%, +10%). If we add those together, we get 60% for the month! But remember, the account is actually *down* $2,700 — -2.7% loss in account value!

Even if all the trades all work out well, we run into that trades overlap each other, which causes the numbers to still be confused. Said differently, we don't have *all* our money in each and every trade.

- *Example 4:* We made 20 trades this month, risking $5,000 on each trade. We made 5% on each trade for a cumulative return of 100%!

Now, you see how they report a 100% return (5% x 20 trades = 100%). But what actually happened in the account? Each trade risked $5,000 and returned 5%, meaning each trade made $250 (5% of $5,000). So overall, 20 trades that make $250 each comes out to a total profit of $5,000, which is 5% of the $100,000 account. Any reasonable person would call that a 5% return, which is a far cry from 100%!

HOW CAN THEY GET AWAY WITH THAT?

Simple — they aren't professionals. Here are some excerpts from the disclosure statement for one such service, *emphasis mine*.

"The Company is not a registered investment adviser, stockbroker, or brokerage. You agree that the Company does not represent, warrant, or take responsibility that any account will or is likely to achieve profit or losses similar to those shown. Examples published by the Company are selected for illustrative purposes only. They are not typical and do not represent the typical results of all stocks within the Company's software or its individual scans and searches."

These people are *not* even brokers or advisors of any kind who owe you so much as a "suitability" duty — much less owe you a *fiduciary duty*! The results? Aren't even typical.

"...has been prepared without regard to any particular investment objectives, financial situation, and needs. Accordingly, you should not act on any information in the Site and the Network without obtaining specific advice from your professional securities or financial advisor, and should not rely on information herein as the primary basis for your investment decisions. Decisions to embark upon trading with real funds based on any information contained within the Site and the Network is your own sole decision and responsibility. Any profits or losses resulting from participating in the markets with real funds rests solely with you, and not with the Company."

I bet you glossed over the first line of this paragraph about having no regard for your situation, but that line is critical. It basically means they can show you trades someone with your risk tolerance should *never* make. They may show you when a high-risk trade pays off handsomely, but not when it loses badly! A fiduciary, on the other hand, has a duty to know your situation and keep you from taking risks you shouldn't be making based on your situation. A fiduciary advisor also can't pick and choose what to show you and what not to show you. They have to take great care in setting realistic expectations for *you* instead of just quoting what their best clients or best trades did.

Also notice the reader is guided to go talk to a professional advisor. This is very important! If you tried to take this company to court or arbitrations, don't you think the defense would ask you if you had consulted a professional advisor? This potentially shifts blame onto either a professional advisor, or you. Since I can't imagine any reputable advisor ever giving this sort of thing his or her blessing, it looks like you may have violated the terms of the agreement. I would guess the defense would then call in an expert witness to testify as to what a professional advisor would likely have said, had one been consulted. One of our partners at WorthPointe regularly serves as an expert witness in arbitration cases and civil court cases on matters involving the Uniform Prudent Investor Act. He and any other WorthPointe advisor would have to testify that we would've advised against it.

"*You agree that you bear responsibility* for your own investment research, investment decisions, and trading execution. The Company *shall not be held liable by you or any others for any decision made or action taken by you or others* based upon reliance on or use of information or materials obtained or accessed through use of the Network. *You assume the entire cost and risk* of any and all chosen trading undertaking(s). Prior to any transaction in securities, you should consult with a qualified professional securities or financial advisor. *You agree that any use of or reliance upon any information on the Network shall be at your sole risk. The Company accepts no liability to you or any other person whatsoever, whether in contract, in tort, for negligence, or otherwise for any direct or consequential loss of any kind* arising out of the use of the Network or any information therein (except insofar as any statutory liability cannot be excluded)."

I'm no attorney, but it seems pretty clear to me. Whatever happens, it's *your* fault. Technically, they aren't giving investment advice at all — just information that may not even be accurate, and you knew that when you paid for the information according to these disclosures.

