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Key money lessons for Rahul Dravid

As returns go up, the risk goes up too—a basic investing rule that many investors forget. Promises of very high returns should raise red flags in any investor’s mind

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Former Indian cricketer Rahul Dravid. Photo: Reuters

Who doesn't want to earn higher returns? Every rational person would want the highest possible returns. But every rational person must also realise that high returns come with higher risk. Former Indian cricket captain and now coach of the under-19 Indian cricket team Rahul Dravid, discovered risk in his high-return portfolio. He recently lodged a complaint against Vikram Investment Company for cheating him of Rs4 crore. According to reports, the

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company had promised him a 40% return on investment. The company, Vikram Investments, has allegedly lured high-net worth investors with offers of 40-50% annual returns on their principal.

Dravid should have paused at this number itself. A 40-50%-guaranteed return is a red flag. No wealth management company or financial planner can assure such a return. “Usually, it’s not possible to get such a return. The thumb rule should be: as your returns go up, no matter who is saying what, the risk has to go up,” said Abhay Aima, group head-equities, private banking, third-party products, NRI and international consumer business, HDFC Bank Ltd.

Entrapment

Why then do sane and rational people fall into this trap? Financial planners and wealth managers attribute it to three deadly sins of money—gullibility, ignorance, and greed. Experts say that most people are extremely gullible. “Sometimes, the person selling is a good salesperson. It could also be because you blindly trusted someone without checking details and verifying authenticity. This usually happens when you have heard of a product from someone who has had a good experience,” said Aima. He explained how in a ponzi scheme an initial set of people make high returns, and that is the basis of authenticity. “As the circle widens, it (the product) fails,” said Aima.

Ignorance and lack of interest in understanding the product or company can also lead to a money trap. “Most people don’t ask how those returns are generated? You should never go by past data if it is short term. In the initial phase, there would be people who would have received outcome in line with what has been promised. Look at rolling data. This means that there a track record, then don’t just look at 1-2-year returns. See if the product has consistently performed,” said Vishal Dhawan, a Mumbai-based financial planner.

BENCHMARK RETURNS TO KEEP IN MIND

Returns depend on the asset class invested in. So if someone promises very high returns, check with some broad numbers



Data is 1-year returns. Equity: Sensex returns; Small savings: Public Provident Fund return; Fixed deposit: SBI 1-year FD of below Rs1 crore for individuals; Cash: SBI savings account

Source: Mint research

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Anti-fraud cheat sheet

The basic question to ask is: if your capital can double every two-and-a-half years, why would your agent or wealth manager not invest her own money here? Why is she helping you?

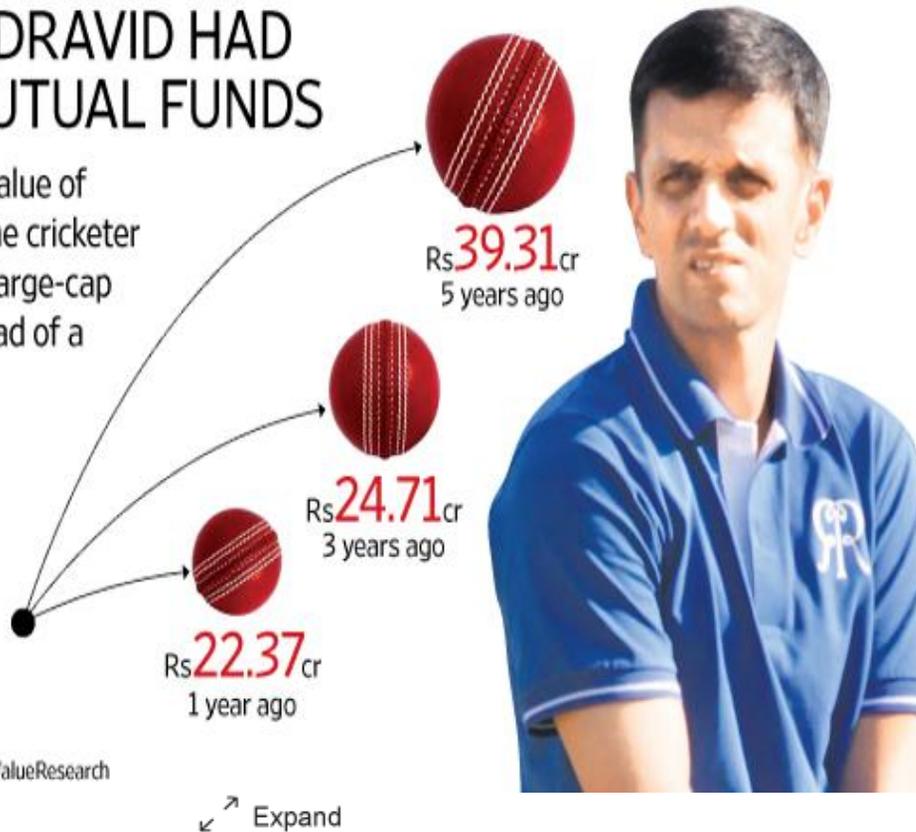
Another way to validate information is to see the top returns that the best investors have delivered. “One takes Warren Buffett as the best example. His performance has been in the 20%-per-year range. So, what’s so special about this strategy that it gives twice of what Warren Buffett has delivered?” said Dhawan.

IF RAHUL DRAVID HAD PICKED MUTUAL FUNDS

What would the value of Rs20 crore be if the cricketer had invested in a large-cap mutual fund instead of a ponzi scheme?



Data on returns taken from ValueResearch



If you are wondering how to evaluate based on returns, here is a thumb rule. “Understand what the actual return is. How much alpha can be generated in reasonable circumstances without needing corrective measures? If it is debt, look at a return of 8-9%; if it is equity, take a benchmark of inflation plus GDP. Be careful of anything that returns beyond that,” said Surya Bhatia, a New Delhi-based financial planner.

Had Dravid been a mutual fund investor, what would his portfolio be like today? An average large-cap fund would have 1-year returns of 11.87%, 3-year returns of 7.31%, and 14.47% for 5 years. See table for what his money would be worth at these rates. Sure, these are not 40% returns, but there is the assurance of nobody running away with his money. It's good to look for avenues to invest and grow your wealth. But tread cautiously and don't get trapped into products that are too good to be true.

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