SENFIN RESEARCH

Strategic Equity Market Outlook 2026

REVISED 2026 EXPECTED TOTAL RETURN

18% – 20%

Narrowed from the January base case of +15% to +22%, on an earnings- and dividend-led basis.

Note: ASPI has returned -2.0% year-to-date through 3 Jul 2026

EXECUTIVE SUMMARY

Market Outlook

18% – 20%

Revised expected total return for 2026

was +15% to +22%

+41.9%

ASPI total return delivered in 2025

S&P SL20 +26.6%

–2.0%

ASPI return delivered YTD 2026

as of 3 Jul 2026

1. **The Sri Lankan equity market delivered an exceptional 2025 ASPI +41.9%, S&P SL20 +26.6% among the strongest performances in frontier markets globally.**
2. **H1 2026 brought a more complex backdrop: CCPI inflation re-accelerated from 2.3% to 6.8% by June, market rates rose 250–280 bps off their 2025 lows, and the rupee depreciated roughly 8% YTD.**
3. **GDP growth has stayed resilient at 5.1% in Q1 2026, remittances are up 26% YoY, and banking-sector earnings momentum remains intact.**

Macro Snapshot: Where We Stand Today

Six indicators that matter most for equity valuation and earnings

5.1%

Real GDP growth, Q1 2026
(vs. 4.8% in Q1 2025)

6.8%

CCPI inflation, June 2026
(vs. 2.1% at end-2025)

10.62%

AWPLR, July 2026
(vs. low of 7.88% in Jul 2025)

10.20%

12-month T-bill yield
(vs. low of 7.94% in June 2025)

LKR 334.4

Exchange rate /USD, Jul 2026
(vs. LKR 309.6 at end-2025)

USD 4.7bn

Trade deficit, Jan–May 2026
Annualizing above 2025's USD 7.9bn

THE STARTING POINT

A Solid Foundation — But Valuations Have Re-Rated

2025 IN NUMBERS

+41.9%
ASPI total return

+26.6%
S&P SL20 return

8.56x
Forward P/E (03/07/2025)

1.23x
P/BV (03/07/2025)

