

The Basics for Wise Investing



Reduce the risks of investing

Meet your financial goals

Avoid scams and frauds

Find the financial adviser right for you



The Basics for Wise Investing



**Department of Consumer & Business Services
Division of Finance & Corporate Securities**

Contact:

503-378-4140

866-814-9710

www.dfcs.oregon.gov

Click on "Investor Information Program"

INSIDE

Oregon Division of Finance and Corporate Securities and the Investor Information Program

Investors today need to be saavy when seeking the best advice, services, and products to meet their investment goals. However, each year millions of dollars are lost by Oregon investors through securities fraud.

To counter these losses and to help investors make sound choices, the Investor Information Program within the Division of Finance and Corporate Securities (DFCS) provides information and guidance.

The division, part of the Department of Consumer and Business Services, regulates financial institutions, registers securities offerings, licenses brokerage and investment advisory firms and their salespeople, and investigates possible violations of the Oregon securities laws. The Investor Information Program, within DFCS, shares information about investments and securities with those seeking to make informed investment decisions.

The Investor Information Program also provides publications on a variety of investment-related topics, including small-business investments, stocks, bonds, and mutual funds. Visit our Web site, www.dfcs.oregon.gov/securities.html, and its links to learn more about investing and other financial topics.

In addition, the program provides speakers to groups of 10 or more at no cost. If you're interested in having an expert present a program from among a variety of investment-related topics, call 503-378-4140 to find out more.

Table of Contents

Part 1: Investing basics.....	5
Identifying your investment goals	5
Setting your personal investment goals	5
Tips for beginners	5
Achieving your goals	7
Risk/reward pyramid.....	7
A sample investment goal	7
Part 2: Choosing a broker	8
Types of brokerage firms.....	8
Limited-products firms	8
Full-service brokerages.....	9
Discount brokerages	9
Eight steps to take before you select a broker	9
Part 3: Online investing	10
Web sites.....	10
Part 4: Opening a new account.....	11
Types of accounts	11
Stock certificates	11
New-account forms.....	12
Part 5: Keeping track of your account.....	13
Discretionary authority	13
Monitoring your account.....	13
Keeping files	13
Part 6: Your legal rights	14
Regulation of brokers	14
Part 7: Understanding stocks and bonds	15
Common stock.....	15
Preferred stock	15
Dividends and yields.....	16
Warrants.....	16
Bonds	16
Corporate bonds	17
Part 8: Public companies.....	18
Public and reporting companies	18
Vital information about public companies.....	18
Part 9: Understanding mutual funds.....	19
How mutual funds work	19
Terms to understand before you invest	19
How to select a mutual fund.....	20
Understanding the three mutual-fund share classes	20

Part 10: Main types of mutual funds	21
Stock funds.....	21
Bond funds	21
Money-market funds	21
Annuities.....	21
Part 11: Registration of securities	23
Get more information	23
Local information	23
Part 12: What you should know about the prospectus.....	24
Do you have to read the prospectus?	24
A close examination of a prospectus	24
Part 13: Small-business investments.....	27
Analyzing the investment.....	27
Making money on your investment.....	28
Other suggestions	28
Part 14: Liquidity.....	28
Part 15: Protecting yourself against fraud.....	29
Techniques typically used by crooks.....	29
Commissions and churning	30
How to deal with phone sales calls	30
Types of investment scams	31
Part 16: Resolving problems or filing complaints.....	34
Record-keeping.....	34
Legal counsel	34
Customer-complaint investigations	34
FINRA's customer-complaint programs	35
Investigation processes by DFCS and FINRA.....	35
Arbitration and mediation of disputes	35
What is arbitration?	36
What is mediation?	36
Part 17: Where to go for help	37

Part 1: Investing basics

Identifying your investment goals

First, ask yourself, “What do I want to accomplish through my investments?” Although you may think the answer is simply “to make money,” this guide will show you why it is critical to build your investment plan on a carefully considered foundation. For most investors, the following investment goals, or some combination of these, will help guide investment decisions:

Safety — through conservative investments, with minimal risk of losing the original investment (the principal).

Income — achieved by purchasing investments that provide regular payments.

Growth — realized over the long term through increases in market value. Growth investments carry a higher risk than investments based on the first two objectives and generally provide little or no dividend income.

Speculation — although it has the potential to produce higher-than-average returns, speculation involves higher-than-average risk. Speculation strategy may include short-term trading of new or unproven companies’ stocks.

Setting your personal investment goals

Properly planning your investment goals will go a long way toward achieving them. One of the first things you should determine is how much you can afford to invest. If you’re just beginning, first make sure you have emergency funds for those “just in case” items such as car or major appliance repair or the loss of a job. Set aside money for this first before you invest. Also, if you owe any debt, consider whether you should pay off that debt before you invest. Take into account any credit card, auto loan, student loan, medical bill, or similar debt that you have not paid in full.

The following questions, and your answers, will help you — whether you’re a beginner or seasoned investor — identify the goals around which your investment plan will be built. Write the answers to these questions before you talk with a financial adviser or embark on an investment plan on your own:

- Why do I need or want to invest?
- How much can I afford to invest?
- What am I trying to accomplish?
- How much do I want to invest?
- How much return do I need?
- How much risk am I willing to take to achieve my goals?
- How will I know when I’ve accomplished what I set out to do?

If you can’t answer these questions fully, please read this guide carefully and then come back to them — *before* you invest.

Tips for beginners

- Set aside money for emergencies before you invest.
- Find a trained and licensed professional financial adviser.
- Check the credentials of those who offer to sell you securities. Verify answers with an independent source.
- Be selective. You have the right to say NO.
- Ask about all fees and charges related to your investment choices prior to purchase. Fees reduce your rate of return; it may take a year or more to recover such fees.
- Don’t invest in a company just because it’s in a fast-growing or successful industry.
- Don’t invest just because you received a “hot tip.”
- Never invest on the basis of an unsolicited phone call, e-mail, spam, or via an Internet chat room.

After you develop a sensible investment plan, stick with it.

Most of the discussion in this booklet concerns topics related to brokers, who *sell* securities, as opposed to investment advisers, who sell *advice* about securities.

Risk

All investors accept risk. Risk means that you may lose all or part of your principal. **No matter how you choose to invest your money, there will always be some degree of risk.** If an investment is touted as “risk-free,” report it to us at 503-378-4140 or toll-free at 1-866-814-9710. These numbers also are listed in “Where to go for help” at the back of this book.

Investors who seek higher returns may face more risk than investors who seek modest returns from safer investments. The more you want to make from your investments or the more money the broker says you can make from your investments, the more risk you must accept. This is an indisputable reality of investing. If a high level of risk makes you uncomfortable, select your investments accordingly. As an investor, you have the right to know of the risks involved with any investment. The Investor Bill of Rights, below, by the North American Securities Administrators Association, will help you with your investment choices.

The Investor Bill of Rights

When You Invest, You Have the Right to

- **Ask** for and receive information from a firm about the work history and background of the person handling your account, as well as information about the firm itself.
- **Receive** complete information about the risks, obligations, and costs of any investment before investing.
- **Receive** recommendations consistent with your financial needs and investment objectives.
- **Receive** a copy of all completed account forms and agreements.
- **Receive** account statements that are accurate and understandable.
- **Understand** the terms and conditions of transactions you undertake.
- **Access** your funds in a timely manner and receive information about any restrictions or limitations on access.
- **Discuss** account problems with the branch manager or compliance department of the firm and receive prompt attention to and fair consideration of your concerns.
- **Receive** complete information about commissions, sales charges, maintenance or service charges, transaction or redemption fees, and penalties.
- **Contact** your state or provincial securities agency in order to verify the employment and disciplinary history of a securities salesperson and the salesperson’s firm; find out if the investment is permitted to be sold; or to file a complaint.

If an investment doesn’t fit the plan you’ve crafted, don’t make that investment. Financial tragedies happen when people ignore the reasoning upon which they built their plan and “go for the gold” on a whim. **And, as always, don’t invest in anything you don’t fully understand.**

Achieving your goals

You may need professional assistance to achieve your investment goals. If you choose to work with a financial adviser, communicate your investment goals and financial objectives clearly. Present them in writing, and keep a copy for your records.

DFCS offers a helpful tool for keeping track of phone conversations with your financial adviser: "When Your Broker Calls, Take Notes," publication no. 440-3222, available in English or Spanish. Call DFCS, 503-378-4140 or 1-866-814-9710 (toll-free) for a free copy or find it online at www.oregondfcs.org/investor/publications/3222.pdf.