"To the maximum extent permitted by applicable law, *you will defend, indemnify and hold harmless* the Company (and any of its parents, subsidiaries, affiliates, employees, agents, distributors, third party content providers, or licensors (and their respective directors, officers, employees, and agents)) *from and against all claims, liability, and expenses, including* *attorneys' fees and legal fees and costs*, arising out of your use of the Network, or your breach of any provision of this Agreement. The Company reserves the right, in its sole discretion and at its own expense, to assume the exclusive defense and control of any matter otherwise subject to indemnification by you. You will cooperate as fully as reasonably required in the defense of any claim. *You further agree to pay all costs (including attorneys' fees and expenses) incurred in collecting overdue subscription fees from you. You also agree to pay any fees that may be assessed in connection with any products, services, or information ordered by you and any related taxes."*

Also, you agree to defend the company and are even responsible for all legal fees. Obviously, there is risk in all investing/trading, and disclosures should be expected. Even your grocery store has a long list of legal disclosures because there *are* people out there looking to take advantage of good businesses. The point is that these firms aren't our competition. Instead, they exist in a world that is *totally* separate from ours as professional fiduciary advisors. They can make outrageous claims because there is little consequence in doing so.

“FAKE NEWS” & “INFOTAINMENT”

The investment advisory world struggles with the same issues as the mainstream media. Everybody wants to be assumed to be credible, but the different parties competing for your investment advisory attention are neither held to the same standards, nor pursuing the same goals! Whatever level of respect you have for *The Wall Street Journal,* you probably trust it more than you do *BuzzFeed* — as you should. The *WSJ*, though not without flaws, is primarily written by industry professionals, reporters and journalists. *BuzzFeed* is written by entertainers and marketing pros. Taking *BuzzFeed* as seriously as you take the *WSJ* is much like taking a broker or especially a non-professional “trading service” as seriously as you take a person who has agreed to owe clients a fiduciary duty at *all times* and on *all accounts*.

The same goes for hiring a friend as a “trader” to trade an account for you. Investment pros are heavily regulated by the government and trade organizations and must be registered with the SEC or have a federal license. If someone is investing for you for compensation while keeping your investments separate from a registered or licensed firm, they are likely breaking laws that were put in place to protect you. I get it; it’s a lot cheaper to operate without the government on your back. As a partner at WorthPointe, I can tell you firsthand that a huge chunk of the fees clients pay us don’t really go to us — they go to the direct and indirect costs of complying with federal and state regulations. Some rules seem very fair to me, and others seem unnecessarily onerous, but whatever my opinion of them, we comply and said compliance is costly.

Advisors are feeling the burn. A 2016 survey by Natixis Global Asset Management revealed the pressure on them due to increased regulations and unrealistic client expectations is so great that nearly half say they will have to change their business model, and over one-quarter are considering selling their practices, merging with another firm, or exiting the industry. Still, the biggest difficulty advisors say they are faced with is managing around the unrealistic expectations and irrational behaviors of clients. Is this any surprise when legitimate advisors can be confused with and unrealistically compared to “fake news” investment services with low overhead — services that promise consistently outrageous returns with little risk, little time commitment, and the ability to bypass the thousands of hours of training and practice professional advisors have?

IF THEY AREN'T ANY GOOD, THEN HOW DO THEY STAY IN BUSINESS?

Because of churn. They just need to reach a large number of people and charge a small number of them a small fee! Some academics are even focusing on "mass-marketing frauds (MMFs)" and "cyberpsychology" to better understand why people fall for scams. Often, those who *are* guilty of criminal behavior live in a different country and are very difficult to trace.

Beyond the legality of it all, the most important thing to understand is these marketers don't depend on you being a client for life like an advisor who is a business owner does. Servicing a client is much more expensive than many clients imagine. In fact, my break-even on a new client usually doesn't happen until the client has been with us for nearly two years! I don't *want* temporary clients because temporary clients literally *cost* me money as a business owner. Temporary clients aren't profitable. But fake news investment marketers are in a totally different business than I am. They are in the business of churn, which is why their financial barriers to entry are so low!

