FSSA Investment Managers

For professional/Institutional investors only



Against the current:

Why we're focused on quality amid the market rally

February 2026

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.

Important Information

This material is a financial promotion / marketing communication but is for general information purposes only. It does not constitute investment or financial advice and does not take into account any specific investment objectives, financial situation or needs. This is not an offer to provide asset management services, is not a recommendation or an offer or solicitation to buy, hold or sell any security or to execute any agreement for portfolio management or investment advisory services and this material has not been prepared in connection with any such offer. Before making any investment decision you should conduct your own due diligence and consider your individual investment needs, objectives and financial situation and read the relevant offering documents for details including the risk factors disclosure.

Any person who acts upon, or changes their investment position in reliance on, the information contained in these materials does so entirely at their own risk.

We have taken reasonable care to ensure that this material is accurate, current, and complete and fit for its intended purpose and audience as at the date of publication. No assurance is given or liability accepted regarding the accuracy, validity or completeness of this material.

To the extent this material contains any expression of opinion or forward-looking statements, such opinions and statements are based on assumptions, matters and sources believed to be true and reliable at the time of publication only. This material reflects the views of the individual writers only. Those views may change, may not prove to be valid and may not reflect the views of everyone at First Sentier Group.

Past performance is not indicative of future performance. All investment involves risks and the value of investments and the income from them may go down as well as up and you may not get back your original investment. Actual outcomes or results may differ materially from those discussed. Readers must not place undue reliance on forward-looking statements as there is no certainty that conditions current at the time of publication will continue.

References to specific securities (if any) are included for the purpose of illustration only and should not be construed as a recommendation to buy or sell the same. Any securities referenced may or may not form part of the holdings of First Sentier Group portfolios at a certain point in time, and the holdings may change over time.

References to comparative benchmarks or indices (if any) are for illustrative and comparison purposes only, may not be available for direct investment, are unmanaged, assume reinvestment of income, and have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities) that are different from the funds managed by First Sentier Group.

Selling restrictions

Not all First Sentier Group products are available in all jurisdictions.

This material is neither directed at nor intended to be accessed by persons resident in, or citizens of any country, or types or categories of individual where to allow such access would be unlawful or where it would require any registration, filing, application for any licence or approval or other steps to be taken by First Sentier Group in order to comply with local laws or regulatory requirements in such country.

About First Sentier Group

References to 'we', 'us' or 'our' are references to First Sentier Group, a global asset management business which is ultimately owned by Mitsubishi UFJ Financial Group (**MUFG**). Certain of our investment teams operate under the trading names AlbaCore Capital Group, First Sentier Investors, FSSA Investment Managers, Stewart Investors and RQI Investors all of which are part of the First Sentier Group. RQI branded strategies, investment products and services are not available in Germany.

This material may not be copied or reproduced in whole or in part, and in any form or by any means circulated without the prior written consent of First Sentier Group.

We communicate and conduct business through different legal entities in different locations. This material is communicated in:

Australia and New Zealand by First Sentier Investors (Australia) IM Ltd, authorised and regulated in Australia by the Australian Securities and Investments Commission (AFSL 289017; ABN 89 114 194311)

European Economic Area by First Sentier Investors (Ireland) Limited, authorised and regulated in Ireland by the Central Bank of Ireland (CBI reg no. C182306; reg office 70 Sir John Rogerson's Quay, Dublin 2, Ireland; reg company no. 629188)

Hong Kong by First Sentier Investors (Hong Kong) Limited and has not been reviewed by the Securities & Futures Commission in Hong Kong. First Sentier Group, First Sentier Investors, FSSA Investment Managers, Stewart Investors, RQI Investors and Igneo Infrastructure Partners are the business names of First Sentier Investors (Hong Kong) Limited.

Singapore by First Sentier Investors (Singapore) (reg company no. 196900420D) and this advertisement or material has not been reviewed by the Monetary Authority of Singapore. First Sentier Group (registration number 53507290B), First Sentier Investors (registration number 53236800B), FSSA Investment Managers (registration number 53314080C), Stewart Investors (registration number 53310114W), RQI Investors (registration number 53472532E) and Igneo Infrastructure Partners (registration number 53447928J) are the business names of First Sentier Investors (Singapore).

United Kingdom by First Sentier Investors (UK) Funds Limited, authorised and regulated by the Financial Conduct Authority (reg. no. 2294743; reg office Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB)

United States by First Sentier Investors (US) LLC, registered with the Securities Exchange Commission (SEC# 801-93167).

other jurisdictions, where this document may lawfully be issued, by First Sentier Investors International IM Limited, authorised and regulated in the UK by the Financial Conduct Authority (FCA ref no. 122512; Registered office: 23 St. Andrew Square, Edinburgh, EH2 1BB; Company no. SC079063).

To the extent permitted by law, MUFG and its subsidiaries are not liable for any loss or damage as a result of reliance on any statement or information contained in this document. Neither MUFG nor any of its subsidiaries guarantee the performance of any investment products referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk, including loss of income and capital invested.

© First Sentier Group