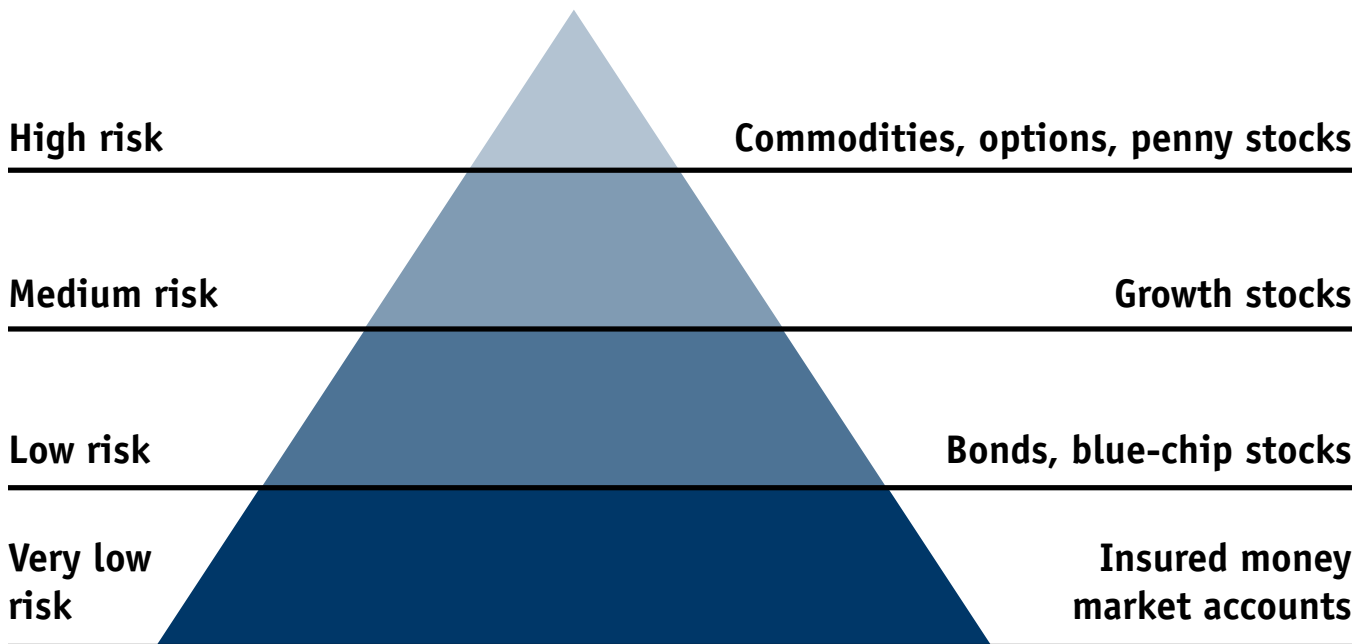
A sample investment goal

Income with hedge against inflation, plus small speculative position

Total investment capital: **\$10,000**

Portfolio proportions:

■ Income securities	70%	7,000
■ Growth securities	20%	2,000
■ Speculative	10%	1,000
Totals	100%	\$10,000



Part 2: Choosing a broker or adviser

The industry that sells securities, the *brokerage industry*, is large and varied. There are Oregon-based firms and national firms with Oregon offices; others conduct business from outside the state by mail, over the phone, or on the Internet. No matter where the companies offering to sell securities are located, Oregon law requires them and their salespeople to be licensed by the Oregon Division of Finance & Corporate Securities.

Licensing, however, doesn't guarantee that a firm or salesperson will perform according to your wishes; it only tells you that they have complied with the state's minimum standards.

A salesperson can be a broker, sales agent, account executive, financial consultant, or registered representative.

The industry that sells advice about investing in securities, *investment advising*, is also large and varied. *Investment advisers* must be registered with the Securities Exchange Commission (SEC) and abide by the rules of the *Investment Advisors Act* or be registered under Oregon securities laws. Which registration they must have depends on the dollar amount under management.

There are no licensing requirements for *financial planners*. *Certified financial planners* (CFPs) have completed the certificate program of a training establishment. Depending on financial planners' activities, they may have to be licensed as investment adviser representatives.

Designations

Watch out for designations, or "alphabet soup" lettering, behind someone's name. If someone is touting a designation, ask what it means and how he or she obtained it. Some designations indicate that the person has taken extensive training at a legitimate entity and also may have to complete a specified number of hours on an annual basis to maintain the designation. Be especially wary of "senior" designations as many are merely a marketing or selling technique toward targeting seniors. Call us — 503-378-4140 or 1-866-914-9710 — if you have a question about designations.

Types of brokerage firms

Brokerage firms may be classified into three basic types: limited products, full service, and discount, depending on what kind of services and products are provided to customers.

Shop for a brokerage just as you would for any other professional service. Brokerage firms may be one-person firms, international corporations, or anything in between. Similarly, the services, commissions, and fees of firms vary significantly.

Brokerages may have their own mutual funds. If that is the case, their securities salespeople may have incentive to sell the brokerage's own funds, a practice that is known as *proprietary sales*.

Some dealers are "market makers." Rather than profiting from commissions on each sale of securities to investors, market makers buy blocks of securities called "round lots" on the stock exchanges. If the securities increase in value, the dealer makes a profit because the dealer owns the securities. Market makers also profit by maintaining "spread" — that is, the difference between the bid price of their inventoried stock, which is the highest price a buyer will pay, and the asked price, which is the lowest price the seller is willing to accept.

Limited-products firms

These firms specialize in limited securities products such as mutual funds, limited partnerships, or specific types of bonds or insurance products like variable annuities.

Full-service brokerages

A full-service brokerage firm can provide complete investment services, including recommending securities, researching a particular issue, and providing individualized service through a salesperson. The firm receives its payment in the form of a commission that is calculated according to the type of security and the amount invested. A full-service firm is best for investors new to the market or those who don't have the time or desire to do their own investment research.

Discount brokerages

A discount brokerage also provides a range of services, but its salespeople are not usually allowed to give investment advice, make recommendations, or provide research. For these reasons, a discount firm charges lower commissions than full-service brokers and is best suited to experienced investors who do their own research and direct their own buy-and-sell transactions.

Eight steps to take before you select a broker

- 1. Make a plan.** Thoroughly consider your financial objectives and evaluate your personal finances before discussing your financial goals with a broker.
- 2. State your net worth honestly.** Don't exaggerate your net worth to impress brokers; they will be making investment recommendations based on what you tell them. Make sure you, and your broker, exclude the value of your home when you calculate your net worth for investment purposes.
- 3. Decide whether you'll use a full-service or discount brokerage.**
- 4. Get references.** Ask friends, relatives, and co-workers for the names of brokers who served them well for a year or more.
- 5. With your plan in hand, meet with each broker** who sounds as if he or she might be right for you. Talk with prospective brokers about what you want and assess their responsiveness to your needs. Ask about their experience and education. Ask for customer references by name and phone number.

Be wary of brokers who attempt to sell you a product during this interview. The interview should be free if the person is paid on commission. If the broker provides a fee-only service, the meeting might be free or the broker should tell you the fee before you meet.
- 6. Contact each reference** and ask about the broker's performance.
- 7. Ask brokers about fees and commissions,** which should be clearly stated. Take notes. Most brokers or investment salespeople receive a commission based on the size of your investment. Broker/dealer salespeople earn commissions based on a percentage of the dollar amount invested. Investment adviser representatives receive a fee based on a percentage of the money under management.
- 8. Do your homework.** If you like one of the brokers you've met, call the Financial Industry Regulatory Authority (FINRA), 1-800-289-9999, to get his or her Central Registry Deposit number, which is the broker's license number. This number is linked to the broker's employment and disciplinary history.

Next, make sure the salesperson is licensed to sell securities in Oregon. Contact DFCS 503-378-4140 or 1-866-814-9710 (toll-free). If an individual is not registered with us, ask the salesperson about his or her status and, of course, verify the information.

FINRA is the largest non-government regulator for all securities firms doing business in the U.S.

Part 3: Online investing

There are hundreds of online investment firms, with millions of accounts. You can buy almost any kind of stock, bond, or mutual fund online. People from all walks of life are trading online.

The biggest difference between trading online and dealing with a broker is that online, you are responsible for finding the answers to any questions you may have about the investments you're considering or have made. One of the most common complaints from online investors is that the firms with which they've dealt do not respond adequately to customer inquiries or complaints. This may change for the better as the online investment industry matures, but as an inexperienced investor, you may want to start with a full-service broker.

If you decide to proceed with online investing, please call us at 503-378-4140 or 1-866-814-9710 (toll-free), to request the free publication *"Risky Investments and Online Investing."* Read it before you invest online.

Some tips:

- As with any investment decision, do your homework before you invest online.
- Read national financial publications.
- Visit Internet sites that evaluate online brokers.
- Don't make hasty decisions or decisions based on hunches, tips, or online chat-room gossip.
- For help finding a securities lawyer: www.osbar.org (Oregon State Bar); www.piaba.org (Public Investors Arbitration Bar Association) or www.martindale.com

Web sites

- For extensive information about online investing:
www.investorprotection.org
- For help finding a securities lawyer:
www.osbar.org (Oregon State Bar); www.piaba.org (Public Investors Arbitration Bar Association) or www.martindale.com
- To file an online complaint or find a mediator:
www.finra.com
(Financial Industry Regulatory Authority)
- To contact Oregon Division of Finance and Corporate Securities:
www.dfcs.oregon.gov
- To access lists of state regulators and investor information:
www.nasaa.org
(North American Securities Administrators Association)
- To find out about online investment scams:
www.sec.gov/consumer/cyberfr.htm
(Securities and Exchange Commission)
- To do online investing groundwork:
www.investingonline.org/

Part 4: Opening a new account

Types of accounts

There are several types of accounts you may open with brokers:

Cash accounts — Most investors open cash accounts. A cash account is an arrangement that requires you to pay in full for each security purchase.

Combination money market and cash account — This type of account typically requires you to keep a minimum balance in your account, but it offers flexibility in that you may buy securities with continuous transfers or “sweeps” of unused cash into a money market account. Check for additional fees with this type of account.

