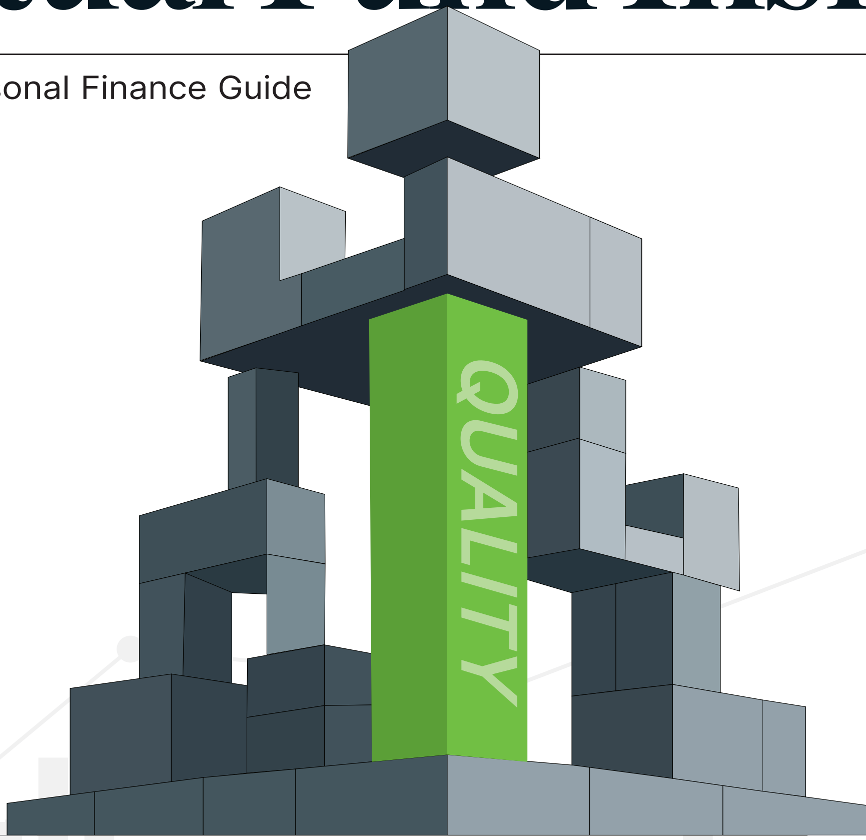
Value Research

Mutual Fund Insight

Special Supplement
May 2025

Complete Personal Finance Guide



THE FACTOR EDGE

Quality factor

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Dhirendra Kumar
Editor-in-chief

The long game belongs to quality

Every few years, the market likes to play a little game with us – not just with our portfolios, but with our nerves. And this year? Oh, it's been a full-blown pop quiz. Global uncertainty, local volatility, investor anxiety. It's like *déjà vu*, but with a fresh set of headlines.

Cue the familiar question: Am I doing the right thing with my money?

It's not a new question. But when the going gets rough, it tends to shout instead of whisper.

At **Mutual Fund Insight**, we've said it repeatedly – investing isn't about predicting what's around the corner. It's about preparing for whatever shows up. That's where quality steps into the spotlight. Not flashy, not faddish – just quietly consistent.

Sure, we've seen all kinds of styles strut down the catwalk momentum, value, small-cap sprints, thematic trends that burn bright (and sometimes burn out). But quality? It's the classic that never goes out of style – not in the abstract sense, but in a real, measurable way – investing in well-run, resilient businesses, often through mutual funds or portfolios that filter for exactly that.

This supplement is our way of nudging the spotlight back where it belongs. We've broken down performance across styles, sectors and cycles. We've zoomed in on how quality behaves during crashes, during recoveries and over the long haul. And the evidence is hard to ignore.

Quality doesn't always win the popularity contest year after year. But when you zoom out, it's usually ahead, especially when you factor in risk. When markets wobble, quality stumbles less. And when recovery comes knocking, it gets back on its feet faster.

That's not luck. That's math – and management. High return on equity, low debt, steady earnings, and smart capital allocation are the building blocks of businesses that can take a punch and still grow.

For mutual fund investors, the takeaway is simple: quality isn't a seasonal pick. It's the foundation. It lowers your risk, steadies your returns and helps you stay the course – especially when everything else is trying to shake you off track.

Because investing isn't about chasing the next shooting star, it's about building something that lasts.

And quality? That's what lasts.

What's 'quality factor'?

In investing, not all stocks are created equal. Some companies are simply built better – stronger balance sheets, consistent profitability and better capital allocation. 'Quality factor' is about identifying and investing in such companies.

Factor investing, at its core, is a rule-based approach to selecting stocks based on certain characteristics – or 'factors' – that have historically driven returns. Quality factor is among the most widely studied and used. It focuses on stocks of companies that demonstrate high financial quality. But how do you define 'quality' in numbers? Most strategies, including those used globally, rely on a few common parameters:

Return on equity (ROE): This metric measures how efficiently a company uses shareholder capital.

