

## Be Wary Of Penny Stocks

This warning goes out to newbie investors, and more times than not, it falls on deaf ears. But I'll repeat it one more time just for posterity's sake: if you're new to investing, be very careful of making investments in penny stocks. You will undoubtedly be very attracted by the potential returns due to the deflated share prices, but keep in mind that things are usually not what they seem to be, and sometimes penny stocks really are "too good to be true."

Why do pennies pose such a risk? In a word: reporting. Or more accurately, lack of reporting. Since Over the Counter (OTC) stocks are not listed on any exchange, they don't have to follow the stringent reporting criteria which we've all become accustomed to for major exchange traded stocks. What this means is that these companies generally offer very little financial guidance, and tend to rely much more on hype than exchange traded stocks.

Penny stocks usually have very small floats (the amount of shares actively traded) and for this reason, coupled with thin capitalization, the stocks can be manipulated quite easily by several buyers or sellers, and some news or rumors. Many penny stock companies use spam email to promote their products. They send out to large groups of internet users who end up becoming interested in the stocks. As the emailed people start buying, the price goes up, and the investment starts to look like a great deal. At this point, the pump and dumpers will start selling all the shares they can, and the investment will come back down to Earth. The pump and dumpers make the money, and the investors who come in later are left holding the bag.

These pump and dump schemes are extremely common, and penny stocks are almost always what are used for the promotion. Particularly vulnerable to this ruse are small and new investors who have tiny amounts of capital. Most of these types of investors want to accumulate a large amount of shares with the hopes of turning a meager \$200-\$500 investment into a retirement nest egg. Most end up losing their capital.

These warnings might seem obvious, but it's amazing how often people lose their head when dealing stocks. Most people feel that the number of shares is their best chance for making profits. They feel if they can buy 100,000 stocks for 0.001 that somehow they'll get rich if only the stock hits 1 cent! This is true, of course, but almost never happens. Most stocks that sell for fractional pennies are more likely to stay in that neighborhood rather than to rocket to even \$10.

Remember that the only metric you need concern yourself with as it relates to investing is total returns. The higher your percentage return, the more money you have. You will never end up concerning yourself with share price if you are a studious investor. It's meaningless in the final analysis. For savvy investors who do a ton of research, finding a bargain in the penny stock heap is possible. Once you've done a few trades of "normal stocks" give it a try, but lay off the pennies until you have a very good understanding of what makes share price move.

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### About the Author

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