



Investment Insights

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Lessons from Enron

The recent implosion of Enron Corporation has made headlines for months. By now, everyone is aware of the headline-grabbing subplots: politically-connected executives, accusations of massive accounting fraud, billions of dollars lost by investors and employees, and hearings on Capitol Hill to try to place the blame on someone for this huge scandal. Right now, the press and politicians are focused on the details of this case, and are trying to find solutions to the problems caused by Enron's deceit when it is likely that no good solutions exist. Investors have lost almost \$60 billion with the decline in Enron stock, and the majority of that money is probably gone forever, even if Enron executives and Enron's accountants, Arthur Anderson LLP, are forced to pay tens of millions of dollars in penalties. Talk of giving jail time to parties who are found guilty of fraud in the case is just, but what does that do to restore any of the \$60 billion that has been lost? Overlooked in the saga may be the most important issue of all for the future: what can we learn from this costly and potentially criminal event? Here are two major lessons that the Enron case has emphasized.

Lesson number one: diversify your investments! Enron was #7 on the year 2000 list of Fortune's Top 500 Companies as ranked by revenue, ahead of IBM, AT&T, and Bank of America, to name a few well-known companies. This should give a clear signal that no one is "too big to fail". Enron was not a small, upstart internet company. This was a company that controlled almost 20% of all energy trading in the United States last year. If you still have a substantial portion of your investment dollars in one company's stock, think hard about what the Enron downfall did to the fortunes of thousands of investors. How would this effect your financial situation? If the answer is "I would be devastated", diversify now. Pick up the phone, call your advisor, and set up a plan to systematically move assets from your big holdings into other assets that will minimize your risk. The time to do this is before disaster strikes, when your holdings still have value. Buying earthquake insurance the day after the earthquake is pointless—with stock prices under a dollar per share today, diversifying out of your large Enron holdings would also be pointless.

Lesson number two: if you work at a company, and your paycheck depends on that company's financial well-being, don't compound the risk by putting your investment dollars into that same company's stock. The hardest-hit Enron employees were the ones

who not only lost their jobs and income, but also had a large part of their 401(k) assets in Enron stock. If your company offers their own shares as an investment option in your 401(k) account, choose that only for a small portion of your overall portfolio, and diversify the remainder into the various investment accounts they are likely to offer. With Enron's 401(k) plan, only company matching contributions had to be in company stock—the employee contributions could be invested in a variety of funds and fixed accounts. The retirees who have shared with Congress their gut-wrenching stories of how they lost their entire retirement savings did so voluntarily. They could have easily directed their contributions into other options! Again, no matter how well your company is doing, and no matter what the person sitting next to you at work is telling you about how the company stock is going up and up, don't fall into this trap—diversify!

Much like everyone, I, too, hope that there is a thorough and productive investigation into the events surrounding the downfall of Enron. The level of apparent fraud and deception that took place cannot be allowed to happen again. However, the ultimate value of this whole debacle should be to make ourselves better investors so that if this situation ever happens again, it won't be one of us testifying in front of Congress about how we lost our life savings.

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