Margin accounts — Opening a margin account allows you to borrow money from the brokerage — typically, up to 50 percent of the value of the securities you hold — against your securities or cash balance so that you can buy additional securities. A margin account requires you to pay interest on what you borrow. If you buy securities on margin, remember that you’re liable for the balance of the loan even if the value of your securities drops. A margin account involves a high degree of risk and is best used by a seasoned investor. When you sign a margin agreement, the broker **is authorized to sell securities in your account without notice** to cover shortfalls resulting from a decline in the value of your securities. This is called a “margin call.” Be prepared to pay cash from other sources to cover these “calls.”

Stock certificates

You usually have several choices on how your stock certificates will be handled:

- Receive a certificate made out in your name that shows the number of shares purchased. This certificate must be endorsed and returned to the broker should you sell the stock. Keep stock certificates in a safe deposit box or other secure place, not in your home. Stock certificates are difficult to replace if stolen or destroyed.
- Have the stock certificate held in your name at the brokerage firm. Although the certificate still must be endorsed by you if the stock is sold, this option eliminates storage concerns.
- Have your broker hold the stock certificate in “street” name, which means that the brokerage firm is listed as the shareholder of record, even though you, the customer, are the stock owner. Your broker must forward annual reports and proxy materials to you, which may delay them; however, when you sell the stock, the transfer is much simpler. Loss of stock due to broker negligence will be covered by the Securities Investor Protection Corporation if it’s held in street name; this is not true of certificates held by investors.

Discuss these options with your broker and decide which is right for you. Ask about additional fees charged by the broker for holding stock in street name and any related custodial fees.

New-account forms

When you fill out your new-account form, you provide the broker with information about your financial situation, your investment objectives, and the level of risk you're willing to take. You have a right to expect your broker to follow your instructions. Brokers have a responsibility to know their clients and recommend suitable investments.

The new-account form requires you to specify the level of risk you're willing to accept to achieve your financial objectives. If you don't understand some of the terms on the form, ask your broker to explain. Make sure you understand how much risk is involved.

Don't sign the form until it's completed, the information is accurate, you understand everything, and you're willing to accept the terms and conditions it imposes on you. Take your time and ask questions. And be sure to read both the front and back of the information you receive.

Take a copy (both front and back) of your new-account form with you when you leave, or make a photocopy of the documents your online brokerage has sent you to sign. Note the information, usually on the back, regarding dispute resolution and arbitration terms. Such documents could easily be falsified, changing your permanent file. Don't accept a promise that you'll get your copy in the mail.

Your responsibilities don't end once you've made an investment plan and selected a broker or online investment firm. Once you purchase securities, you must do the following:

- Keep them in a safe place.
- Maintain records.
- Monitor your investment account.

If something goes wrong, it's important to quickly recognize the problem and take action.

Part 5: Keeping track of your account

Discretionary authority

Ordinarily, you'll be making your own investment decisions. However, should you choose to give your broker permission to make these decisions for you, you'll need to sign a discretionary authority form.

Discretionary authority allows your broker to make investment decisions based on his or her determination of what will best meet your investment objectives. Your broker will then do so without consulting you about the price or type of security, or when to buy or sell. If you decide to give the broker discretionary authority for your account, you must do so in writing.

If you give discretionary authority, it's even more important that you review and understand your monthly statements so that you know what was purchased and how frequently trades are being made. Discretionary authority may be withdrawn at any time, also in writing.

Monitoring your account

After you've invested, you'll receive account statements. Don't throw them away or delay reading them. Read each statement and make sure each trade was completed as you instructed. Check to see how much commission you were charged. You should be informed in advance about increases in charges, such as commissions and custodial fees. If you elected to have your securities held in street name (see Page 11), you can request to have dividends or interest payments forwarded to you or reinvested. Pay attention to inserts included with your statement, including fee disclosure documents.

Keeping files

Keep all investment-related information together. As soon as you review the confirmation slips and monthly statements, file them. If you have a dispute with your broker regarding your investment, this file could prove invaluable.

Always take notes when you talk with your broker and always keep these notes with your investment files. If you've used DFCS' "When Your Broker Calls, Take Notes" forms, keep them with these materials, as well. (Check our Web page at www.dfcs.oregon.gov/investor/publication/3222.pdf. Or contact DFCS at the address on Page 37 to order this free form.)

Part 6: Your legal rights

As an investor, you aren't protected from a decline in the value of securities purchased on your broker's recommendation; however, you may have recourse if you lose money because of a broker's recommendations that were clearly unsuitable. Unsuitable investment recommendations are prohibited by Oregon securities law and by the Financial Industry Regulatory Authority (FINRA). In Part 1 of this guide, we urged you to explore your reasons for investing and to write down your goals. This is another reason for doing that. Should you ever seek recourse for securities losses that you believe were unsuitable, your written goals may be the evidence that makes your case.

Some tips:

- Never make your investment check payable to the sales representative.
- Never make an investment decision based on a phone solicitation or sales promotion from someone with whom you have never done business.
- Don't invest on the basis of "inside information" or new products or developments without investigating for yourself.
- Don't abandon your common sense or your plan. If you're promised spectacular returns — "your money will double in a year or less" — or promised "guaranteed returns," *be wary*.
- Don't wait if you think there's a problem with your account or brokerage firm. Call and express your complaint to your broker, the broker's manager, and the compliance officer for the brokerage firm. And call us and FINRA to report the problem immediately. You'll find more information about reporting and resolving problems on Page 34.

Regulation of brokers

The Financial Industry Regulatory Authority (FINRA) is a self-regulatory organization that licenses all registered representatives. Before a sales representative can sell securities to the public or supervise those who do, FINRA reviews the applicant's employment and disciplinary history.

If you're working with an attorney, accountant, or financial planner as an investment adviser, understand that these people don't have to be registered with FINRA; however, if they sell securities as broker/dealer salespeople in Oregon, they do.

Information on the Securities Investor Protection Corporation: The Securities Investor Protection Corporation (SIPC) covers certain securities losses only if an SIPC member fails financially and is unable to meet securities customers' obligations. It does not cover loss to an investor resulting from a decline in the market value of securities, bad advice, or unsuitable recommendations by a broker. SIPC is a nonprofit membership corporation funded by securities brokers. All brokers and dealers registered with the Securities and Exchange Commission and with national stock exchanges are required to be members of SIPC. SIPC is neither a government agency nor a regulatory authority. Don't confuse the SIPC with the Federal Deposit Insurance Corporation: The FDIC guarantees funds on deposit in member banks and thrift institutions.

Part 7: Understanding stocks and bonds

Stocks and bonds are the staples of many investment portfolios. Stock represents a share of ownership in a corporation. A bond is a security that represents a debt owed by the corporation to the bondholder.

A share of stock is issued in a number of different ways — following are descriptions of the most common forms:

Common stock

Common stock — also called common shares, capital shares, or capital stock — represents units of ownership in a corporation. Purchasers of common stock are granted specific rights that may include the following:

- Voting at stockholder meetings.
- Selling or otherwise disposing of stock.
- Having the first opportunity to purchase additional shares of common stock issued by the corporation.
- Sharing dividends with other common stockholders.
- Receiving annual reports and inspecting the corporation's books and records.
- Sharing in assets (after creditors are paid) if the corporation is liquidated.

A corporation may be authorized to issue more than one class of stock. For example, a class of common stock might have enhanced voting rights. This stock may be more expensive than regular shares.

Preferred stock

Preferred stock gets its name from the preferences granted its owners, which may include dividends or sharing assets should company liquidation occur. Preferred stock generally doesn't carry voting rights. It is issued by a company to raise capital without jeopardizing the controlling interests of the common stockholders. Preferred stock is sometimes convertible to common stock.

Preferred stock is similar to bonds in that most preferred stock dividends offer a fixed rate of income. Most offer future financial options. Be sure to get a full description from your broker of preferred stock you're interested in. Preferred stocks offer relative safety of income, but usually have more modest growth potential than common stock.

Dividends and yields

Unlike the interest paid on bonds or certificates of deposit, which remain constant, dividends on stock may be reduced or eliminated in lean periods; however, in good years, they may earn higher dividends, have increased market value, and yield higher returns to the stockholder.

If you see a stock marked with an “x” in a newspaper, that stock has gone ex-dividend, which means it will pay a dividend to investors. But it will not pay a dividend to investors who buy shares during the ex-dividend period (the period between the announcement and the payment of the next dividend) — only to those who held shares when the dividend was announced.

Preferred stock dividends are usually paid at a fixed rate and before dividends are paid on common stock. In addition, most preferred stock dividends are cumulative, which means that if the company fails to pay a dividend when due, the unpaid dividend obligation accumulates. These obligations must be paid in full before common stockholders receive any dividend payments.

Stock is often referred to as having par value, book value, and market value.

- **Par value** is an arbitrary value set by the company at the time of issuance and is of little concern to most investors.
- **Book value** is calculated by dividing the total net assets of the company by the number of shares outstanding.
- The price at which shares of stock can be bought and sold is called the **market value**. Shares that are not publicly traded, however, will have no market value.

Warrants

A warrant is a type of security, usually issued together with a bond or preferred stock. The warrant entitles the holder to buy a proportionate amount of common stock at a specified price that is usually higher than the market price at the time the warrant is issued. A warrant is usually offered as a “sweetener” to enhance the marketability of accompanying fixed-income securities. Warrants for shares of publicly traded stocks are usually tradeable on exchanges and usually have a life of several years. Similarly, subscription rights to new issues often are sold to existing shareholders. These rights, also known as options, are usually exercisable at a price below current market value of the stock in question. They usually expire within a short time.