2026 YTD (TO 3 JUL)

-2.0%
ASPI total return

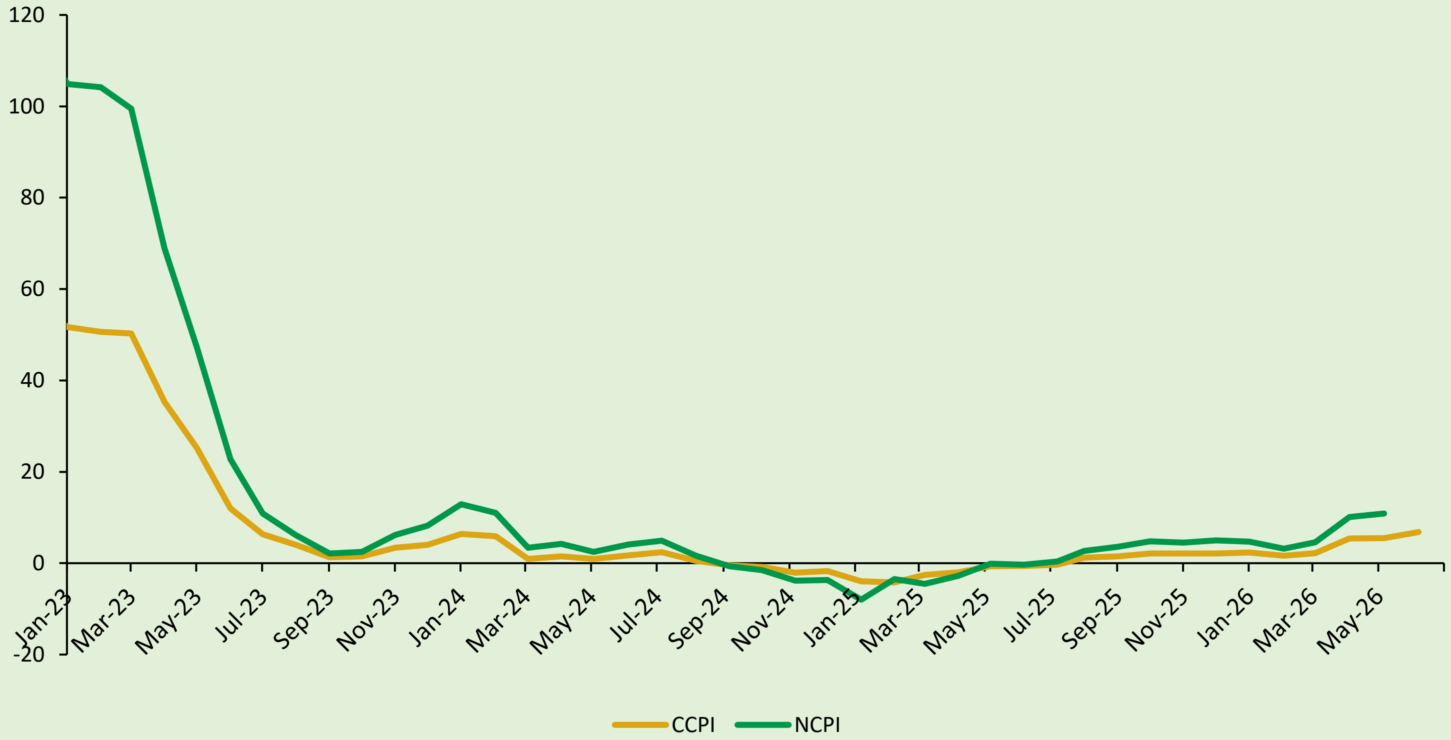
0.6%
S&P SL20 return

11.68x
Forward P/E (03/07/2026)

1.37x
P/BV (03/07/2026)

The Disinflation Cycle Has Reversed

CCPI & NCPI inflation, % year-on-year, monthly



THE SHIFT

2.3% → 6.8%

Headline CCPI, January → June 2026

What changed

CCPI inflation troughed near zero in mid-2025 and has re-accelerated sharply to 6.8% by June 2026, driven by base effects and firming domestic demand.

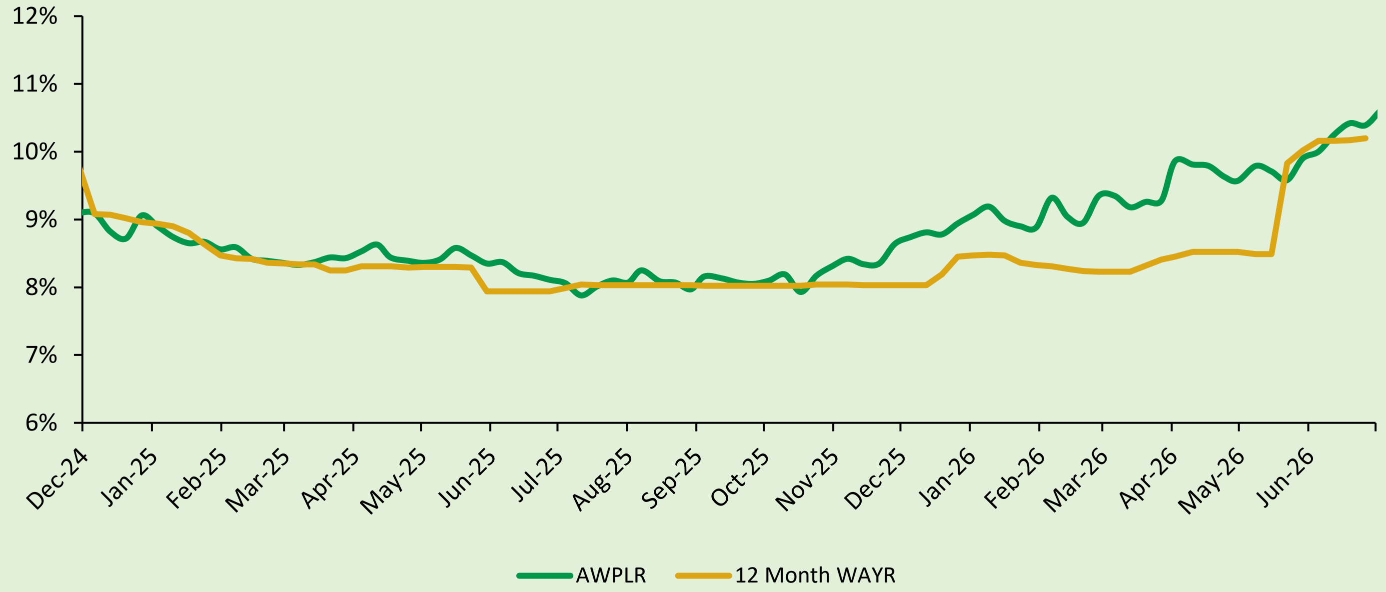
Policy implication

The Central Bank's easing cycle has paused; market yields have moved up 250–280 bps off their 2025 lows.