Earnings stability: Consistent earnings growth over time, without wild fluctuations.

Low financial leverage: A preference for companies with low levels of debt relative to equity or assets.

Strong cash flows: Reliable and recurring operating cash flow signals a healthy business model.

Dividend payout ratio: A reflection of a company's ability and willingness to return profits to shareholders consistently.

Some models also include **capital efficiency metrics** and **profit margins** to refine their definition of quality. The exact parameters can vary, but the underlying philosophy remains the same – favour profitable, prudent and predictable businesses.

Quality is not about glamour or popularity. It's about resilience and sound fundamentals – companies that may not always lead in bull markets but often stand out when the tide turns.

In a way, quality factor is simply a structured method of what many seasoned investors already do – look under the hood and favour businesses built to last.

Why quality factor matters

In investing, the true test isn't how well something performs in a bull market – it's how well it holds up when things go wrong. That's where quality shows its actual worth.

A high-quality business doesn't just grow; it endures. It generates strong and consistent profits, reinvests capital wisely and avoids the kind of financial fragility that brings down lesser quality companies. These aren't flashy traits, but they're the ones that tend to matter most over time. Quality isn't about the next quarter – it's about surviving the next cycle.

Ignore quality, and you might overlook consequences right away. In good times, everything seems to work. But when the cycle turns – as it always does – low-quality businesses are the first to falter. Their reliance on borrowed money, weak cash flows or erratic earnings becomes hard to hide. And that's when investors start paying the real price.

What makes quality even more compelling is its relationship with time. Over long periods of time, quality businesses tend to not just protect capital, they compound it. In fact, one

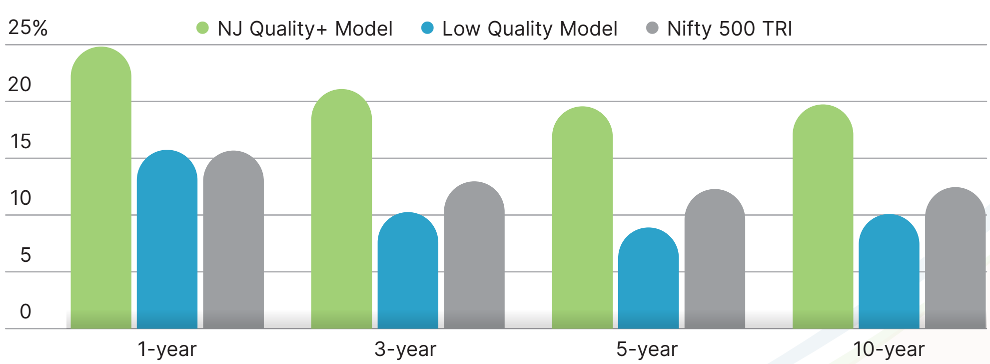
Quality wins on growth, volatility and downside risk

High cumulative returns, low volatility

Segment	Cumulative growth of ₹1,000	Yearly volatility (%)	5Y loss probability (%)
NJ Quality+ Model	24,545	16.9	0.0
Low Quality Model	4,510	22.9	17.7
Nifty 500 TRI	8,202	20.2	1.2

Quality delivers across time frames

Consistently higher returns over one, three, five and 10 years compared to low-quality stocks and the broader market



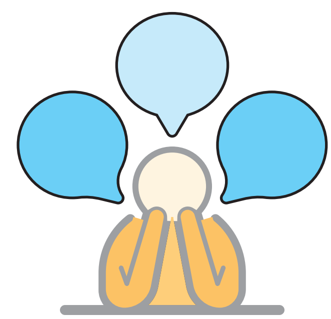
Source: Internal research of NJ AMC, CMIE, NSE. Average of daily rolling returns calculated for different holding periods. The period for calculation is September 30, 2006 till February 28, 2025. Past performance may or may not be sustained in future and is not an indication of future returns. NJ Quality+ Model and Low Quality Model are proprietary methodologies developed by NJ Asset Management Private Limited. The methodology will keep evolving with new insights based on the ongoing research and will be updated accordingly from time to time.

model tracking a quality-centric portfolio over the last two decades shows a 24-fold growth compared to just an eight-fold growth for the broader market and less than five-fold for a portfolio of low-quality stocks. See the table 'Quality wins on growth, volatility, and downside risk.'

It's not just about returns, either. Quality also tends to reduce regret. The same study shows that the chances of losing money over a five-year holding period were practically zero for the quality portfolio, while the low-quality portfolio carried nearly an 18 per cent chance of losses.

In short, quality brings three things every investor should want: durability, consistency and peace of mind. While it doesn't promise miracles, it promises resilience – and in the long run, that's often the better deal.

Who is investing in quality?

