

EQUITY OUTLOOK



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Global Markets: Crude, Yields and FII Selling Drive September Correction

Global financial conditions deteriorated during September as escalating tensions in West Asia pushed crude oil prices above USD100/bbl, while government bond yields moved sharply higher across developed markets. Renewed expectations of a higher-for-longer interest-rate environment added to valuation pressures, while the AI trade regained momentum and attracted capital back toward technology-heavy markets.

Indian equities came under significant pressure amid this challenging backdrop. The Nifty 50 declined sharply as concerns around inflation, the import bill, corporate margins and tighter global liquidity led to renewed foreign investor selling. Despite these external headwinds, India's underlying macroeconomic and corporate earnings fundamentals remain resilient, with strong domestic liquidity continuing to cushion market volatility.

Indian markets declined approximately 7% MoM in USD terms during September, alongside weakness in France (-7%), Germany (-6%), the UK (-4%), China (-3%) and the MSCI Emerging Markets Index (-1%). In contrast, Taiwan (+9%), Russia (+6%), Brazil (+5%), Japan (+2%), Nasdaq (+1%) and South Korea (+1%) posted gains.

On a CY26YTD basis, India remains among the weakest-performing major equity markets, declining approximately 19%, second only to Russia (-23%), while most global peers have delivered positive to marginally negative returns.

Indian Markets: Broad-Based Sell-Off as Technology and Financials Lag

The correction in Indian equities was broad-based during September. Large-cap, Mid-cap and Small-cap indices declined approximately 6%, 8% and 3%, respectively. Technology (-11%), Financials (-9%) and Automobiles (-9%) were among the key sectoral laggards as rising bond yields and risk aversion weighed on growth and rate-sensitive segments.

Despite the recent correction, SMIDs (Small & Mid Cap) continue to outperform large caps on a CY26YTD basis, supported by stronger earnings momentum, robust domestic flows and investor interest in emerging investment themes.

Defence (+20%), Healthcare (+16%), Metals (+14%) and Capital Goods (+10%) remain the strongest-performing sectors during CY26YTD. In contrast, Technology (-27%), Consumer (-20%), Infrastructure (-9%), Financials (-8%) and Private Banks (-7%) remain the key underperformers.

Global Rates: Tightening Financial Conditions Emerge as a Key Risk

The sharp rise in global bond yields and renewed monetary tightening have emerged as important risks for equity markets. The US Federal Reserve raised policy rates by 25bp to 3.75–4.00% during September, marking its first rate increase in three years, while the ECB [SJ1.1] also raised rates by 25bp amid renewed inflation concerns. The Bank of Japan has maintained a tightening bias, with policy rates now at 1.25%.

This change in the global interest-rate environment has been reflected across bond markets. The US 10-year Treasury yield briefly moved above 5%, UK gilt yields approached 5.4%, Japan's 10-year government bond yield rose to around 3%, and India's 10-year G-sec yield moved above 7.1%.

India is also increasingly expected to move toward monetary tightening as higher crude oil prices, firmer inflation and currency pressures increase. However, any domestic hiking cycle is likely to remain calibrated, provided energy-driven inflation does not become broad-based.

Higher global yields and tighter liquidity could continue to weigh on valuations and foreign portfolio flows. Nevertheless, India's strong domestic growth momentum and resilient domestic liquidity should help contain the impact relative to previous global tightening cycles

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Primary Markets: Strong Issuance Reflects Depth of Domestic Liquidity

India's primary market continues to remain vibrant despite a largely range-bound secondary market over the past two years. Between FY24 and FY27YTD, approximately INR10.1 trillion has been mobilized through IPOs, FPOs, OFS and QIPs, reflecting strong institutional and retail participation.

Fundraising has been broad-based across new-age businesses, consumer companies, manufacturing and financials, highlighting investor confidence in India's long-term growth opportunity.