Equity read-through

The valuation tailwind from falling discount rates a central pillar of the original 2026 thesis is now more muted, tempering multiple expansion assumptions.

Market rates have troughed and turned higher



Market interest rates have followed inflation higher

AWPLR: 7.88% (Jul-25 low) → 10.62% (Jul-26) | 12-month T-bill: 7.94% (Jun-25 low) → 10.20% (Jul-26)

THE SHIFT

8.5% → 10.2%

12-month T-bill, early-2026 trough → July

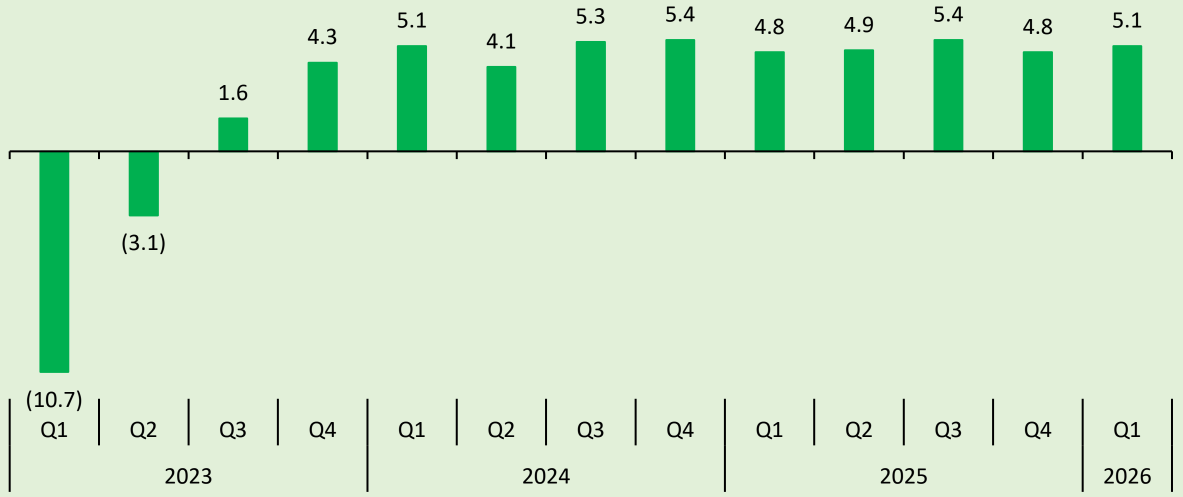
The re-rating engine has stalled.
Higher discount rates cap the multiple-expansion contribution that powered 2025's rally. Corrected: this brings the bull-case ceiling down from +30% to +28%, and the base-case ceiling down from +22% to +20% two separate ceilings, not one.

Context:
At 10%, rates sit far below the 30%+ crisis peak a tightening bias at the margin, not a punitive one. Financial conditions are firmer, not restrictive enough to derail the broader recovery.

GROWTH MOMENTUM

GDP Growth Has Held Above 5% Through Early 2026

Real GDP growth (% YoY)



Recovery consolidating

Growth has held in the 4.8%–5.4% band for five consecutive quarters a marked contrast to the 2022 contraction and 2023 recovery phase.