Bonds

While a share of stock represents partial ownership or equity in a company, bonds represent debt payable by a company to the bondholders. Interest on bonds must be paid in good times or bad, which makes bonds attractive to investors seeking greater capital security and assured income.

A company issuing a bond repays with interest the amount borrowed upon the bond’s maturity. On the face of a bond certificate is the name of the company issuing the bond, the serial number, the principal amount of the bond, the rate of interest, and the maturity date.

The quality of a bond usually can be determined by its rating. There are three publications that rate bonds: Fitch, Moody’s, and Standard & Poor’s (S&P). They all rate the credit-worthiness of registered bonds on a grading scale of AAA to BBB-. Any bond rating below that (BB+ to C) is considered to be a low-grade bond or a “junk” bond. The default potential of the debtor corresponds inversely to these bond ratings — the higher the grade, the lower the risk, the lower the grade, the higher the risk. D ratings indicate payments are in default.

Fitch, Moody's, and the S&P ratings are considered industry norms for bonds. Ask your broker for the Fitch, Moody's, or S&P ratings of bonds you're interested in. In a bankruptcy or other liquidation, bondholders' claims must be satisfied before payments are made to preferred or common stockholders.

Bonds are issued by business corporations and by foreign, federal, state, and local governments. U.S. government bonds are considered the safest because the U.S. government has the highest credit rating of any borrower. State and local governments offer what are commonly referred to as "municipal bonds," which may offer the advantage of a federal tax exemption on interest paid.

While municipal bonds usually are considered quite safe, not all municipal bonds are the same. The issuing body can be any entity from the U.S. government to a small irrigation district. Different bond issues have different levels of safety. In the past, bonds issued by municipalities have been rated as junk bonds. It is important to check the bond rating for municipal bonds.

Note: Bond prices generally move conversely to interest rates. That means an increase in interest rates generally leads to a decline in bond prices. When interest rates are higher than current bond yields, demand tends to shift away from the bond market.

Corporate bonds

Corporate bond issues vary widely, but a few of the more common corporate bonds include the following:

- **Sinking-fund bonds:** Some bonds are backed by a "sinking fund" for which the issuer is required each year to set aside a certain amount of money to retire the bonds when they mature. A sinking fund may be allowed to accumulate or may be used each year to redeem outstanding bonds.
- **Mortgage bonds:** Bonds for which a corporation pledges certain assets (real estate) as collateral to secure the bond payment.
- **Debentures:** These bonds aren't secured with collateral or specific property, but are backed by a corporation's general credit. Debentures aren't necessarily less creditworthy than mortgage bonds. Some have top credit ratings.
- **Junk bonds:** These are high-yield, high-risk bonds of two types: those that were investment-grade when originally issued but have subsequently been downgraded, and those originally issued as low-grade bonds. The latter group includes bonds issued by low-rated companies to finance operations, as well as those issued in connection with corporate takeovers.
- **Convertible bonds:** Convertible bonds give you the privilege of exchanging them for other securities issued by the company at a future date and under specific conditions.
- **Zero-coupon bonds:** Zero-coupon bonds make no periodic interest payments, but instead are sold at less than face value. Gradual appreciation allows buyers of such bonds to redeem them at face value on a specified maturity date.
- **Penny stock:** The term "penny stock" generally refers to low-priced (below \$5), speculative securities of very small companies. While penny stocks generally trade over-the-counter, such as on the OTC Bulletin Board or in the Pink Sheets, they also may trade on securities exchanges, including foreign securities exchanges. In addition, penny stocks include the securities of certain private companies with no active trading market. Penny stocks may trade infrequently, which means that it may be difficult to sell penny stock shares once you own them. Because it may be difficult to find quotations for certain penny stocks, they may be impossible to accurately price. *Investors in penny stocks should be prepared for the possibility that they may lose their whole investment.*

Part 8: Public companies

When you invest in securities listed on the New York Stock Exchange (NYSE), you're participating in the growth or trading of equities of some of the largest U.S. and foreign corporations. The NYSE lists approximately 1,700 stocks and 2,300 corporate bonds. But many more stocks and bonds are offered on other markets, including NASDAQ, the American Stock Exchange, the Pacific Stock Exchange, Boston Stock Exchange, Cincinnati Stock Exchange, Chicago Stock Exchange, and Philadelphia Stock Exchange.

Public and reporting companies

A public company is a company that has gone through the initial public offering (IPO) process and is obligated to provide certain information and documents to the Securities and Exchange Commission (SEC) and to one or more stock exchanges on a regular basis.

Reporting companies, unlike public companies, may not have gone through the initial public offering (IPO), but voluntarily provide information similar to what public companies provide to the SEC.

Both public and reporting companies must meet reporting requirements based on shareholders and assets.

Vital information about public companies

Information about public companies whose stocks or bonds are traded — on the New York Stock Exchange, American Stock Exchange, NASDAQ, or as over-the-counter (OTC) stock — is contained in the documents these public companies file with the Securities and Exchange Commission (SEC). Among the items reported:

- Financial statements
- Description of business
- Vital information about executive officers and the board of directors
- Location and character of principal properties
- Legal proceedings
- Stock options and the compensation of top executives
- Proposed offerings of securities
- Number of shareholders
- Number of employees

You can find filing for companies and mutual funds by searching the EDGAR database on the SEC's **Web site: www.sec.gov**.

Part 9: Understanding mutual funds

A mutual-fund company makes investments for people who share common financial goals; it allows a group of investors to pool their assets in a diversified portfolio of stocks, bonds, options, commodities, or money-market securities.

Diversification means that your investment risk is spread out. Because your fund buys and sells large blocks of securities, its investment costs are lower than those typically paid by an individual.

Most mutual funds are sold through brokers, banks, financial planners, or insurance agents and are known as full-service funds. Because of loads, charges, fees, and relatively slow growth, mutual funds are not good tools for short-term investing or for rapid buying or selling.

How mutual funds work

An investment company pools the money of many people and invests it in stocks, bonds, or other securities that are selected by the fund manager to achieve the fund's objectives. These holdings are called a "portfolio."

You buy shares that represent an undivided interest in the whole portfolio. The investment company attempts to earn money on the portfolio of securities and distributes the earnings to you and other investors as dividends. The dividends paid out are in proportion to the number of fund shares that you own.

You can determine the value of your shares by looking in the financial pages of larger newspapers. Find your fund's name and then look under the column marked "NAV," which shows the net asset value per share. A fund's NAV fluctuates daily as its holdings change in value.

Terms to understand before you invest

→ **Diverse portfolio**

→ **Specialized portfolio**

→ **Open-end and closed-end mutual funds**

If you purchase an open-end mutual fund, you'll be able to cash in all or part of your shares at any time and receive the current market value of your shares (this feature is called liquidity), which may be more or less than you originally invested. The open-end mutual fund provides this liquidity if you need access to your money quickly. Mutual fund companies issue shares on demand. Open-ended funds usually have diverse portfolios — that is, funds are invested in stocks, bonds, or money-market instruments, depending on the type of mutual-fund company.

Most closed-end funds have fixed numbers of shares and are on major stock exchanges. They tend to have specialized portfolios of stocks, bonds, convertibles, or combinations of these and are oriented toward income, capital gains, or a combination of these objectives. Because they have a limited number of shares, they do not issue and redeem like open-end funds. These funds have less active trading than open-end funds. Purchasers of closed-end funds can cash in their shares prior to maturity only by finding another buyer through such sources as a stock exchange, which may be difficult and time-consuming.

→ **No-load mutual funds**

"Load" refers to the sales charge paid by an investor who purchases a mutual fund. No-load funds, which are sold directly to the public, do not charge a sales load, because you make your selection of funds without the assistance or advice of a broker. Be sure to check the prospectus for hidden fees and restrictions, such as management fees and overhead expenses like 12b-1 fees for promotional expenses.

→ Front-end load vs. back-end load

When you purchase shares in a mutual fund and pay a sales charge at that time, you're paying a front-end load. This type of charge reduces the amount of money you're investing in the fund.

For example, if you're investing \$5,000 in a mutual fund with a seven percent front-end load, \$350 will go to pay the sales charge and \$4,650 will be invested in the fund. A back-end (or deferred) load is a sales charge that is deferred until you sell your shares. It usually is highest in the first year of your investment and gradually diminishes the longer you own your shares. Again, check the prospectus for hidden management fees that can range up to 1.5 percent.

Back-end-loaded funds typically have lower stated fees than front-end-loaded funds, but generally have higher fees over all. Most mutual funds sold by full-service brokerage firms are the front-end- or back-end-loaded funds, while no-load funds are available through discount firms and directly from the fund.

→ Management fees

Management fees are paid to the portfolio manager for operating the fund. Fees vary widely between funds. In fact, some no-load funds end up charging more in total fees than load funds, after management fees are added.

→ Trading within fund families

Certain families of mutual funds will allow you to move in and out of different funds within that family of funds at little or no additional cost.

How to select a mutual fund

There are thousands of mutual funds from which to choose, with a variety of investment objectives and levels of risk. If you don't know where to start, get professional guidance from a broker.

It's a good idea to talk with family members and friends who have invested in mutual funds. Find out what they did and didn't like about the fund they selected. The reference desk at your local library will refer you to directories of funds and reference books. You can also check the Internet for information but make sure you know who is offering the advice and that it is not biased toward one mutual fund from another.

Remember, when you do research, past performance doesn't necessarily represent what the future may bring. Look at trends rather than one year or two.