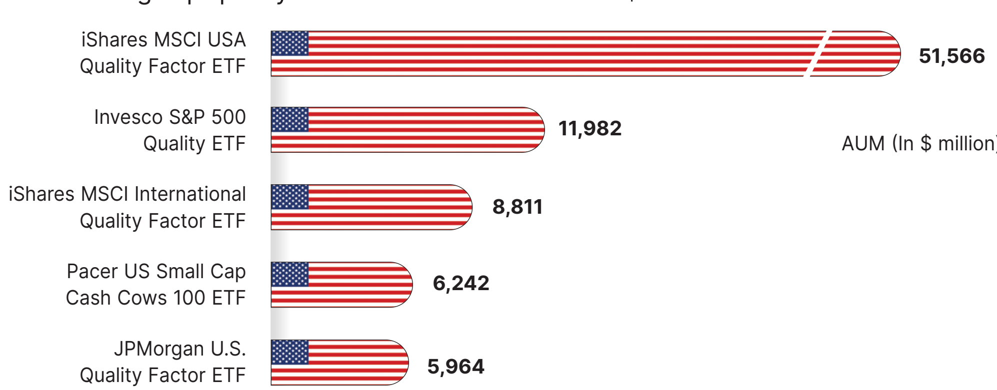


Quality factor is no longer a niche idea. Over the last decade, it has gained widespread acceptance among institutional investors across the globe – particularly in the form of smart beta strategies and factor-based ETFs (exchange-traded funds).

Some of the largest asset managers have built multi-billion-dollar funds around quality. The iShares MSCI USA Quality Factor ETF, for instance, now manages over $50 billion in assets, making it one of the most popular single-factor products in the world. Other major offerings from Invesco,

Top five quality factor ETFs in the US

iShares' flagship quality ETF alone commands over $50 billion in terms of assets



Source: Bloomberg. Data as of February 28, 2025.

JPMorgan and Pacer have also attracted billions in investor capital.

What's even more telling is the trend. Over the past 10 years, quality-focused smart-beta ETFs have seen the fastest growth in AUM (assets under management) among all factor-based categories – compounding at nearly 36 per cent annually, far ahead of value, momentum or low-volatility strategies. The number of quality-centric equity ETFs has also grown significantly, albeit from a smaller base.

This surge in adoption suggests that investors are increasingly looking beyond market-cap-weighted indices and embracing systematic approaches that emphasise fundamentals. Quality, with its blend of defensiveness and long-term performance potential, fits neatly into that shift.

For retail investors, this global trend offers a signal worth noting. Institutions often move slowly – but deliberately – and their rising preference for quality may well reflect a broader recognition: strong fundamentals still matter in a noisy world.

Factor-wise surge in AUM and number of equity smart-beta ETFs over the last decade

Quality leads the pack in AUM growth among smart-beta factors

	Growth in no. of equity smart-beta ETFs			Growth in AUM of equity smart-beta ETFs		
Factor	2014	2024	Growth (% pa)	Dec '14($ mn)	Dec '24($ mn)	Growth (% pa)
Quality	**8**	**28**	**13.3**	**4,672**	**1,00,194**	**35.9**
Value	43	71	5.1	94,554	4,82,121	17.7
Momentum	18	29	4.9	3,533	27,454	22.8
Low volatility	18	26	3.7	14,412	50,788	13.4
Size	44	48	0.9	26,763	1,49,839	18.8
Growth	39	53	3.1	98,460	6,42,604	20.6
Multi-factor	85	172	7.3	33,929	2,06,847	19.8
Others	94	343	13.8	1,21,455	5,42,384	16.1
Total	**349**	**770**	**8.2**	**3,97,778**	**22,02,231**	**18.7**

Source: Bloomberg

Quality trends across the globe

Quality isn't just a local story – it's a global one. Across geographies, quality-focused strategies tend to outperform the broader market over time. Whether in developed markets like the US and Europe or emerging ones like India, quality factor has earned its place through cycles of boom and bust.

In the US, data from the mid-1990s shows that quality stocks have delivered higher returns than the broader market over the long term. Despite periods of underperformance, especially in liquidity-fuelled bull runs, the overall trajectory has favoured companies with strong fundamentals. Over the full period observed, quality outpaced the US market both in annualised returns and rolling return medians.

Europe tells a similar story. Though the region's economic cycles have been more turbulent in recent years, quality strategies have still managed to stay ahead. The margin of outperformance isn't as wide as in the US or India, but it's consistent enough to suggest that

Region-wise summary of quality factor performance

India, US and Europe all show long-term outperformance of quality stocks versus the broader market