If these marketers came out with an expensive fee — the type of fee you would *logically* expect to pay for someone who can deliver such amazing returns — you'd be less likely to try them out. The best is never the cheapest — it's so with any profession, so why would one of the most basic rules of economics be any different for a profession so closely tied to economics and finance? Low barriers to entry (read: low prices) attract people who are *less* serious about it, and that's the type of people they want. It's a lot easier to get 20 people to pay $50 a few times a year than it is to get one person to pay $1,000. If the cost was very high, you would attract people who would be more likely to take it very seriously! If you are a fake financial advice marketer, you don't want people who take it very seriously. "But for only $50 – $200 upfront, why not try it?" That's exactly the reasoning they are banking on. People see ads like this and think, “well, if it’s only 10 minutes a week, I can do that… and if it’s a scam, no big deal, it’s not much money.”

Of course, it’s even better for them if when you sign up, you agree to an annual auto-renewal that allows them to take their small annual fee out again quarterly, semi-annually or annually. Sure, you can cancel any time, but very few people check their banking or credit card statements every month anyway, or they forget to cancel because of the hassle.

There are three types of people who sign up for these types of services:

1. By the time the first newsletter or class arrives, “life happens” and you go back to your normal routine. The class/newsletter is pushed down the inbox with everything else. *Maybe* it is glanced at now and then, but it is never truly put to the test. It looks interesting, though, so “as soon as you have time” you are really going to take it seriously and start trading. When the auto-renewal comes up, you decide to keep it or just forget about it entirely.
2. You follow it religiously but never really act on it because you “aren’t ready” or “don’t know enough” yet. The program has become *infotainment.*
3. You follow the program to a T and quickly learn it’s not all it is cracked up to be. You abandon the program and cancel the auto-renewal.

The overwhelming majority of people are probably going to fall into the first two groups, believe it or not. I once did a trial subscription to the video on demand service, “Hulu,” which is somewhat like Netflix. I watch so little television that I don’t even have a television provider, so for only $7.99/month, it seemed like a good way to have some television available if and when I wanted it. I am ashamed to admit I kept the service for months and months without *ever* turning it on after the first two days I had it. I would think about logging in to cancel my subscription several times a month, but by the time I would sit down at my computer, important business was screaming for my attention and I'd forget about Hulu! The simple truth is most people forget to cancel auto-subscriptions.

The formula is pretty simple:

1. Make outrageous claims that appeal to people's greed.
    a. Ultra low-cost for absurdly high value
    b. Incredible returns with low risk
2. Name drop and litter in some terms that sound fancy enough to build authority.
3. Set a low entry point.
    a. The cost of being wrong is very low.
    b. The cost of reporting to the authorities is very high. (The vast majority of victims of all types of scams never report it due to not knowing where to turn, or embarrassment.)
4. Hope they never *really* read and apply it so it remains cheap entertainment. Keep them on auto-pay, if possible, and add more new victims than you churn through due to attrition.

BUT I SAW THEIR ADVERTISEMENT ON A CREDIBLE WEBSITE

Unfortunately, it doesn't matter. Pay no attention to where the email came from or what website you saw it on. The website often has no control over the ads being run, or they are careful to add a disclaimer that says something like "this is a third-party offer/advertisement, and the opinions expressed are those of the advertiser and not our opinion." In summary, "they paid us to send you this or put this ad here, but we don't endorse it."

WHAT SHOULD I LOOK OUT FOR?

Be leery of simple answers to complex questions. Services that make it all sound too easy and simple are the ones that should cause you the most concern. A credible advisor will never speak, write or set expectations the way fake investment pros will. Some questions are well-intended and may seem simple, but are actually incredibly complex! One example is, "*What were your returns last year?*" When someone asks something like this, they likely don't realize it, but they may be asking the advisor to misbehave. Unlike the fake financial advice sources, you should expect a credible advisor to be very careful about talking investment performance. Why? Because it's just not as simple as quoting one return, especially if the advisor offers clients a boutique level of management and not just a short list of model portfolios. There is not just one *return* the advisor achieved. Any credible advisor is going to want to know something about you before he starts talking about returns. This is because he may not *intend* for what he's saying to be considered a setting of expectations, but he knows that's the way the listener will take it. Consider the following when you're doing your due diligence.

