FSSA Investment Managers



Against the current:

Why we're focused on quality amid the market rally

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High-quality, durable businesses are often overlooked during thematic market rallies – but these are the companies that tend to compound value over the long term.

There are market phases when simply being patient is a contrarian act. Times when liquidity swells, a single theme seizes the narrative, and benchmarks are driven higher by a clutch of popular stocks. For investors in solid, steadily compounding businesses – the kind that seldom feature in these frenzies – it can feel rather like being aboard a yacht, bobbing in the wake of fuel-guzzling speedboats.

Such was the sensation among quality-focused investors last year. By way of illustration, the MSCI Emerging Markets Quality Index returned 14% in 2025, compared with 34% for the MSCI EM Index – the widest annual gap since the quality index was launched in 2012. A similar, if less dramatic, divergence was observed between MSCI's main Asia index and its quality counterpart.[1]

Although FSSA's definition of quality is more holistic than MSCI's – incorporating management capability, sustainability considerations and strategic positioning, rather than relying purely on backwards-looking quantitative data – these trends are instructive. In such an environment, it is unsurprising that several of our strategies, which favour high-quality companies, lagged broader benchmarks.

While we are long-term, index-agnostic investors, and do not base our decisions on short-term performance metrics, we feel now is a good time to set out our thinking on market dynamics, the rationale behind our positioning, and why we believe the principles behind our investment approach are more relevant than ever.

The AI boom

In assessing the current market landscape, there is no escaping the impact of artificial intelligence (AI). Excitement over the scale of capital expenditure (capex) being lavished on data centres and other AI-related infrastructure has led to rising share prices across the value chain, from model builders to component suppliers to mining firms that extract the raw materials needed for high-voltage cables and battery systems.

At FSSA, our stance on AI is balanced. Our portfolios hold some exceptional technology companies that are benefiting from increased data-centre capex, and which should continue to prosper over the longer term as AI becomes more embedded in everyday life. Among them are the leading foundry of advanced AI chips, **Taiwan Semiconductor Manufacturing (TSMC)**, and Korean memory-chip makers **Samsung** and **SK Hynix**. These firms combine technological leadership, scale advantages and high barriers to entry that make their competitive positions difficult to challenge.

Our analysis tells us that in times of technological change it is often the firms that take advantage of new advances to improve processes, distribution models and products that reap the biggest rewards. We own several companies that are using AI in this way. Perhaps the best example is Chinese internet giant **Tencent**, which is sharpening its advertising targeting and boosting user engagement through application of the technology, thereby widening its already-impressive competitive moat.

[1] The MSCI AC Asia ex-Japan Quality Index returned 21% in 2025, compared with a 32% return for the MSCI AC Asia ex-Japan Index. All index returns shown in USD, net of tax.

Tencent has kept its AI-related capital investments relatively modest. This is in stark contrast to the so-called hyper-scalers, the global tech firms whose individual capex commitments dwarf the annual outlay of entire sectors. We are sceptical that hyper-scalers' returns on invested capital will sustain, whereas firms that utilise AI in a more targeted way should be able to leverage technological advances to improve both growth and returns. Over time, we would expect the markets to recognise and reward businesses on the right side of this distinction.

For this reason, we are avoiding companies whose recent growth is mostly attributable to hyper-scaler spending rather than their own fundamental strengths. While this has affected our relative performance, we feel justified in our caution. Many companies deemed to be AI winners in emerging markets – particularly smaller component suppliers without durable competitive advantages – are valued as if the capex surge will persist indefinitely, despite limited visibility on its longevity.

History doesn't repeat, but it rhymes

Emerging markets are not solely being driven by technology, however, and other salient factors are worth highlighting here. One is that the recent rally has favoured more-cyclical segments of emerging markets that are not aligned with FSSA's investment approach.

For instance, top index performers in 2025 included Chinese state-owned enterprises (SOEs) in sectors such as industrials, financials and materials, where governance standards are patchy and capital allocation is often driven by policy concerns rather than shareholder value. Another key growth area was Korean industrial cyclicals, a sector in which companies are routinely hampered by high fixed costs and a lack of sustainable competitive advantages.

We are wary of the enthusiasm for these sorts of businesses. In cyclical industries, management teams may have no visibility on returns beyond the next few quarters, but are often tempted to over-invest or engage in merger-and-acquisition (M&A) activity when the going is good. This can sharply compromise long-term shareholder returns.

Making money from lower-quality cyclical companies during these types of rallies is possible, but requires investors to be exceptionally nimble, and success is more often down to luck. We saw similar dynamics when the real estate and commodities sectors attracted attention before the Global Financial Crisis, and when internet and software as a service (SaaS) firms became market darlings in 2020-21. When conditions shifted, many of these once-celebrated companies saw their valuations collapse just as quickly as they had risen, and shareholders lost out.