		Annualised return (% pa)		Three-year median rolling return (% pa)		10-year median rolling return (% pa)	
Region	Period	Quality	Market	Quality	Market	Quality	Market
US	Jul 5, 1995 - Dec 31, 2000	26.4	19.3	27.2	25.8	-	-
	Jan 1, 2001 - Dec 31, 2006	6.5	2.9	10.4	9.0	-	-
	Jan 1, 2007 - Dec 31, 2012	6.4	2.3	4.6	1.6	-	-
	Jan 1, 2013 - Dec 31, 2018	11.2	12.2	9.9	10.9	-	-
	Jan 1, 2019 - Feb 28, 2025	18.2	16.8	11.7	10.4	-	-
	Entire period	13.2	10.4	11.8	11.2	11.0	8.0
Europe	Jul 15, 2014 - Dec 31, 2018	6.9	3.0	6.4	3.6	-	-
	Jan 1, 2019 - Feb 28, 2025	12.9	12.0	8.3	9.0	-	-
	Entire Period	10.3	8.1	8.4	7.6	9.9	7.5
India	Apr 1, 2005 - Dec 31, 2012	18.8	14.8	16.5	8.6	-	-
	Jan 1, 2013 - Dec 31, 2018	16.5	12.8	16.3	13.1	-	-
	Jan 1, 2019 - Feb 28, 2025	14.9	14.5	20.5	19.1	-	-
	Entire period	16.9	14.2	16.4	13.2	16.4	12.8

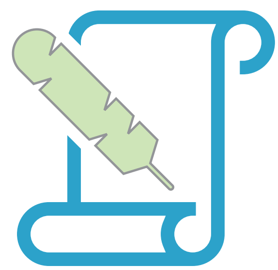
Source: Bloomberg, NSE. Past performance may or may not be sustained in future and is not an indication of future return. The S&P 500 Quality TRI, S&P Europe 350 Quality TRI, & Nifty 500 Quality 50 TRI are used to represent the Quality index for the USA, Europe and India regions, respectively. The S&P 500 TRI, S&P Europe 350 TRI & Nifty 500 TRI are used to represent the market index for the USA, Europe and India regions, respectively.

financial resilience is rewarded even in structurally slower economies.

Closer home, India has seen particularly strong results for quality over the last two decades. Be it annualised returns or median rolling returns, the gap between high-quality stocks and the broader market has been meaningful. Even across different time frames – pre-2012, post-2013 and in recent years – quality has stayed a step ahead.

The conclusion is straightforward: quality is not a region-specific anomaly. It's a fundamental investment principle that seems to hold across markets, offering long-term investors a more stable path to growth, irrespective of geography.

What history tells us about quality-based investing in India



In investing, the debate around quality is not philosophical – it is empirical. And the Indian market offers nearly two decades of data to examine how quality-centric metrics have translated into investment outcomes.

Take return on equity (ROE) – a common measure of capital efficiency. A portfolio of companies with the highest ROEs delivered annualised returns of 14.6 per cent, comfortably ahead of both the broader market and companies with the weakest ROEs. And that performance didn't come with added risk. In fact, high-ROE portfolios were significantly less volatile and experienced shallower drawdowns than their low-ROE counterparts.

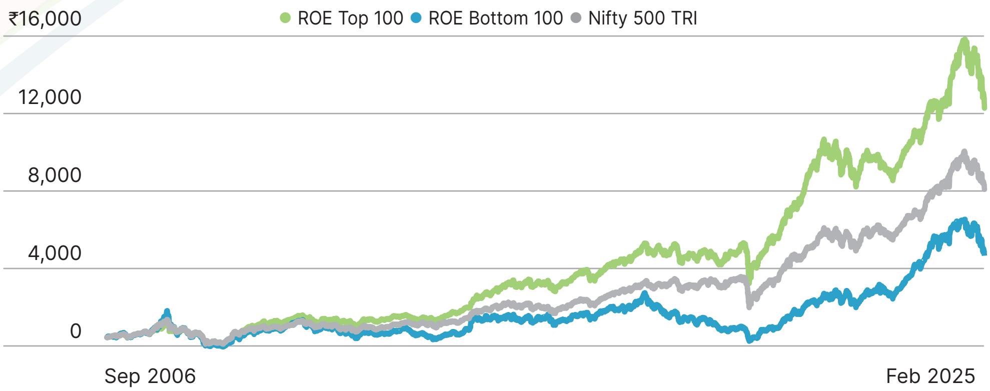
The difference becomes even more stark when you look at ROE consistency. Firms that maintained high ROEs year after year – not just occasionally – delivered even stronger results, with annualised returns of over 16 per cent and the lowest drawdowns in the set. In contrast, inconsistent ROE performers lagged on every measure: return, volatility and resilience.

The story repeats itself with dividend payout and debt-to-equity ratios. Companies that shared profits consistently or maintained conservative leverage not only outperformed in absolute terms but also offered a smoother ride. They fell less during drawdowns and recovered faster.

This data proves that quality is not a vague or abstract concept. It can be defined, measured and most importantly, rewarded. Whether it's profitability, stability, prudence or discipline, the market has historically paid a premium for these traits.

