Is The Indian Market Too Volatile?

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January wasn't a month that investors in India want to remember. The Indian stock market was down 10.1 percent, its worst performance in more than two years. And if the problems within India weren't enough, the troubles in Egypt also took their toll. Next to the Egyptian market, which was the hardest hit, the Indian markets fell to a close second.

Is this the time to bail out of India? Are emerging markets, still so full of risk, too volatile to invest in? On the contrary, analysts say, this may be the best time to invest in India.

A 10 percent drop in the Indian markets is not unusual. In its most recent research on India, Morgan Stanley points out that this is the 26th occasion in 30 years that the market has dropped more than 10 percent in one calendar month. And almost every time the market has more than rebounded, except in the most dire bear markets. Barring 1992-93 and 2008, in bull phases average 3-month return following the correction has averaged 10 percent with 80 percent probability, notes Morgan Stanley.

For long -term investors, India is stronger than ever, says Hiren Ved of Alchemy Funds, a Mumbai-based investment fund. Inflation peaked in India in April 2010 at 11 percent. A large part of the primary inflation is due to erratic weather patterns and certain speculative tendencies by traders that should correct in next 6 months, he says.

Ved believes India will grow at about 8.6 percent in the year ending March 2011. And while growth is expected to slow down in fiscal 2012, given the high base effect and ongoing withdrawal of stimulus measures enacted in 2008, the opportunities are better than ever, he explains. Ved, Alchemy's chief investment officer, is a firm believer in the long term. His fund has returned over 35 percent annually since its formation in 2002.

Indeed, 2011 is a great year to visit India, says Manish Hemrajani of Oppenheimer & Co., in his report on India. Hemrajani finds India as an attractive investment destination due to "relatively strong GDP and earnings growth versus other economies – emerging as well as developed." The Oppenheimer analyst is encouraged that India has a politically stable environment at least over the next 5 years with a near-majority government in place that has accelerated reforms both in the financial arena and outside.

Most important, Hemrajani sees "solid long-term growth potential given a higher mix of domestic demand versus other emerging economies, and “favorable demographics with India's burgeoning young populace as one of the most compelling growth drivers.”

For all the bullishness, be selective in your investments, says Anshuman Ray, senior vice president for South Asian equities at Auerbach, Grayson & Co. Some of the basic problems – lack of transparency, political corruption, the vulnerability of earnings growth to fund flows – remain, says Ray. Invest in areas that are most leveraged to domestic growth, especially rural demand. Most important, invest for the long term.