EQUITY OUTLOOK

Harish Krishnan
Chief Investment Officer - Equity
Aditya Birla Sun Life AMC Limited

Global Markets: AI Trade Unwinds as India Extends Its Recovery

Global equity markets witnessed sharp divergence during July as the prolonged rally in artificial intelligence and semiconductor-related stocks began to lose momentum. A significant correction in AI-heavy markets, alongside renewed geopolitical tensions, led to steep declines in South Korea, Taiwan and Japan.
South Korea declined 16% during the month in USD terms, while Taiwan and Japan fell 6% each. China declined 6%, Russia fell 8%, and the MSCI Emerging Markets Index corrected 3%. In contrast, Brazil and the UK gained 5% each, while Germany and France rose 3% and 2%, respectively.
Indian equities extended their gains for a second consecutive month, rising approximately 1% in USD terms. The recovery was supported by stronger-than-expected earnings, easing valuations, resilient domestic institutional flows and the return of foreign institutional investors after four consecutive months of selling.
Despite the recent recovery, India remains among the key underperforming markets in calendar year 2026, declining approximately 12% in USD terms on a year-to-date basis. However, the correction in AI-led markets could encourage global investors to diversify beyond a narrow group of technology stocks, potentially improving the relative attractiveness of fundamentally strong markets such as India.

Indian Markets: Broader Indices Gain as Technology Rebounds

Large-cap and mid-cap indices gained approximately 2% during July, while the small-cap index rose 3%. The continued strength in the broader market pushed the mid- and small-cap segment to a record high.
Technology was the strongest-performing sector, rebounding 17% after five consecutive months of decline. Media, Real Estate and Automobiles also registered gains of approximately 9% each. In contrast, Capital Goods declined 5%, while Oil & Gas and Defence fell 3% and 2%, respectively.
On a calendar-year-to-date basis, the mid- and small-cap segments continue to outperform the Nifty 50, which remains down approximately 7%. Defence, Healthcare, Capital Goods, Metals and Oil & Gas have delivered the strongest gains. Technology, Consumer stocks, Automobiles and Private Banks remain the key underperformers
The wide dispersion in sector performance suggests that future returns are likely to be driven increasingly by earnings delivery and company-specific fundamentals rather than broad-based valuation expansion.

India Macro: High-Frequency Indicators Signal Resilience

India's high-frequency economic indicators continue to reflect a strengthening domestic growth environment.
Systemic credit growth has accelerated to approximately 18% year-on-year, its highest level in two years, following the moderation witnessed during 2025. Automobile volumes have risen to their strongest levels since the 2022–23 peak, supported by GST rate reductions and improving consumer demand.
GST collections have consistently remained above INR2 trillion, while industrial production growth has accelerated to a two-year high. These trends point to resilient domestic demand, broad-based economic momentum and a macroeconomic environment that remains supportive of corporate earnings growth.
Energy prices continue to represent a near-term risk. However, crude oil has been unable to sustain levels above USD90 per barrel, while global oil trade has largely normalized compared with the disruptions witnessed during March and April 2026. A moderation in geopolitical tensions should further reduce pressure on inflation, external balances and corporate margins

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Earnings Outlook: Financials and Metals Lead a Strong Start to FY27

The first-quarter FY27 earnings season has been stronger than initial expectations, although headline growth has been affected by losses reported by oil marketing companies. The 39 Nifty companies that had announced results recorded earnings growth of approximately 11%, ahead of the estimated 7%. Reliance Industries, JSW Steel, ICICI Bank, Bajaj Finance and Axis Bank were the key contributors. Importantly, Nifty earnings estimates remain broadly stable at INR1,225 for FY27 and INR1,424 for FY28. Corporate earnings for Nifty universe is expected to compound at approximately 15% over FY26–28. A broader-based recovery across sectors will be important for sustaining market participation.

Liquidity: Foreign Investors Return as Domestic Flows Remain Supportive

Domestic institutional investors invested approximately USD3.7 billion during July, extending their sequence of net monthly inflows to 36 consecutive months. However, the monthly inflow was the lowest in 15 months.

Foreign institutional investors turned net buyers after four consecutive months of selling, investing approximately USD2.5 billion during July—the highest monthly inflow in 13 months.

On a calendar-year-to-date basis, domestic institutions have invested approximately USD54 billion. Foreign investors remain net sellers, with cumulative outflows of approximately USD27 billion, already exceeding total calendar-year 2025 outflows by 42%.

Domestic liquidity should continue to provide an important cushion against external volatility. Nevertheless, a sustained rerating of Indian equities will likely require a more durable return of foreign capital

Valuation: Large Caps Offer a More Balanced Risk-Reward

The valuation correction over the past two years has materially improved the attractiveness of Indian large-cap equities.

The Nifty 50 currently trades at approximately 18.9 times 12-month forward earnings, representing a discount of around 10% to its historical average. This provides a more favourable risk-reward profile, particularly given improving earnings visibility and resilient domestic fundamentals.