Understanding the three mutual-fund share classes

Mutual funds sold through a stockbroker or an insurance salesperson typically have share classes. Each class has different features that you need to understand before purchasing. Make sure you understand how the share class you choose affects your investment over your expected investment time frame.

Class A shares have a front-end load. The money you invest will be reduced by the sales charge amount. Typically, management fees are less than other share classes. These shares are usually best for longer term investing.

Class B shares have back-end load. The average B share back-end load decreases the longer you hold the shares. For example, in Year 1, there may be a 7 percent back-end load diminishing gradually — usually by a percent per year. Management fees are typically higher in B shares funds.

Other types of mutual-fund share classes, such as Class C, D, or E are not recommended for the average investor. Ask your broker to explain each class' benefits and costs.

Check with your broker and the prospectus to see if you will get a sales charge break if you invest a certain amount over a specified period of time. Sometimes funds have "price breaks" at certain purchase levels.

Part 10: Main types of mutual funds

You may get a return on your investment as your fund earns dividends and interest on the securities in its portfolio; when the market value of the securities in the fund increases, the securities are sold, and the fund distributes capital gain; or as the fund retains securities whose value has increased. Any of these can increase the value of the shares of a mutual fund.

If you sell your shares for a higher price than you bought them for, you'll experience capital gain. Many funds will reinvest dividends and distributions.

Mutual funds are not short-term investments. Frequent trading in mutual funds will result in sales commissions eating up much of your principal. If your broker recommends such action, be wary.

Stock funds

Stock funds typically offer the highest returns at higher risk than money-market or bond funds. Stock funds vary in purpose, as well. Some stock funds focus their portfolio purchases in a particular industry, such as technology or health care. Some are designed to accomplish growth or income.

Bond funds

Bond funds may have higher risks than money-market funds, but also seek to pay higher yields. There are many different types of bonds, so bond funds vary in both risks and rewards. Typically, bond funds are suitable for those seeking income and preservation of capital.

Money-market funds

Compared to other mutual funds, money-market funds have relatively low risks. Money-market funds are limited by law to high-quality, short-term investments. The money-market fund pays a fluctuating interest rate on your funds. They often are sold with check-cashing privileges.

Annuities

An annuity is a contract between you and an insurance company under which you make a lump-sum payment or series of payments. In return, the insurer agrees to make periodic payments to you beginning immediately or at a future date. Typically, annuities offer tax-deferred growth of earnings and may include a death benefit that will pay your beneficiary a guaranteed minimum amount, at least the amount of your purchase payments.

There are generally three types of annuities — **fixed, variable, and immediate**. In a fixed annuity, the insurance company guarantees that you will earn a minimum rate of interest during the time that your account is growing. The insurance company also guarantees that the periodic payments will be a guaranteed amount per dollar in your account. These periodic payments may last for a definite period, such as 20 years, or an indefinite period, such as your lifetime or the lifetime of you and your spouse.

In a variable annuity, by contrast, you can choose to invest your purchase payments from among a range of different investment options, typically mutual funds. The rate of return on your investment and the amount of the periodic payments you will eventually receive will vary depending on the performance of the investment options you have selected. Like other investments you will receive a prospectus.

With an immediate annuity you give the insurance company a specific amount of money, \$100,000, and they guarantee to pay you a specified payment for a definite period of time, such as 20 years or for your life. The amount you will receive is based on the amount on deposit with the insurance company and the length of time you will expect to receive payments. Some contracts allow for your beneficiaries to receive the remaining value of the annuity after you die.

Who can sell annuities? As mentioned previously, insurance companies, through agents, can sell annuities. Additionally, brokers, financial planners, or other financial professionals can sell annuities as long as they, and the insurance agents, are licensed to sell them.

Annuity contracts usually have a “free look” period of 10 days or more where you can terminate the contract without paying any surrender charges, and get back your purchase payments. During this time you have the right to ask questions to make sure you understand your contract annuity before the “free look” period ends.

Remember an annuity is a long-term investment with substantial surrender charges, therefore you should never invest 100 percent of your liquid assets in an annuity.

Annuity Advice

- All annuities are designed to be long-term investments to meet retirement or other long-range goals, except for immediate annuities. Annuities are not suitable for meeting short-term goals as there are substantial taxes, and insurance company charges called “surrender charges” that may apply if you withdraw the money early. And, just like other investments, variable annuities involve risks. Annuities are not usually suitable for anyone close to retirement or in retirement.
- Anyone who sells annuities is required to conduct a reasonable inquiry of your needs, goals, financial status, age, and other relevant information to determine the suitability of the annuity before recommending a purchase. Make sure you clearly understand all policy provisions, administrative fees, sub-account fees, and surrender schedules that apply to the product recommended to you. If you are purchasing a variable annuity it's important that you read and understand the prospectus — even the fine print — before you make the purchase.
- Consult a tax adviser and consider all the tax consequences in purchasing an annuity, including the effect of annuity payments on your tax status in retirement.
- If you own an annuity and want to exchange it for a different one, be careful. Regardless of whether or not your surrender period has expired on your current annuity, a new surrender period will generally begin when you exchange the old contract for the new contract. This means you could forfeit your ability to withdraw money from your account without substantial surrender charges. Make sure you understand how your insurance agent or financial adviser is paid. You will want to know all the fees and commissions before you commit.
- Other investment options, such as IRAs and employer-sponsored 401(k) plans, also may provide tax-deferred growth and other tax advantages. For most investors, it will be advantageous to make the maximum allowable contributions to IRAs and 401(k) plans before investing in an annuity.
- Above all else, never purchase any investment on the day it is offered. Give yourself time to consult with your tax adviser and attorney. Remember if it has to be purchased today, it is not worth purchasing.

Part 11: Registration of securities

Securities must be registered with the securities section in each state where they're sold, unless they're exempt or subject to a notice filing. Be aware that neither the SEC nor any state makes recommendations or offers opinions about the quality of securities being offered through the registration procedure. The primary purpose of the registration review is for regulators to analyze the offering documents or prospectus, ensuring that it contains information necessary for investors to understand the offering and evaluate its risks.

Regulators also ensure that promoters, sellers of securities, and their agents do not receive excessive commissions or related fees. You should ask your brokerage firm or investment adviser to help you gather information about a company in which you're interested in investing.

Companies with securities trading on an exchange must file "full disclosure" reports on a regular basis with the Securities and Exchange Commission. Full-disclosure reports will give you all of the fine print concerning many issues with the company and the related investment, including potential risks. These comprehensive reports are generally available online from the Securities and Exchange Commission (www.sec.gov).

Get more information

There are many sources of information about companies. You can start with the Internet, but remember to verify with other sources. If you don't know where to look, start by contacting us at 503-378-4140 or 1-866-814-9710.

Local information

Pay close attention to business and financial newspapers in your area. Often, these periodicals provide in-depth coverage about a company or a segment of an industry. Check with your local reference librarian for assistance in identifying appropriate investment-related materials.

Part 12: What you should know about the prospectus

Do you *have to* read the prospectus?

Whether you go it alone as an investor or work with a professional, the answer is YES.

It's important that you read and understand the prospectus — even the fine print. A prospectus sets forth the plan for a proposed business enterprise or the facts concerning an existing one that an investor needs to make an informed decision.

A **prospectus issued by a mutual fund** describes the history, background of managers, fund objectives, a financial statement, and other essential data. Every fund must provide a prospectus to the purchaser no later than the date of confirmation of your initial purchase. You also can call or write the fund directly, or ask your broker for a prospectus, or get it online. If you are particularly interested in one fund, go online and take a look at it; the same is true for specific stocks.

A **prospectus for a public offering** must be filed with the Securities and Exchange Commission and given to prospective buyers of the initial offering. It contains financial information and a description of a company's business history, officers, operations, pending litigation (if any), risks, and plans.

In a mutual-fund prospectus, pay close attention to the following:

- The minimum dollar amount required to open an account.
- The investment objective — make certain that the fund's objective matches your own.
- The fund's performance. Although past performance is not an indicator of future performance, if the numbers in the prospectus don't please you, find another fund.
- The fund's level of risk.
- Particular services or features of the fund, such as check writing or automatic reinvesting of dividends. Certain funds allow you to switch shares into different funds at no cost.
- The fees you'll be paying.

A close examination of a prospectus

The prospectus discussed here is for an initial public offering (IPO), although the information is relevant to reading most other prospectuses.

→ Step one:

Start with the title page. At the top of the front page, in large type, you'll find the name of the issuing company and the security being issued. You'll find important information such as the existence of a secondary market where these securities are bought and sold and information about "stock dilution."

To be certain the securities are registered with state and federal agencies as required by law, call us and the Securities Exchange Commission (SEC) or check online at www.sec.gov. If the securities are not registered, that fact should be clearly stated in the first section of the prospectus, with an explanation of the exemption the issuer is claiming. However, "covered securities," those that meet specific federal regulation requirements, do not have to register with the state. We will have no information on them.

→ Step two:

Read the summary section. This section summarizes the information most likely to affect an investor's decision. Read this section with great care and write down questions. If these questions aren't answered to your satisfaction by the time you finish reviewing the prospectus, ask your broker for clarification.

The summary reviews the main features of the issue, then reviews company operations, including the most significant financial data taken from complete financial statements, which you'll find at the end of the prospectus. This data typically includes sales, gross income, net income, and earnings per share.

The summary isn't intended to replace the full text of the prospectus. Rather, it'll help you understand what the securities offering represents and enable you to ask important questions as you read through the full document.

