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Investing: Lessons from the FTX Implosion

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“I'm shocked, shocked to find that gambling is going on in here." -- Louis from Casablanca

We might be years away from knowing what really happened with FTX and its founder, Sam Bankman-Fried.

What we do know is that Bankman-Fried is in jail and a bunch of people have lost a bunch of money. FTX, the collapsed cryptocurrency exchange, was founded in 2019 and collapsed late last year.

Unfortunately, FTX is a familiar story of greed. It got me thinking about the dot-com crash in 2001, the Enron scandal in 2001, the collapse of Bernie Madoff in 2008 and the meme-stock bubble in 2021, I keep thinking it’s time to remind ourselves a few things about investing.

1) Make sure you can trust the integrity of the people you are investing with. This should go without saying, but just because someone is getting a lot of press and has a great presentation does not mean you should invest with them. What is their history? Are they surrounded by trustworthy advisers? Do they have good business governance practices? If you aren’t comfortable with the integrity of the leaders, then it doesn’t matter if they have ridiculous returns – run away!

2) What is your level of knowledge about the investment? I don’t mean to suggest you have to be an expert in order to make an investment – following that logic, nobody could buy a car unless they knew how the engine worked. However, if you don’t understand what the company makes and how it is used, consider investing in a fund or something else.

3) Is the company’s market value reasonable? Most of the meme-stocks were good, solid companies, making products or providing services that we can understand. That also was true of many of the dot-com companies in 2000. However, speculators drove the stocks so high that every penny of potential profit for the next 100 years was already priced into the stock.

4) What is your personal risk tolerance. and what does this money mean to you? I have several clients who tell me (usually with a nice grin) they’ve invested in some form of crypto and have done well, and generally took at least their initial investment off the table as prices rose. These clients are wealthy and did not use core retirement or similar funds

for these investments. For them, it was the equivalent of setting aside an amount of money when going to a casino. In fact, the grin on their faces was very similar to that of the rare person who says they went to a casino and made money. They were gambling on crypto and it paid off.

About a year ago, a client mentioned that several employees were asking about the possibility of investing their 401(k) in crypto. I cringed in reply, telling him I don't know if that is legally possible, but even if it is, the company shouldn't allow it. They are speculating on highly volatile products, and I don't believe there is a place for that in a retirement plan.

I personally don't understand cryptocurrency and will leave that speculation to people who do. I don't seem to have any trouble paying for products or services using U.S .dollars, whether that is cash, bank transfers, credit cards or one of the phone payment apps, so I don't grasp the need for a different currency.

When I ask others about it, the response seems to be about privacy and the fact that transactions can't be traced. In other words, while you obviously can use crypto to pay for many legitimate products and services, their primary purpose (or competitive advantage) is to facilitate ransom payments and other criminal enterprises or to keep the government from knowing what people are doing (tax avoidance?). Looking back at the integrity item described in point 1 above, are we really surprised that someone in this industry was taking advantage of investors?

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