High ROE, higher return, lower pain

The top 100 high-ROE stocks outperformed the market with lower volatility and shallower drawdowns

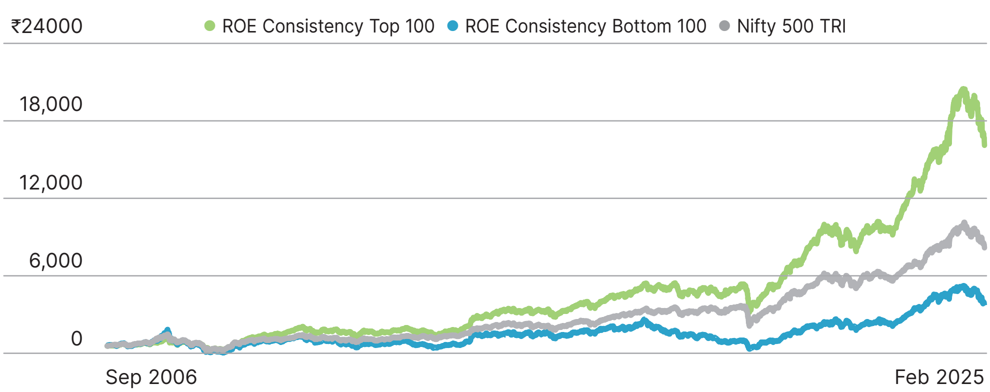


Segment	Annualised return (% pa)	Annualised (%) volatility	Maximum drawdown (%)	Cumulative growth of ₹1,000
ROE Top 100	14.6	17.5	-63.9	12,291
ROE Bottom 100	9.0	24.9	-76.6	4,910
Nifty 500 TRI	12.1	20.2	-63.7	8,202

Data for the period September 30, 2006 until February 28, 2025. The graph shows worth of ₹1,000 invested at the beginning of the period in the three portfolios.

Consistency pays: Steady ROE, stronger compounding

Top 100 most consistent ROE performers delivered twice the growth with far less risk

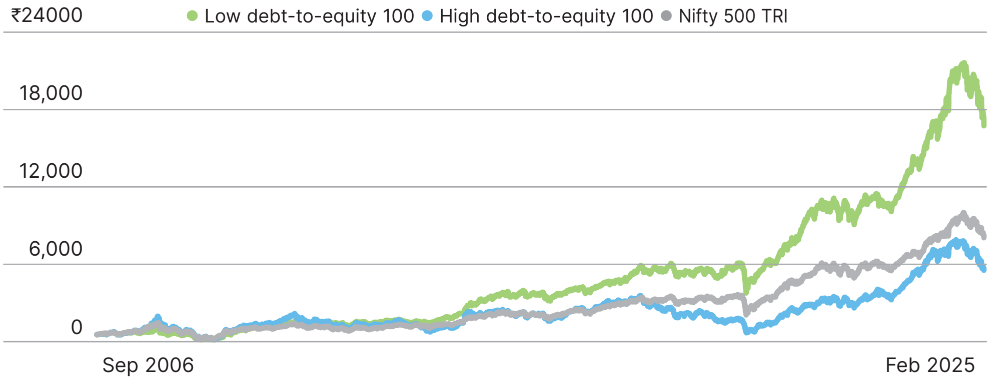


Segment	Annualised return (% pa)	Annualised (%) volatility	Maximum drawdown (%)	Cumulative growth of ₹1,000
ROE Consistency Top 100	16.3	17.8	-57.9	16,096
ROE Consistency Bottom 100	7.5	24.8	-77.1	3,818
Nifty 500 TRI	12.1	20.2	-63.7	8,202

Data for the period September 30, 2006 until February 28, 2025. The graph shows worth of ₹1,000 invested at the beginning of the period in the three portfolios.

Low debt, high returns

The top 100 low-debt stocks grew wealth twice as fast with lower volatility and milder drawdowns



Segment	Annualised return (% pa)	Annualised (%) volatility	Maximum drawdown (%)	Cumulative growth of ₹1,000
Low debt-to-equity 100	16.6	16.9	-60.5	16,850
High debt-to-equity 100	9.9	24.9	-74.1	5,719
Nifty 500 TRI	12.1	20.2	-63.7	8,202

Data for the period September 30, 2006 until February 28, 2025. The graph shows worth of ₹1,000 invested at the beginning of the period in the three portfolios.

The cyclicality of quality – and why it matters now

No investment approach outperforms consistently. Quality is no exception. It often plays second fiddle during frothy bull runs, when speculative sentiment lifts all boats. But when the tide goes out – when fear returns, liquidity tightens and fundamentals reassert themselves – quality tends to come into its own.

History proves this true. During the Global Financial Crisis (2008), quality stocks did fall, but less. And when recovery began, they rebounded strongly, even outperforming momentum strategies. The same repeated in 2020. Quality stocks fell in the Covid crash, but it was milder than the rest. And as the dust settled, they bounced back with vigour.

Why does this happen?

Because quality stocks are just built differently.

These are companies with strong balance sheets, consistent earnings, high return on equity, low debt and prudent capital allocation. They don't need to scramble for cash when the economy slows. They aren't over-leveraged. They aren't betting the house on the next quarter. Their business models are often self-sustaining, and their leadership tends to think in years, not months.

In contrast, poor-quality businesses – those with weak cash flows, excessive debt or fragile margins – get exposed in a downturn. When credit tightens or demand falls, these companies are forced to deleverage, cut back or worse – raise capital at unfavourable terms. The market, sensing this fragility, penalises them disproportionately.