→ Step three:

Look at the information in groups. The following information is included in virtually all prospectuses, though not necessarily in the order presented. Pay close attention to the following:

→ **Competition.** Heavy competition by established companies will make your investment more risky.

→ **Human resources.** This will tell you about the number and types of employees in the company. Watch for a collective bargaining agreement coming to an end or a history of strikes or poor labor relations.

→ **Management.** Study the section describing the management staff and their qualifications. The success or failure of the company depends heavily on management, so the prospectus devotes a considerable amount of space to information about directors and officers: experience, education, ages, histories with this or previous companies, pay, and other compensation.

→ **Activities.** Find out what the company does or makes, and its operations, including how it was incorporated, subsidiaries, real estate that it owns, and legal proceedings in which it is involved.

→ **Customer base.** Use this information to assess the size and availability of the marketplace for the company's products or services. If a key customer finds a new supplier or goes out of business, the effects on the company may be disastrous.

→ Step four:

Establish what securities are offered to you. Don't confuse the success of the company with the value of the securities being offered to you as an investor. Carefully examine the characteristics of the securities being offered.

- Read through the section describing investor rights. This section takes on added importance when the securities involve complex units, employee purchase plans, or warrants. If you don't understand how this section affects you, ask your broker.
- Read through the section explaining how the company intends to use the proceeds from the offering.
- Review the section covering "dilution." When a company issues additional shares of a security, it reduces — or dilutes — the value of shares. This can mean a reduction of your voting power if shares are not issued proportionately to the holdings of existing shareholders. It may be a financial reduction if shares are issued disproportionately and the price at which the new shares are issued is less than the market or book value of outstanding shares.

→ Step five:

Study risk factors. All IPOs are required to have a section about the offering's risk factors. These are the risks that you, the investor, will take, so read such sections carefully. Risk factors include the price or availability of raw materials, a high debt ratio, competition, lack of experience in the business, etc.

→ Step six:

Establish the company's financial situation. These sections describe the company's financial picture. If you're not familiar with reading and analyzing this type of data and the accompanying comments by the accountants, you should consider talking to your own accountant.

- The **financial statements** you'll find in the prospectus include the income statement, the cash flow statement, the statement of changes in financial position for the company's recent years of operations, and the balance sheet. The prospectus also will include an explanation and analysis by management of previous years' financial results.
- The **statement of dividends** paid during the previous five years may help you assess the company's growth rate and potential. If you're investing for the dividend return, pay close attention to the dividend history of the company. Nonpayment of dividends, however, doesn't indicate a poor financial status, because management may have reinvested the money in the company.
- **Price-earnings ratio (P/E)** is a popular way to compare stocks selling at various price levels. The P/E ratio is the current price of a share of stock divided by the earnings per share of the issuing firm for a 12-month period. For example, a stock selling for \$50 a share and earning \$5 a share is said to be selling at a price-earnings ratio of 10.

Part 13: Small-business investments

States have relaxed laws to make small-business start-ups easier. Many investors view start-ups as an opportunity to “get in on the ground floor” of an emerging business and to “hit it big” as these small businesses grow into large ones. Statistically, however, most small businesses fail within the first few years. Small-business investments are among the most risky for investors.

A basic principle of investing in a small business: **Never make a small-business investment that you can’t afford to lose.** Never use funds needed for other purposes, such as college education, retirement, loan repayment, or medical expenses. Instead, use funds that would otherwise be used for a consumer purchase, such as a vacation or a down payment on a boat or RV.

Above all, **never let a commissioned securities salesperson or officer or director of a company convince you that the investment isn’t risky.** Small-business investments are generally illiquid, that is, hard to convert to cash — even though freely transferable, because there’s no secondary market on which they’re traded, and trading may be restricted. You usually won’t be able to sell your securities if the company takes a turn for the worse.

Read the prospectus or offering circular or ask to see the business plan and financial information. Also, just because the state has registered the offering doesn’t mean that the particular investment will be successful. The state doesn’t evaluate or endorse investments. If anyone suggests otherwise, it’s untrue and is a violation of Oregon securities law.

If you plan to invest a large amount of money in a small business, you should consider investing smaller amounts in several small businesses. A few highly successful investments can offset the unsuccessful ones. However, even when using this strategy, only invest money you can afford to lose.

Analyzing the investment

Although there’s no magic formula for making successful investment decisions, certain factors are considered important by professional venture capitalists. Some questions to consider:

1. How long has the company been in business? If it’s a start-up with a brief operating history, are you being asked to pay more than the shares are worth?
2. Consider whether management is dealing unfairly with investors by taking salaries or benefits too large for the company’s stage of development, or by retaining an inordinate percentage of the equity stock of the company compared with the amount investors will receive. For example, is the public putting up 80 percent of the money, but receiving only 10 percent of the company shares?
3. How much experience does management have in the industry and in a small business? How successful were the managers in previous businesses?
4. Do you know enough about the industry to evaluate the company and make a wise investment?
5. Does the company have a realistic marketing plan and does it have the resources to market the product or service successfully?
6. How or when will you get a return on your investment?
7. Is the stock restricted (“144”) stock — which means it is subject to resale restrictions or is it freely tradable?

Making money on your investment

The two classic methods of making money on an investment in a small business are resale of stock in the public securities markets following a public offering and receiving cash or marketable securities in a merger or other acquisition of the company.

Many start-up companies offer the potential of going public or merging with a public company as an inducement to investors. The opportunity of going public depends on many factors outside the control of the small business and should not be given a great deal of weight in your investment decisions.

If the company is not likely to go public or be sold within a reasonable time (i.e., a family-owned or closely held corporation), it may not be a good investment for you — despite its prospects for success — because of the lack of opportunity to cash in on the investment. Management of a successful private company may receive a good return indefinitely through salaries and bonuses, but it's unlikely that there will be profits sufficient to pay dividends proportionate to the risk of the investment.

Other suggestions

Even the best small-business-venture offerings are highly risky. If you have a nagging sense of doubt, there's probably a good reason for it. Good investments are based on sound business criteria. If you aren't entirely comfortable, the best approach is not to invest. Don't let a securities salesperson pressure you into making a bad decision.

It's a good idea to meet management of the company face to face to size them up. Focus on experience and track record rather than a smooth sales presentation. If possible, take along a sophisticated business person to help you analyze the offering.

Beware of information from company representatives that differs from or isn't included in the disclosure document.

Part 14: Liquidity

Pay attention to the liquidity of the securities you purchase. Liquidity refers to the ease of converting your securities into cash.

Some securities, such as stock for which a market exists, can be quickly converted to cash. Other securities, such as limited partnerships or long-term certificates of deposit, involve commitments of five to 10 years. Because there may be no secondary market on which the interests can be sold, conversion into cash may be difficult — or impossible — before the partnership expires.

Part 15: Protecting yourself against fraud

In today's complex financial world, there are many investment opportunities awaiting you. As an investor, your task is to identify those investments with the greatest potential while meeting your personal investment goals. You may be solicited by phone calls, e-mail, postal mailings, or even door-to-door salespeople. Most investment scams begin on the phone or by e-mail. Be prepared to deal with investment scam artists.

Before you send money to anyone, investigate the company making the recommendation, the salesperson, and the investment opportunity by asking questions and checking references. Begin by contacting the appropriate regulatory agencies.

Know which kinds of securities are most often fraudulent. Know that you're susceptible to scams and be ready. Have a set of questions to ask callers. (See Page 13 to get our free publication, "When Your Broker Calls, Take Notes.") Being prepared allows you to assert yourself and helps you detect offerings that sound too good to be true and callers who are suspiciously resistant to your questions.

The best way to avoid becoming a victim of fraud is to carefully select your broker and salesperson. (See "Choosing a broker," Page 8.)

In addition, make sure you thoroughly understand the investment and its risks before you invest. Be informed and certain of what you're buying and who you're buying from before you invest.

Techniques typically used by crooks

- The promise of spectacular profits. An offer that sounds too good to be true probably is too good to be true.
- High-pressure sales tactics such as advising you to "act now."
- Insistence on immediate decisions.
- A guaranteed investment or an investment without risk.
- Offering a "free lunch" or "free dessert" seminar.
- Recommendations based on rumors, tips, inside information, or an unannounced breakthrough.
- Recommendations based on the caller's ability to predict future events.
- Suggestion that you liquidate all your current investments and reinvest your money in products they are selling with a promise of better returns.
- A request for your credit card number for any purpose other than to make a purchase. Requests are typically made for "identification" or "verification" purposes, or as an "expression of good faith."
- Unwillingness to provide written information, state securities registrations, or verifiable references.
- A suggestion that you invest on the basis of trust.
- Using "bait and switch" tactics by initially offering one investment product and then switching it to a riskier investment.
- Getting approached by someone who may be a member of a community, hobby, or faith group or pretend to be a member in order to gain trust.
- Investment opportunities in another country or that are dependent on the participation of a bank in another country.
- Unwillingness to let you discuss the investment with a third person.
- Sending a courier or overnight package service to pick up your check.

Commissions and churning

Most securities salespeople are paid on commission, which is not a fraudulent practice. However, the potential for fraud exists when a broker's livelihood is based on selling investments to clients. If a broker's earnings are based on sales commissions or mark-ups, the more buying and selling a broker does for each customer, the higher his or her income.