In contrast, the mid-cap and small-cap indices trade at approximately 27.5 times and 22.9 times forward earnings, representing premiums of 15% and 31% to their respective long-term averages. Although valuations have corrected from the September 2024 highs, returns in these segments are likely to depend increasingly on earnings execution rather than further multiple expansion.

Source: ABSLAMC Internal Research, MOSL

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DEBT OUTLOOK

Kaustubh Gupta
Chief Investment Officer - Fixed Income
Aditya Birla Sun Life AMC Limited

The West Asia conflict and disruption to shipping through the Strait of Hormuz continues to remain the most important risks for Indian markets and the economy. The temporary improvement following the June ceasefire has reversed, with the agreement unravelling, attacks on commercial vessels resuming and shipping traffic remaining severely restricted. Iran and the US are now making competing claims over control of the Strait, while Iran has linked its reopening to wider conditions including removal of sanctions, lifting of the blockade on Iranian ports and compensation for war-related damage. Negotiations involving Iran and Oman continue, but a durable settlement has not yet emerged. Consequently, crude oil, LNG and freight prices are likely to remain volatile, with the risk premium being driven as much by the availability and security of shipping routes as by the underlying demand-supply balance.

The monsoon has improved meaningfully from the severely deficient June, with normal rainfall in July and near normal rainfall so far in August. The recovery in rainfall has helped narrow the shortfall in total kharif sowing to less than 2% compared to last year, with acreage reaching about 96.8 million hectares after the first week of August. However, paddy and several other crops continued to trail last year. Strengthening El Niño conditions remain upside risks to food inflation, although foodgrain stocks, irrigation coverage and supply-management measures provide some protection.

India's July 2026 CPI (Consumer Price Index) inflation increased marginally to 4.45% YoY (Year on year), from a revised 4.38% in June, while food inflation rose to 5.52%. Food pressures were visible in items such as onion, garlic and ginger, while precious metals continued to contribute significantly to measured inflation. However, the composition remains important from a monetary-policy perspective with underlying demand pressures remaining relatively contained. RBI noted that core inflation excluding precious metals remained around 2.3-2.5% during May-June, suggesting limited generalisation of the food and fuel shock so far.

The latest activity and external-sector data indicate that domestic growth remains resilient, although the trade balance bears watching. Industrial production accelerated to 7.3% YoY in June, from 5.1% in May, supported by 7.8% manufacturing growth and 10.6% growth in electricity and gas supply. Nineteen of the 23 manufacturing groups recorded growth, with electrical equipment, motor vehicles and food products among the leading contributors. The strong headline number supports the view that domestic industrial momentum remains healthy, although part of the strength may reflect sector-specific and base effects.

July trade data shows exports rising to US$44.24 billion, nearly 20% higher than a year earlier, while imports increased to US$76.22 billion, taking the merchandise trade deficit to US$31.98 billion, a six-month high. Higher crude oil, electronics, fertiliser and coal imports contributed to the increase in the import bill. Besides higher merchandise deficit, Services surplus also moderated to US$16.95bn, with moderation in services exports to 6.4% y-y, even as services imports remained high at 9.5% y-y. Overall goods and services deficit of US$15bn was on the higher side.

RBI's August policy was essentially a wait-and-watch policy, keeping the policy repo rate unchanged at 5.25% and retaining the neutral stance. RBI raised its FY27 real GDP growth projection marginally to 6.7% and lowered its CPI inflation projection to 5.0%. It expects inflation to peak at 5.9% in Q3 before moderating, with higher inflation still largely concentrated in food and fuel. In our view, MPC is likely to wait for evidence of a broader generalisation of price pressures before acting, and in our base case we do not see rate action in 2026. The risk to our view stems from a renewed rise in crude prices and tighter global financial conditions, including the possibility of a more hawkish US Federal Reserve.

The capital inflows from the concessional FCNR (Foreign Currency Non-Resident) (B) and ECB (External Commercial Borrowings) swap windows has so far been strong which should provide support to domestic liquidity, demand-supply in bond market, and the external account. With RBI likely to remain on pause, liquidity conditions supportive and underlying inflation still contained, we remain constructive on fixed income. Front-end rates should remain relatively well anchored, while elevated yields continue to offer attractive accrual opportunities. The principal risks remain the West Asia conflict, crude oil prices, the southwest monsoon and possible tightening in global financial conditions.

Investors with a horizon of one month or more can consider our 3-6M Financial Services Index Fund, while those with a three-month or longer horizon can consider our Ultra Short Duration or Low Duration Fund. Investors currently concentrated in overnight or liquid categories may evaluate moving one notch higher on the duration curve. One-to-five-year corporate bonds continue to offer a favourable risk-adjusted entry point, supporting allocations to our Corporate Bond Fund and Banking & PSU Debt Fund. Investors with a horizon of two years or more can consider our Income Plus Arbitrage Fund of Funds, given its tax efficiency.

Source: ABSLAMC Internal Research

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