That is why drawdowns are deeper for low-quality stocks – and recoveries are slower. Not because the market is irrational, but because the underlying economics justify that reaction.

From a behavioural lens, this is also where investors often slip. During easy-money phases, quality appears 'boring' or 'expensive.' But when volatility returns, the same attributes – consistency, resilience, and discipline – suddenly look like strengths again.

This cyclical pattern is precisely what makes quality investing a durable strategy. It doesn't promise market-beating returns every year. Instead, it protects capital when it matters most and compounds meaningfully over time.

And right now, we may be at the cusp of such a shift. With macro uncertainty rising, interest rates off the floor, and frothy pockets of the market deflating, the case for quality is strengthening again.

It's not a timing call. It's a temperament call. If history is any guide, now is a good time to start favouring companies that don't just grow – but endure.

Global Financial Crisis (GFC): Quality absorbed the blow, then doubled up

While momentum and value swung wildly, quality declined less in the crash and surged an astounding 162 per cent during recovery

Index	Pre-GFC bull period (Sep 30, 2006 to Dec 31, 2007; %)	GFC correction (Jan 1, 2008 to Mar 31, 2008; %)	Post-GFC recovery (Apr 1, 2009 to Dec 31, 2010; %)
Nifty 500 Quality 50	52.1	-45.9	161.9
Nifty 500 Momentum 50	161.8	-64.5	95.6
Nifty 500 Low Volatility 50	56.9	-37.8	129.5
Nifty 500 Value 50	109.3	-61.1	228.0
Nifty 500 Multifactor MQVLV 50	65.8	-45.6	175.7
Nifty 500 TRI	82.2	-56.7	116.7

Source: NSE

Covid-19 pandemic: Quality cushioned the fall, stayed in the race

Minimal gains before the pandemic, smaller losses during the crash and a strong rebound helped quality stay steady through the chaos

Index	Pre-pandemic period (Jan 1, 2019 to Dec 31, 2019; %)	During pandemic period (Jan 1, 2020 to Mar 23, 2020; %)	Post-pandemic period (Mar 24, 2020 to Dec 31, 2021; %)
Nifty 500 Quality 50	1.8	-28.5	124.3
Nifty 500 Momentum 50	8.6	-32.8	214.7
Nifty 500 Low Volatility 50	8.2	-26.5	99.7
Nifty 500 Value 50	-15.8	-42.1	180.6
Nifty 500 Multifactor MQVLV 50	3.6	-26.8	126.5
Nifty 500 TRI	8.6	-36.7	139.8

Source: NSE

Does quality work across size?

One of the enduring myths in equity investing is that quality is a large-cap story. After all, the assumption goes, it's only the bigger businesses that can consistently deliver high returns on equity, maintain low debt and reward shareholders through dividends.

However, the data tells us a more layered – and more interesting – story.

Across large, mid and small caps, quality factor shows a consistent pattern: the higher the quality, the better the long-term outcomes. But the degree of impact differs depending on the terrain.

Let's start with **large caps.** Here, the performance gap between the top-quality group and the broader index is modest. But the real advantage lies in risk metrics. High-quality large caps show lower volatility, smaller drawdowns and lower loss probability, making them ideal for investors seeking relative safety without giving up much return. As Bharat Shah (one of India's greatest investors) would argue, capital preservation is a form of capital compounding – and these companies embody that principle.

It's in the **mid-cap** space that quality truly flexes its muscle. The top-quality mid caps don't just beat the benchmark – they blow past it, delivering annualised returns of 18.3 per cent with lower volatility than the mid-cap average. Their 10-year median rolling return crosses 20 per cent, showcasing their compounding power. And they do this while offering a 0 per cent chance of a loss over any five-year period.

Why does this happen? Because mid caps sit at the sweet spot of growth and maturity. Many are in the ascent phase of their business life cycle, but only a few combine that growth with discipline. When investors find those rare businesses – high ROE, low debt and consistent payout – they are often rewarded with outsized returns.

Nowhere is the divergence more visible than in **small caps**. Here, the difference between the top and bottom quality buckets is night and day. High-quality small caps return 18 per cent annually – over double that of their low-quality counterparts – while being significantly less volatile. Their drawdowns, though still steep, are shallower. Their consistency is superior. It reinforces a timeless truth: in the riskiest parts of the market, quality becomes even more valuable.

Put simply, quality acts as a compass in the often chaotic world of mid- and small-cap investing. While market cap tells you how big a company is, quality tells you how well it is run. The latter matters far more for long-term wealth creation.

As Peter Lynch might remind us, you can make money in all kinds of companies, but the ones that let you sleep peacefully at night are usually the ones with clean books, smart capital allocation and staying power.

Whether you're fishing in a large pond or prospecting in smaller waters, one rule holds true: if the quality is poor, the size won't save you. But if the quality is high, the market will eventually recognise it – often with interest.