Salespeople's pay isn't based on their ability to earn profit for clients; it's based on their ability to sell. Watch out for end-of-the-month selling, which may indicate the broker is trying to pad his or her own monthly income at the expense of your goals.

Unnecessary buying and selling to earn commissions is called "churning."

For example, if your broker suggested a mutual fund in April and in July suggested another fund to replace the original one, this would be considered churning unless some drastic change in the market required the transfer. Mutual funds are considered long-term investments and shouldn't need to be "replaced" within a matter of months. Churning is prohibited by Oregon securities law, the Securities and Exchange Commission rules, and FINRA rules.

If you suspect that certain recommendations have been unsuitable or that your account is being churned, immediately contact us or the FINRA.

How to deal with phone sales calls

Much fraud is committed by phone, so it's a good practice to hang up as soon as you realize you're being solicited to buy something by somebody other than your broker. Don't worry about being rude; these callers are interrupting your life for their own profit.

When you're contacted by phone or in person to make an investment and you are interested in what the person is saying, use DFCS' publication, "When Your Broker Calls, Take Notes," or ask the following questions and write down the responses:

- What is your name and phone number and what firm do you work for?
- How did you get my name?
- Where is your office located?
- How long has your firm been in business?
- Are you and your firm licensed with DFCS to sell this investment?
- Is the investment registered with DFCS?
- What are the risks of this investment?
- Can you send me an offering document or prospectus that explains the details of this investment?
- How do I liquidate this investment, and how long will it take?
- Would you explain this investment to a third party, such as my attorney, accountant, investment adviser, or banker?
- Can you tell me the names of your firm's principals and officers?

- Can you provide references?
- Are these investments traded on a regulated exchange, such as securities or futures exchanges?
- What governmental or industry regulatory supervision is your firm subject to?
- How much of my money would go to commissions, management fees, and the like?
- If disputes should arise, how will they be resolved?

Remember: A skillful presenter will have answers to all of your questions. It's your responsibility to verify the answers you get.

Types of investment scams

Con artists work hard to take money from their victims. They're smooth, so be smart. Trust your initial reaction. It's always better to ask questions than to remain silent and regret it later.

One of the best ways to become educated on investment scams is to "follow the headlines." News stories on new technology or rising prices for commodities such as oil and gas usually bring out the fraudsters. The following are some of the best-known fraudulent investment types:

- **Agriculture and livestock** — For a fee, you can invest in pairs of animals for breeding, with the goal of profiting from the selling of the eggs or offspring to zoos, other ranchers, etc. Typically, the fee you pay is said to be for boarding and care of the animals. However, the profits may never materialize, and the investment may not exist. These schemes often include "buy-back" or repurchase agreements, giving the impression that you can't lose. You can.
- **"Boiler rooms"** — Those calls you get at dinnertime that offer immediate investments in "get-rich-quick" schemes are from boiler rooms. The name comes from the heat and high pressure generated by callers as they try to convince you to part with your money. Boiler rooms may be apartments or offices with multiple phone lines and impressive-sounding addresses, sometimes in another state. In many cases, neither the company nor the product exists or operates as represented. Phone pitches are read from prepared scripts that contain answers to the most common objections. Boiler-room callers get phone numbers from directories, lists, or newspaper articles. Boiler-room operators have been known to prey on the bereaved and those who have lost large sums of money. They offer to help recover losses quickly and effortlessly. They usually can't or won't.
- **"Pump-and-dump" stock schemes** — Scam artists continue to take advantage of technology to lure investors into "pump-and-dump" schemes. In these schemes, scam artists tout company stocks through unsolicited e-mails, phone calls, or faxes, and phony Web sites. Unwitting investors purchase the stock in droves, creating high price demand and pumping up the price. But when the fraudsters behind the scheme sell their shares at the peak and stop aggressively selling the stock, the price plummets, and investors lose their money.
- **Affinity Fraud** — Con artists target religious, ethnic, cultural, and professional groups. Some may be members of the group or pretend to be members in order to gain trust. Con artists often recruit a respected member of a community or religious congregation to promote their schemes by convincing them that a fraudulent investment is legitimate.

- **Prime bank schemes** — Often promising high-yield, tax-free returns, promoters of these schemes offer to let the “little guy” in on what they claim are financial instruments from elite overseas banks usually offered only to the world’s wealthiest investors. Prime banks do not exist and the scam artists have no intention of creating a profit for anyone but themselves.
- **Investment seminars** — Promoters of investments that are unsuitable due to age or financial situation seek potential investors, particularly seniors, by offering seminars, many of them promising a free meal along with “higher returns and little or no risk.” These seminars commonly pitch real estate investments or annuities. Unfortunately, in many cases that securities regulators see, the investment delivers just the opposite of what the seminars promise: high risk, no returns, and disastrous losses. Remember, those in the 65+ age group probably need individual attention when it comes to investments rather than a seminar.
- **Coins and precious metal schemes** — Promoters offer “investment-grade” gold and silver coins, claiming that their value can be verified and promising tremendous profits, usually based on some current event or political occurrence. For the cost of your investment and a storage fee, the promoter will purchase the metals for you and have them delivered to and stored in a large, “well-known” — usually distant — bank. Promoters may offer to “leverage” your purchase. (Leveraging is like buying on margin, in that you make only a down payment on the total. The rest of the money is advanced or loaned to you, with the precious metal serving as collateral.) Some such schemes charge extremely high commissions, which are seldom apparent on your invoice; your investment would have to achieve great increases before you’d see any profit. Others never purchase the coins or metals; the promoters just take your money and move on to the next town.
- **Gold and silver mines** — These speculative investments typically offer new or secret methods for extracting minerals from untested or abandoned mines or from soil in your geographic area “where no one else would think to look!” These are classic frauds. Often, the promoter bases a mining forecast on an “expert’s” geological report or prediction or uses part of a valid report. Promoters exaggerate the quality and quantity of the minerals to be extracted while downplaying the expense or likelihood of recovering them.
- **Prime bank notes** — Promoters offer the “little guy” a chance to pool money with other investors to buy international bank notes, often touting a large foreign bank as instrumental in the deal. Investments range from a few thousand dollars to \$100,000 or more. Returns of fantastic wealth are promised, often in the \$100 million range. Details about how the program works are either unavailable or, when examined closely, nonsensical. Many such programs require investors not to discuss the deal with third parties.
- **Oil and gas wells** — Investors are promised “can’t-miss opportunities” for great wealth through interests in a “proven” oil field or an oil field in the vicinity of proven oil fields. These investments are frequently sold to people who live far from the oil company’s headquarters, which may be nothing more than a rented trailer. Promoters frequently offer new and secret methods for extracting oil from previously drilled oil fields. These schemes become more common during times of high fuel costs.

- **Ponzi schemes** — Promoters offer high rates of return on various impressive-sounding investments; however, promoters use the money of new investors to pay “interest” or “return” to earlier investors. These earlier investors then serve as word-of-mouth advertisers for the promoters, reporting the high returns to their friends, who also invest. But in a Ponzi scheme, there really is no business. Such schemes continue only as long as new investors provide additional funds. When the scheme collapses (as it always does), current investors lose their money and the promoters walk away rich.
- **Pyramid promotions** — Pyramid promotions focus on the quick profits to be earned from recruiting other investors, who recruit others, and so on. Little emphasis is placed on the product or service to be sold. A pyramid scheme is a classic example of a Ponzi. Pyramid schemes are illegal in Oregon, but are difficult to prosecute. Victims’ money is often filtered up through the pyramid and lost.

Common elements of a pyramid scheme:

- An invitation from a friend, neighbor, or co-worker to attend an “opportunity meeting” to learn how to earn lots of money.
- A well-rehearsed presentation that offers an exciting shortcut to wealth and adventure.
- Hefty fees for products, courses, etc., or for the right to recruit others and profit from their participation.
- An emphasis on recruiting others.

Mortgages and trust deeds — This type of transaction involves loaning money to someone who wishes to purchase or refinance real estate. The investor counts on receiving interest payments as the return on the investment, and expects to receive the title to the property if the borrower defaults. More often than not, the borrower is unable to repay the loan. The investor may discover that the property’s value does not cover the investment or that the deed wasn’t recorded in the investor’s name.

Real estate investment contracts — Despite the recent decline in property values, investments in real estate long have been viewed as a “sure thing” with little downside risk and the potential for substantial returns. Some real estate investments are securities that are subject to full regulation under state and federal securities laws, including registration requirements and antifraud rules. Just because an investment involves real estate it still may involve a security — check with us to make sure it is registered.

Foreign exchange trading — Foreign exchange (forex) trading can be legitimate for governments and businesses concerned about fluctuations in international currencies, and it even can be appropriate for some individual investors. But the average investor should be wary when it comes to these complex markets. Forex scams attract customers with sophisticated-sounding offers placed in newspaper advertisements, radio promotions, or on Internet sites.

Part 16: Resolving problems or filing complaints

Regardless of how careful you are in selecting a broker, problems may still occur. Contact your broker at the first sign of trouble and tell him or her your concerns orally and in writing. Ask your broker for a written reply that explains how your problem has been — or will be — handled. You also should file a copy of your written document with the manager of the broker's firm. Each firm should have a compliance officer to whom you may voice your concerns. **The speed with which you act may be crucial.**

Record-keeping

It's wise to keep copies of complaint letters you send and the responses you receive. These documents can be of great benefit to you later. Keep these in your investment file with monthly account statements, your copies of offering materials, and trade confirmations.