However, the large pipeline of new issuance could temporarily divert liquidity away from the secondary market. Large offerings such as the INR226 billion NSE IPO and other large sizeable issues, could compete for institutional and HNI capital and contribute to near-term market volatility.

Nevertheless, sustained domestic institutional flows and continued investor participation should provide an important cushion.

Liquidity: DII Buying Accelerates as FII Selling Resumes

Foreign investor sentiment weakened materially during September as rising global bond yields, renewed monetary tightening and crude oil prices above USD100/bbl triggered a return of risk aversion.

FIIs sold more than USD4 billion of Indian equities during the month, reversing the positive flows recorded during the previous two months. In contrast, DIIs invested approximately USD8 billion, extending their sequence of monthly net inflows to 38 consecutive months.

On a CY26YTD basis, domestic institutional inflows have reached approximately USD68 billion, while foreign investors remain net sellers with cumulative outflows of around USD28.3 billion—already approximately 50% higher than their total outflows during CY25.

The structural shift toward domestic liquidity remains evident over a longer horizon. Between CY21 and CY26YTD, DIIs invested approximately USD287 billion, while cumulative FII flows remained negative at around USD40 billion.

This persistent domestic participation continues to provide an important cushion against volatile foreign flows and global market shocks

Valuation: Correction Improves Risk-Reward Across Large and Mid Caps

The sharp market correction has meaningfully improved valuation comfort across Indian equities.

The Nifty 50 currently trades at approximately 17.2 times 12-month forward earnings, around 18% below its long-term average.

The Mid-cap index trades at approximately 22.8 times forward earnings, around 8% below its long-period average.

Small-cap valuations remain relatively elevated, with the index trading at approximately 23.2 times forward earnings, representing a premium of around 25% to its long-term average, although valuations remain approximately 7% below their 2024 peak.

The valuation reset, particularly within large caps and mid caps, has improved the medium-term risk-reward profile. However, sustained rerating will require continued earnings delivery and greater stability in crude oil prices, bond yields and foreign investor flows

Conclusion: Domestic Fundamentals Remain Resilient Amid Rising External Risks

India's underlying fundamentals remain healthy, but the external environment has become considerably more challenging. Crude oil above USD100/bbl, elevated global bond yields, renewed monetary tightening and persistent geopolitical uncertainty have increased near-term risks to inflation, corporate margins, valuations and foreign portfolio flows.

Continued FII selling and tighter global financial conditions could prolong market consolidation. However, healthy corporate earnings, resilient economic growth, strong domestic institutional liquidity and increasingly comfortable valuations provide meaningful support.

Nifty universe earnings are expected to compound at approximately 15% over FY26–28E. T[SJ2.1]he key monitorables will be the durability of earnings growth, the impact of higher crude and input costs on corporate profitability, and whether rising global yields and weaker external demand begin to affect the earnings outlook.

Overall, Indian equities remain caught between strong domestic fundamentals and elevated global risks. Following the recent correction, valuations have become increasingly supportive, particularly within large caps. While near-term volatility is likely to remain elevated, the combination of healthy earnings growth, resilient domestic liquidity and improved valuation comfort provides a stronger foundation for medium-term returns[S.

Source: ABSLAMC Internal Research

Sector(s) mentioned in the document are for the purpose of information and should not be construed as recommendation

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DEBT OUTLOOK



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The global backdrop continued to be an important driver of Indian yields with surging global yields, and continued conflict in West Asia that continues to keep crude prices elevated and volatile. Although Saudi Arabia's East-West pipeline has resumed operations and regional crude exports have recovered substantially, shipping remains vulnerable to renewed attacks, expensive rerouting and logistical bottlenecks. The recovery in export volumes should therefore not be mistaken for normalisation of delivered energy costs. While Brent crude has averaged near 102, India crude basket average 116 in September, and while diversification of supply sources provides protection against physical shortages, but sustained high energy and freight costs remain adverse for inflation and the external balance.