Performance of quality factor across market caps

Top-quality mid and small caps delivered stronger returns, lower risk and greater consistency over time

						Median rolling return (% pa)			
Market cap category	Portfolio	Annualised return (%)	Annualised volatility (%)	Maximum drawdown (%)	5Y loss probability (%)	1-year	3-year	5-year	10-year
Large cap	Top tercile	13.3	17.6	-55.2	0.0	12.8	14.8	13.9	13.9
	Middle tercile	12.3	21.4	-66.3	1.7	11.4	13.7	12.1	12.9
	Bottom tercile	11.6	24.8	-75.1	11.2	11.3	13.2	11.1	11.3
	Large cap	12.6	20.6	-66.4	0.9	11.6	13.7	12.1	12.9
Mid cap	Top tercile	18.3	17.1	-63.2	0.0	17.7	19.7	20.1	20.2
	Middle tercile	15.0	21.3	-69.2	0.3	12.8	17.7	15.1	16.6
	Bottom tercile	8.3	25.0	-80.4	27.5	6.9	9.3	6.8	6.9
	Mid cap	14.1	20.5	-71.6	1.5	12.1	15.8	13.7	15.0
Small cap	Top tercile	18.0	18.3	-63.4	0.0	15.1	21.8	20.4	20.8
	Middle tercile	12.4	22.2	-73.2	4.5	13.5	17.9	11.3	14.2
	Bottom tercile	8.3	24.6	-75.7	18.3	5.0	10.3	6.0	7.6
	Small cap	13.0	21.2	-71.2	2.5	11.0	16.8	12.6	14.2

Data for the period September 30, 2006 to February 28, 2025. Quality is measured based on a combination of ROE, dividend payout ratio and debt to equity.

Sectoral performance: Where quality thrives

Quality is not randomly distributed across the market. Some sectors are inherently more fertile ground for quality businesses. Others, by design or constraint, are structurally hostile to the very traits that define quality – capital efficiency, consistent profitability, low leverage and prudent capital allocation.

This section takes a deeper look at how quality factor behaves across sectors. But more importantly, it explores why certain sectors tend to foster quality and why others chronically struggle.

Quality delivers across sectors but not equally

When companies within each sector are ranked by quality – based on return on equity (ROE), dividend payout ratio and debt-to-equity – we see a clear and persistent pattern:

- In 15 out of 19 sectors, high-quality companies outperformed their low-quality counterparts.
- In all 19 sectors, high-quality companies exhibited lower volatility.
- The median quality alpha (five-year rolling) was a compelling +6.5 per cent, with a median volatility advantage of -4.5 per cent.

The most telling metric? In sectors like industrials and IT, the best-quality companies not only earned higher returns, but did so with lower drawdowns, lower probability of loss, and significantly smoother return paths across all holding periods.

A clear pattern: Quality leads more often than not

In the majority of sectors, high-quality companies not only deliver better returns but also come with lower volatility

Metric	Value
Total no. of sectors	19
No. of sectors where high-quality stocks outperform low-quality stocks	15
No. of sectors where high-quality stocks are less volatile than low-quality stocks	19
Average quality alpha across sectors (5-year rolling median) (%)	5.4
Median quality alpha across sectors (5-year rolling median) (%)	6.5
Average quality excess volatility across sectors (%)	-5.5
Median quality excess volatility across sectors (%)	-4.5

Data for the period September 30, 2006 to February 28, 2025. Quality is measured based on a combination of ROE, dividend payout ratio and debt to equity. Based on the proprietary sector classification of NJ Asset Management. Insurance sector is excluded from the study.

This isn't accidental. These are sectors where capital efficiency, operating leverage and competitive moats combine to create conditions in which quality compounds. They have the kind of operating economics that Warren Buffett would approve of – high ROCE, modest reinvestment needs and long-duration earnings visibility.

Not all sectors offer equal ground for quality

Sector-wise differences in quality outcomes are not just about the companies – they are also about industry structure.

As Buffett said, some industries face constant reinvestment pressures just to stay in place. In capital-intensive or heavily regulated sectors – like utilities, telecom, or infrastructure – returns are more dependent on macro factors, government policy or commodity cycles than on managerial excellence.

These sectors often suffer from:

- High capital intensity (certain capex, uncertain returns)
- Low pricing power
- Weak or no moats
- Balance sheet fragility (high leverage)
- Over-dependence on external variables (interest rates, subsidies, regulation)

Contrast that with consumer staples, IT or industrials, where:

- Growth is demand-led and organic

Quality works across sectors but some stand out

High-quality stocks outperform and fall less across most sectors, with some delivering superior consistency and resilience