Legal counsel

Consider consulting a lawyer for help resolving a securities dispute. While we and FINRA may investigate for violations of securities laws and rules, neither of these organizations will function as a collection agency. In other words, when a broker is sanctioned for a violation, the broker isn't necessarily forced to repay money you've lost. Sometimes, the only way for you to recover your investment is through a lawsuit or arbitration. See Page 38 for Web sites for the Oregon Bar Association and the Public Investors Arbitration Bar Association.

Customer-complaint investigations

Investors who think they've been unfairly treated or been the subject of abusive sales practices by securities professionals should take immediate action. **Contact your broker at the first sign of trouble. Ask your broker for a written reply that explains the handling of your problem. If the salesperson isn't responsive to your concerns, report your concerns to the compliance officer at the firm.**

If you aren't satisfied with the result, or if this process takes more than two weeks, you should also contact FINRA and us.

Although your initial contact may be over the phone, you'll be asked to document your complaint, and you should be prepared with facts about your investment, including dates, amounts, and types of securities. Often, your account statements or other documentation will need to be attached to your written complaint.

Consult with legal counsel first if your losses are substantial.

Please see Part 17 - Where to go for help - on Page 37 for organization names and contact information for attorney referral and arbitration information.

FINRA's customer-complaint programs

FINRA regulates the business conduct of its member broker-dealers. Virtually all brokerage firms registered in the U.S. to do business with the public are members of FINRA and are regulated by it. FINRA has regulatory responsibilities in the following areas:

- Formulation of rules governing business and sales practices of its members and their sales representatives.
- Review for fair dealing by members with customers.
- Investigation of violations and enforcement of securities laws and self-regulatory rules by member firms and sales representatives.
- Testing, registration, and licensing of security-industry professionals.
- Review of advertising and sales literature used by members.
- Examination of firms' office practices and financial records.
- The imposition of disciplinary sanctions.

Investigation processes by DFCS and FINRA

Both DFCS and FINRA have authority to conduct investigations involving brokers doing business in Oregon or with Oregon investors. Staff investigators usually begin by requesting information and documents from member firms and their employees. They contact the investor for additional information and to verify facts. Oregon securities law requires brokers and their employees to cooperate in investigations.

Similarly, the FINRA *Rules of Fair Practice*, which govern member firms, require brokers and their employees to cooperate with FINRA investigations.

While it's impossible to predict the outcome of an investigation or the time it may take, it's important that you communicate your concerns. In many instances, no violation of rules or regulations is found. In other cases, your complaint may be one in a series of similar complaints that indicates the need for immediate regulatory action. You also may be referred to another agency or regulatory body for more assistance.

Finally, you should be aware that DFCS and FINRA are regulatory agencies and can't represent you in legal disputes. If you're seeking to recover lost investment funds or want to file a private civil action, you should consult a lawyer.

Arbitration and mediation of disputes

Most customer agreements with a securities broker/dealer include an "arbitration clause" that requires arbitration if you have a dispute over your rights or liabilities under the agreement. Even if securities laws have been violated, this provision will almost always prevent you from filing a lawsuit in a state or federal court. Instead, you will be required to take your complaint to binding arbitration.

There is no requirement that an investor must sign an agreement that requires arbitration of disputes; if you don't, however, you will find it almost impossible to find a broker/dealer who will do business with you. You may ask that the arbitration requirement be removed from the agreement. In the event of a dispute, however, arbitration may be faster and less expensive than the courts.

What is arbitration?

Arbitration is a dispute-resolution process in which a neutral third person — the arbitrator — makes a decision after a hearing at which both parties have an opportunity to present their case. Arbitration begins when you file a claim and pay a filing fee with an arbitration service.

Arbitration is not part of the court system. Although it is controversial, it may be a faster and less-expensive alternative to filing a lawsuit. Because arbitration is binding and is subject to court review on a very limited basis, an investor should seek legal advice before agreeing to arbitration.

There are few formal rules governing either procedure or evidence at an arbitration hearing. Hearings, at which both sides present evidence, seldom last more than a day or two; however, the entire arbitration process may take months or years. And don't be misled into thinking arbitration is informal, like small-claims court. Brokerage firms are always represented by their attorneys at arbitration hearings. If you pursue arbitration, you will want to be represented by an experienced securities attorney.

Cases may be heard by a single arbitrator or a panel of three arbitrators. The size of the panel depends upon the amount of the claim. During the proceeding, the arbitrator will hold a hearing, listen to oral testimony, review the evidence, and render a decision.

Arbitration hearings can be held at almost any location convenient to the parties. Arbitrators are usually required to make a decision in 30 business days. For small claims (less than \$10,000), you may request that the case be decided based solely on the submission of evidence presented.

Arbitrators are not required to provide reasons for their decisions. As a result, an investor can lose a decision with little or no explanation and cannot appeal to the court system for relief.

Remember: The arbitration procedure is final and binding, subject to review by a court only on a very limited basis.

Usually, the organization having jurisdiction over your dispute is named in the arbitration clause in your brokerage agreement.

What is mediation?

Mediation is an informal alternative to arbitration. In the mediation process, a neutral third person — the mediator — helps disputing parties reach an agreement. Unlike an arbitrator, the mediator has no power to impose a decision on the parties, i.e., it is not binding. If a settlement cannot be reached in mediation, the parties move on to binding arbitration or to the courts.

FINRA offers investors the option of voluntary mediation to settle disputes with firms or brokers. Mediation may result in settlements within weeks.

Part 17: Where to go for help

Oregon Division of Finance and Corporate Securities

For any of the following:

- Find out the licensing status of a broker, adviser, or the investment firm.
- See if securities are registered.
- Find out the disciplinary history and employment history of the salesperson or firm.
- See if complaints similar to yours have been filed against the salesperson or firm.
- To file a complaint.
- To get free publications about investing or to find a speaker knowledgeable about investing.

Telephone: 503-378-4140 or 1-866-814-9710 (toll-free)
E-mail: dcbs.dfcsmail@state.or.us
Web address: www.dfcs.oregon.gov
Address: Division of Finance and Corporate Securities
350 Winter Street NE, Room 410
P.O. Box 14480
Salem OR 97309

Securities and Exchange Commission

- To find out about civil enforcement actions against companies or individuals.
- To view the EDGAR database of disclosure documents that companies are required to file.
- To find out about online investing.
- To file a complaint.

Telephone: 800-SEC-0330 (toll-free investor information)
Hours: Monday-Friday, 9:00 a.m. - 5:30 p.m. Eastern Standard Time
Fax: 202-772-9295
Web address: www.sec.gov
Address: Securities and Exchange Commission
450 Fifth St. NW
Washington, DC 20549-0213

SEC San Francisco Regional Office

Telephone: 415-705-2500
Address: 44 Montgomery Street, Suite 2600
San Francisco, CA 94104

Oregon Department of Justice — Financial Fraud Unit

→ To find out if a company has complaints filed against it or to file a complaint.

Consumer Protection Hotline:

Hours: 8:30 a.m. to 4:30 p.m.

Telephone: 1-877-877-9392 (toll-free in Oregon)

503-378-4320

503-378-4732

Web address: www.doj.state.or.us/

Mailing Address: 1162 Court St.
Salem, OR 97301

Physical Address: 340 Vista Ave SE
Salem, OR 97302

Oregon State Bar Lawyer Referral Service

→ To find a lawyer.

Oregon State Bar Center

Web address: www.osbar.org/

Telephone: 503-864-3763 (Portland area);

1-800-452-7636

Address: P.O. Box 231935
Tigard, OR 97281-1935

Financial Industry Regulatory Authority (FINRA)

For information on the following:

- Final disciplinary actions and criminal convictions involving firms, brokers, and individuals registered with FINRA.
- Civil judgments involving securities matters.
- Pending formal disciplinary proceedings initiated by the Securities and Exchange Commission, FINRA, other self-regulatory organizations, and individual states.
- Criminal indictments and related information reported by the securities industry and the U.S. Department of Justice.
- FINRA arbitration decisions involving public customer claims dealing with securities matters.

Telephone: 1-800-289-9999

206-624-0790

Web address: www.finra.org/

Address: 2 Union Square
601 Union St., Suite 1616
Seattle, WA 98101-2327

FINRA Dispute Resolution

→ For securities arbitration hearings and information.

Telephone: 212-858-4200
Web address: www.finra.org/
Address: One Liberty Plaza
165 Broadway, 27th Floor
New York, NY 10006

American Arbitration Association

→ For securities arbitration hearings and information.

Telephone: 1-800-778-7879
Web Address: www.adr.org/
Address: Corporate Headquarters
1633 Broadway, 10th Floor
New York, NY 10019

Seattle District Office

Telephone: 206-622-6435
Address: 701 Pike Street, Suite 950
Seattle WA 98101

Municipal Securities Rulemaking Board

→ For municipal securities arbitration hearings.

Telephone: 703-797-6600
Address: 1900 Duke Street, Suite 600
Alexandria, VA 22314

Public Investors Arbitration Bar Association (PIABA)

→ For attorneys who represent investors in arbitration.

Telephone: 1-888-621-7484
Web Address: www.piaba.org/
Address: 2415 A Wilcox Drive
Norman OK 73069

Notes:



This publication is brought to you by the
Oregon Department of Consumer and Business Services

Division of Finance and Corporate Securities
Investor Information Program

350 Winter St. NE, Room 410

P.O. Box 14480

Salem, OR 97309

503-378-4140

1-866-814-9710 (toll-free)

www.oregondfcs.org