India's growth continues to remain resilient. Urban consumption remains healthy aided by last few years of tax cuts, while infrastructure spending, private capex and robust credit flows should sustain investment. Buoyant services exports and bilateral trade agreements aided by weaker currency, provide additional support. However, deficient rainfall and El Niño pose risks to agriculture and rural demand, while geopolitical tensions, elevated commodity prices and tighter global financial conditions remain headwinds. Also, the consumer sentiments has been negatively affected by rising prices and likely by weakness in equity markets. RBI has raised its FY2026-27 GDP (Gross Domestic Product) growth forecast to 7.1%, and we broadly agree with the assessment.

The monsoon recovery did not fully offset the early-season shortfall. Cumulative rainfall ended 12.6% below normal as of 30 September, while kharif acreage stood at 1115.3 lakh hectares on 2 October, approximately 1% above normal but marginally below last year. The distinction between acreage and crop yields remains important, particularly given the uneven distribution of rainfall. Deficient rainfall and strong El Niño conditions pose risks to agricultural output, the upcoming rabi season and rural demand, although healthy foodgrain buffers and government supply-management measures provide cushion. Increase in food prices till now has been moderate.

The exceptional foreign-currency mobilisation has strengthened forex buffers (at record highs) and thus firepower available with RBI to prevent excess volatility in INR. However, we do not expect RBI to completely stall INR adjustment to pressure emanating from stronger dollar and higher commodity prices. Latest reporting puts FCNR (Foreign Currency Non-Resident) (B) mobilisation at approximately US\$133 billion, with the ECB (External Commercial Borrowings) and overseas foreign-currency borrowing windows remaining open until December-end. Reserves remain adequate, with approximately 11 months of import cover. Big surge in INR liquidity which was an outcome of strong USD inflows, remains in surplus, although materially below its peak, with surplus banking liquidity moving from above INR 11tn in early September to less than 4tn now.

August CPI (Consumer Price Index) inflation came at 4.82%, with core inflation at 4.2% and core excluding precious metals at 2.9%. More importantly, items representing approximately 37% of the CPI basket recorded inflation above 4%, indicating a widening of price pressures. The RBI has raised its FY2026-27 CPI forecast to 5.2% from 5.0%, with inflation projected to peak at 6.0% in Q3 before moderating to 5.7% in Q4. While evidence of supply shocks becoming embedded in pricing behaviour remains limited, food, energy and inflation expectations warrant closer monitoring.

Against this backdrop, RBI MPC unanimously increased the repo rate by 25 basis points to 5.50% and shifted its stance to "calibrated tightening". The guidance rules out near-term cuts under current conditions, while leaving the choice between further hikes and a pause dependent on incoming data. We expect 50bp of further tightening by RBI, taking the repo rate to approximately 6.0%, with crude oil price being the important X factor. With the central bank continuing to see limited evidence of demand-side inflationary pressures, the policy response is therefore better understood as a recalibration against a worsening inflation outlook than as an attempt to cool an overheating economy.

We continue to favour carry at the front end rather than an aggressive duration position. Comfortable liquidity provides support but should not be viewed as a firm cap on longer-term yields. If elevated crude prices, global yields and weather-related inflation risks persist, domestic yields may grind higher; a reversal in these conditions could also produce a meaningful unwind of the sell-off. One-to-two-year corporate bonds remain our preferred carry segment, with duration to be added tactically on further market weakness, rather than on the assumption that all adverse developments are already priced in.

Investors with a horizon of three-month or longer horizon can consider our Ultra Short Duration or Ultra Short to Short Term Fund. Investors concentrated in overnight or liquid categories may evaluate moving one notch higher on the duration curve, consistent with their liquidity needs and risk tolerance. Investors with a horizon of two years or more can evaluate our Income Plus Arbitrage Fund of Funds; any tax-efficiency benefit should be assessed against their applicable tax treatment. These allocations remain consistent with the latest internal desk recommendations

Source: ABSLAMC Internal Research

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SEBI Registration No. MF/020/94/8

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