FOMO vs. fundamentals

There are, then, good reasons for our limited exposure to areas that have delivered the lion's share of returns in Asia and other emerging market regions of late. Nevertheless, at times like this, some investment managers might be tempted to compromise on their philosophy and buy a few of the stocks rising higher on liquidity-driven speculation, for fear of missing out (FOMO).

At FSSA, we remain committed to a quality-focused approach, which we believe is the best way to grow our clients' capital over the long term. We see quality businesses as those with solid corporate governance; attractive franchises, characterised by secular growth opportunities and competitive advantages; sound financials, such as strong free cash-flow generation and low leverage; and good track records on sustainability issues.

These are the kinds of firms that can deliver attractive returns for longer than the market expects – even if they are overlooked during the strongest of bull markets. That's why we look for opportunities to buy them at a sensible price, then hold for the long term.

A consequence of this approach is that while our performance may lag in very buoyant or momentum-driven environments, we usually compensate quickly once such bubbles burst. Historically, our portfolios tend to perform better in "normal" markets (as defined as one-year rolling returns of -15% to +15%) and bear markets (more than a 15% decline), than in steeply rising markets (defined as over 15% one-year rolling returns). The reason is simple: our holdings tend to preserve capital and return to favour when market exuberance gives way to the unavoidable reality of earnings and cash flows. While there are no guarantees in investing, we would expect the pattern to repeat.

New opportunities

Not that we are simply waiting for market conditions to reverse. Patience does not equal passivity. We continue to travel across key economies to engage with management teams, test our investment theses and investigate the broader networks in which the companies we own are embedded. Recent trips have included Korea, the Philippines, Taiwan and India, as well as numerous visits to mainland China.

We have been energised by these trips, having identified ample opportunities for new investments across FSSA strategies. As the premium for quality businesses has compressed, the kinds of companies we favour are often now available at relatively more attractive valuations – especially among areas of the market that are being neglected amid the AI boom.

In China, for instance, consumer companies have suffered through a prolonged period of sluggish demand, due in part to the knock-on impact of the property-market slump. But with household savings still high – at RMB160tn (US$22tn), or more than 100% of GDP[2] – and the government committed to boosting consumption, we see potential for these firms to rebound. A good example is hotel operator **H World**, which has recently delivered improvements in key operational metrics. The company has a long runway of growth as it taps into trends including increasing travel, urbanisation and upgraded consumer preferences.

In India, bottom-up opportunities have been difficult to come by over the last two years, due to expensive valuations. However, earnings have grown and, in some cases, valuations have become more attractive. Take **Kotak Mahindra Bank (KMB)**; as previous investors in KMB, we decided to initiate new positions in the company across several FSSA strategies after seeing signs of positive change. The new CEO, Ashok Vaswani, aspires to expand the business and is showing a greater focus on consumer banking and digitisation. The growing trend towards formalised financial savings in India is expected to benefit KMB's insurance, mutual funds and asset management businesses.

Governance improvements are emerging elsewhere, too, including at **Jardine Matheson**, the Hong Kong-based group with roots stretching back to 1832 and sprawling operations across Asia. Over recent years, the company has redefined itself, with a new focus on professional management across its businesses, which have been exiting non-core ventures to boost returns on invested capital and return cash to shareholders where appropriate. Encouraged by these developments, we recently added to our position in Jardine Matheson in our regional strategies.

We also see opportunities across Southeast Asia, despite the fact the region currently appears unloved by investors. An example is **Sea Limited**, a Singapore-headquartered internet group with operations across e-commerce, digital financial services and online gaming, and a leadership team that places a strong emphasis on long-term value creation.

Staying the course

This snapshot of our recent investments illustrates a wider point: even as markets are driven higher by a cohort of AI-related and cheap cyclical names, there remain plenty of durable growth opportunities across Asia and the broader emerging-market universe.

The challenge of late has not been in finding these companies, or fundamental issues with our existing holdings, but rather the composition and drivers of the index itself. Companies with stable and predictable growth have not been rewarded by the market. While this has affected our relative performance, it has also enabled us to seize new opportunities and accumulate larger positions in our highest-conviction holdings, following our belief that it is those firms with stable earnings and free cash-flow growth over time that generate the most reliable future returns.

Rather than following the crowd, then, we remain focused on the characteristics that have compounded capital for our clients over decades: stewardship-minded management, conservative balance sheets and the ability to grow profitably through cycles. These attributes rarely command the spotlight at the peak of a liquidity-driven rally, but they matter when markets return to fundamentals. After all, when the tide turns and the wind changes, it's the sturdiest vessels that make the strongest headway.

[2] CICC Research/Wind, December 2025.

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