1. An "advisor" is different from a "fund." You invest *in* a fund, but you invest *with* an advisor. Reporting performance for a fund is easy because it's *one* fund that isn't personalized. Reporting can be very difficult for an advisor, particularly a boutique advisor who customizes portfolios. An advisor may be able to keep "composite" performance that ignores special client situations and basically reports how the model performed without consideration for individual clients. However, some things the advisor does may be so specialized they aren't reportable at all. In situations like that, the advisor may set a range of expectations to take into account the differences caused by major variables. Advisors may also choose to list actual model performance as hypothetical performance just to ensure if there is any misunderstanding, they have erred on the side of caution. I believe it is always best to understand a composite as being hypothetical since individual client

circumstances can theoretically prevent *any* clients from getting *exactly* what the model got.

2. All clients aren't the same. Advisors have to be careful not to compare apples to oranges. Some clients have special circumstances such as a concentrated stock position. All clients are a mix between many different variables. They have different definitions of success, risk tolerances, sophistication levels, emotional hangups, and levels of willingness to let an advisor do what he or she is supposed to do. The more customization the advisor offers, the more careful he or she has to be with quoting returns.
3. Some advisors may run many different strategies, and said strategies will naturally have different returns. Still, the strategy with the "best return" in any given time period may not be the best strategy for *you.* Different strategies may use different kinds of investments, make sense in different market conditions, trade more or less frequently, have different tax consequences, cost more or less to implement, etc.
4. Talking returns without talking about the risk it took to get them is the biggest error investors make. Scammers don't talk about risk, or they promise low risk for extravagant returns. Novice investors will often look at investments that made 10% and 12% and decide they want the one with the higher return. This is a grave mistake! You can only compare the returns of these investments if they were taking the same amount of risk to get their returns! If the one that got 12% took twice as much risk as the one that got 10%, a lot of investors will be better off with the one that got 10%. This is another reason why advisors don't want to talk returns until they know something about you. A credible advisor does not want to set expectations for high returns for a client who is completely risk averse.
5. Legally, an advisor can't show you anything that could be remotely construed as a recommendation, testimonial or reference. That means no individual client performance or record of trades, either recent or historical. Any of that would be

considered “cherry picking” of returns and thus considered a deceptive sales practice.

IN SUMMARY

1. Don’t expect pros to talk the way “infotainers” do. Fiduciary pros should be especially careful because the fiduciary standard subjects them to potentially tremendous legal scrutiny. As demonstrated above, the scammers have very little scrutiny.
2. Infotainers don’t have any pressure to fully disclose the risk to you, because they don’t have any legal liability to you.
3. Talking about investment returns is not simple. Fiduciary advisors have to be especially careful not to engage in deceptive sales practices, but this can be difficult since clients can unwittingly request information from an advisor that it is illegal for the advisor to provide.

Important Notes & Legal Disclaimers

This brochure is for informational purposes only and should not be considered investment advice or a recommendation to trade. Options trading is generally more complex than stock trading and may not be suitable for some investors. Before trading options, a person should review the document titled Characteristics and Risk of Standardized Options, which is referenced above. Information pertaining to RIA advisory operations, services, and fees is set forth in the most current Form ADV Part 2 brochure, which is available upon request or at www.adviserinfor.sec.gov.

Differences in account size, age of clients, risk tolerance, timing of transaction, client mandated changes in investment plan, and market conditions prevailing at the time of investment may lead to different results and clients may lose money. Fees and expenses also may vary based on custodial relationships, trading costs, management fees and other factors such as account size. Thus, commissions and other expenses may not be fully considered in the results, and if all potential fees and expenses had been taken into account, the results may be lower.

Contact Us

(800) 620-4232
bespoke@wpwm.com