2026 outlook: 5.0%–5.5%

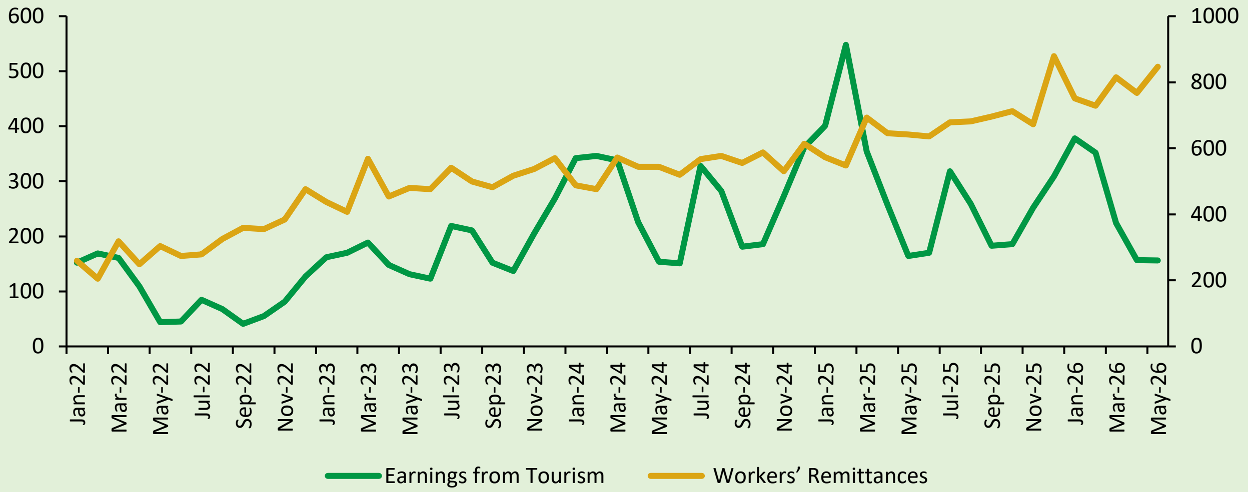
Supported by continued construction activity, tourism-linked services, banking sector normalization, and gradually easing (though now less accommodative) real borrowing costs.

Equity read-through

Sustained growth near 5% supports revenue expansion and operating leverage for cyclical, banking and consumption-linked sectors, even as the rate cycle turns.

Remittances Remain a Bright Spot; Tourism and Trade Mixed

Tourism earnings & remittances (USD Mn)



Export Income & Import Expenditure (USD Mn)

Remittances: still growing

Up 26% YoY in Jan–May 2026, a key structural support for banking system liquidity and CASA balances.

Tourism: softer earnings

Arrivals are roughly flat, but USD earnings are down sharply pointing to lower spend per visitor and/or currency effects.

Trade: deficit widening

The Jan–May 2026 deficit run-rate is tracking well above 2025's full-year pace, adding to FX pressure alongside a weaker rupee.

IMF PROGRAM OVERLAY

The IMF Anchor: Sri Lanka in Its Final EFF Year

How the IMF's May 2026 review reframes the macro backdrop behind our forecast

US$2.4bn

IMF funds disbursed of US$3bn EFF
Combined 5th & 6th reviews cleared, 27 May 2026

3.0%

IMF 2026 GDP growth forecast
vs. SenFin base case of 5.0%–5.5%

1.4%

2026 primary-surplus target (% GDP)
Down from 5.4% in 2025; 2.3% anchor from 2027

US$6.9bn

Gross official reserves, end-May 2026
Rebuilt from near-zero in mid-2022

–0.5%

IMF 2026 current-account (% GDP)
Flipped from surplus on oil & tourism

2027

EFF ends Q1 2027 (48-month term)
Policy continuity now a key question

IMF OVERLAY vs. OUR BASE CASE

Where the IMF Backs Us — and Where It Pushes Back

Same shocks, one important gap: the IMF sees materially slower 2026 growth

Driver	IMF view — May 2026	Equity read-through
2026 GDP growth	3.0% (was 3.5% pre-shock)	*If IMF is right, our 9–10% EPS skews to the low end*
Inflation & rates	Inflation is mainly from rising energy costs, so the central bank raised interest rates to 8.75%	*Agree — the re-rating tailwind is gone*
External / FX	The country is spending more abroad than it earns (a small trade deficit), largely because tourism income dropped 38.8% from last year.	*Agree, but IMF is more bearish; FX is the swing risk*
Fiscal stance	IMF approved fiscal easing: 2026 primary surplus target cut to 1.4% of GDP, down from 5.4% in 2025	*2026 is mild support, not restraint*
Program & debt	Debt restructuring is almost finished — this is the last year of the IMF's support loan program.	*Caps tail risk; post-EFF exit a new watch-item*

BOTTOM LINE

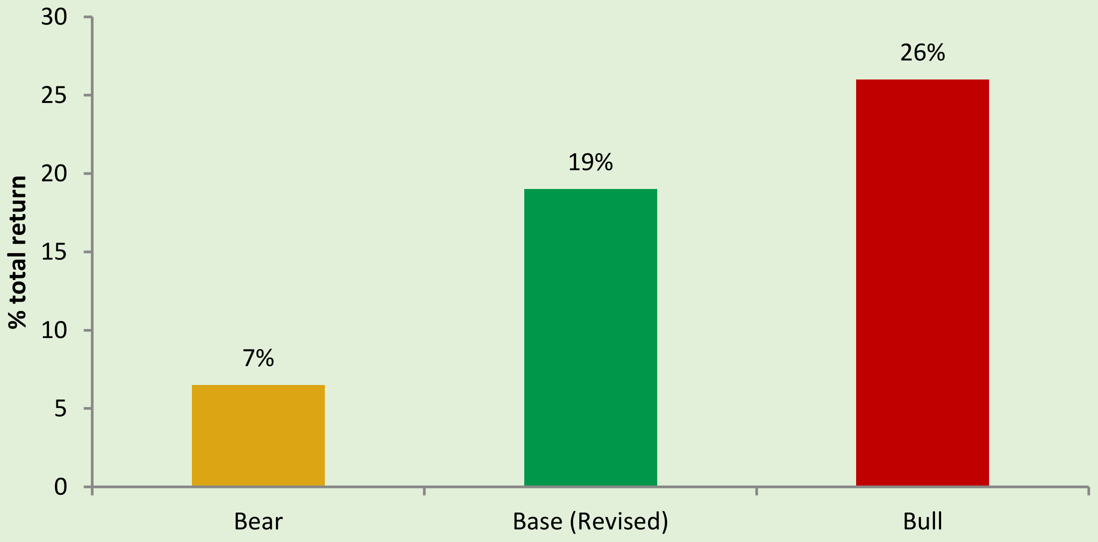
The IMF validates our more cautious H2 macro, but flags a growth gap our base case does not. We hold 18–20% as the earnings- and dividend-led central case, while treating the IMF’s 3.0% growth path — and the post-EFF transition — as the main reason risks skew to the lower half of that range.

2026 TOTAL RETURN FORECAST — REVISED

Base Case Narrowed to 18% - 20%

Revised for renewed inflation & rate pressure; earnings and dividends now do more of the work

Scenario	EPS Growth	Dividend Yield	Multiple Expansion	Liquidity / Flows	Total Return
Bear Case	3% – 4%	3% – 4%	(2%) – 0%	0% – 1%	**4% – 9%**
Base Case	9% – 10%	4%	2% – 3%	3%	**18% – 20%**
Bull Case	13% – 14%	4%	4% – 6%	3% – 4%	**24% – 28%**



Why the base case moved to 18%–20%

EPS assumptions were raised (banking NII recovery, capital goods) to 9–10% to offset a reduced multiple-expansion contribution, now trimmed to 2–3% given rates are no longer falling. Dividend yield and liquidity contribution are held as stable, near-fixed inputs (4% and 3%) rather than wide ranges, reflecting their lower sensitivity to the rate cycle and a more cautious foreign-flow backdrop into the election cycle.

Macro–Equity Transmission, Revisited

Remittance-Driven Liquidity

STRONGLY POSITIVE

Record formal-channel inflows support bank CASA & credit growth

GDP Growth Momentum

POSITIVE

5.1% Q1 2026 growth broadens earnings visibility across cyclicals.

Overnight Policy Rate

NOW RESTRICTIVE

+100bps of market-rate increases reverses the easing transmission modelled in January tighter at the margin, but still well below crisis-era levels

Fiscal Discipline

MILDLY POSITIVE

Primary surplus near 5% of GDP in 2025 supports credibility, though it limits near-term stimulus.

KEY RISKS TO THE OUTLOOK

Downside Risks Are Now More Macro Than Political Alone

What could push returns toward the bear case

1 Inflation Persistence

If CCPI stays above 6.8% into H1 2026, the Central Bank may need to tighten further, pressuring valuations.

2 Currency Depreciation

A further slide beyond the 8% YTD move would raise imported inflation and import-cost pressure on corporates.

3 Widening Trade Deficit

Jan–May run-rate implies a materially wider full-year deficit than 2025, a drag on FX reserves and BOP stability.

4 Tourism Earnings Softness

Flat arrivals but falling USD earnings could signal weaker spend, denting the services surplus.

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