Market cap category	Portfolio	Annualised return (%)	Annualised volatility (%)	Maximum drawdown (%)	5Y loss probability (%)	Median rolling return (% pa) 1-year	3-year	5-year	10-year
Consumer discretionary	Top half based on quality	11.5	21.2	-78.3	6.9	13.3	14.7	13.7	14.7
	Bottom half based on quality	7.8	24.6	-81.3	26.5	11.3	9.6	7.2	7.2
	Consumer discretionary	9.9	22.0	-79.9	13.6	13.4	13.7	10.7	11.5
Information technology	Top half based on quality	18.6	22.5	-73.4	4.3	17.5	20.7	26.2	24.5
	Bottom half based on quality	16.3	25.5	-74.3	10.4	11.2	14.5	20.0	19.2
	Information technology	17.7	22.3	-73.0	6.1	13.5	17.7	23.7	22.5
Diversified banks	Top half based on quality	8.5	26.7	-70.6	24.9	8.9	10.0	8.2	6.1
	Bottom half based on quality	8.3	30.7	-80.4	40.7	9.4	8.8	4.7	2.5
	Diversified banks	8.7	27.8	-72.6	32.8	9.6	9.0	6.4	4.5
NBFC	Top half based on quality	23.2	25.3	-68.2	0.0	21.8	25.8	23.4	25.6
	Bottom half based on quality	18.5	27.3	-76.3	14.4	21.1	22.8	19.5	16.1
	NBFC	21.4	25.0	-71.3	0.5	23.0	24.2	19.8	21.9
Financial services non-lending	Top half based on quality	20.9	20.4	-70.5	0.0	19.2	23.5	22.2	22.7
	Bottom half based on quality	16.8	26.7	-80.7	7.7	16.8	18.1	11.8	17.5
	Financial services non-lending	19.1	21.6	-76.5	1.1	19.3	22.9	16.9	20.3
Automobiles and ancillaries	Top half based on quality	15.1	19.8	-65.6	2.9	17.3	21.7	20.7	17.9
	Bottom half based on quality	15.5	23.4	-79.1	6.1	15.0	16.2	20.5	19.3
	Automobiles and ancillaries	15.9	20.4	-71.3	3.5	15.4	19.6	19.9	19.8
Industrials	Top half based on quality	17.5	17.8	-67.0	0.0	17.2	20.0	19.6	20.5
	Bottom half based on quality	16.6	22.3	-77.7	15.3	16.7	17.8	13.7	14.2
	Industrials	17.3	19.4	-72.8	2.3	16.9	19.0	16.8	17.5

Data for the period from September 30, 2006 till February 28, 2025. Quality is measured based on a combination of ROE, dividend payout ratio and debt to equity. Based on the proprietary sector classification of NJ Asset Management.

- Moats are built on distribution, brands, or intellectual capital
- Businesses reinvest retained earnings at high rates of return

This explains why some sectors consistently score high on quality over time. Data shows that IT, staples, and industrials have ranked among the top on quality metrics across multiple market cycles from 2006 to 2024. Their DNA aligns with the very definition of quality.

The real insight

A small, high-quality company in a structurally strong sector may be a better bet than a large company stuck in a structurally weak industry.

Sector-aware quality investing isn't about timing – it's about recognising that some sectors give you the wind at your back. Others are perpetual headwinds. When quality shows up in the right sectors, you get the rare mix of:

- Higher returns
- Lower volatility
- Greater durability of earnings

And over time, that's how serious wealth is built.

Some sectors are naturally higher quality than others

Over the years, sectors like IT, consumer staples and industrials have consistently scored high on quality, while others lag

Sector	2006-2010	2011-2015	2016-2020	2021-2024
Chemicals	9.2	5.4	6.8	5.3
Energy	4.6	8.2	7.0	4.5
Consumer staples	10.4	5.2	3.6	2.8
Consumer discretionary	15.2	11.6	11.2	13.0
Metals and mining	8.2	12.2	12.6	9.0
Media & entertainment	17.8	15.4	13.4	14.8
Industrials	1.6	4.0	6.6	5.0
Information technology	3.4	1.0	1.0	1.0
Healthcare	5.6	4.4	7.8	7.3
Telecommunications	19.0	19.0	17.4	17.3
Real Estate	14.0	16.8	17.4	18.5
Diversified banks	13.4	11.2	17.0	18.3
Infrastructure	11.4	15.6	13.6	9.0
Automobiles & ancilliaries	8.8	7.8	3.6	9.3
Materials	12.0	12.4	14.6	13.0
Utilities	16.6	17.6	17.0	14.3
NBFC	3.4	7.0	6.8	10.3
Financial Services - Non-lending	3.4	2.4	2.0	2.0
Transportation & logistics	11.0	12.0	9.8	14.5

Data for the period September 30, 2006 to February 28, 2025. Quality is measured based on a combination of ROE, dividend payout ratio and debt to equity. Based on the proprietary sector classification of NJ Asset Management. Data shown above is the average of rank of individual years for the period mentioned.

Is quality making a comeback – or was it ever gone?

It's tempting to ask whether quality factor is making a comeback, especially after a few years in the shadow of flashier themes like momentum. But to pose the question that way is to look at quality through the wrong lens.

Because quality isn't a theme. It's not a trend. And it's certainly not a bet on next quarter's leaderboard. Quality is a way of investing in enduring business merit. It is a belief that businesses with strong balance sheets, high return on equity, consistent cash generation, and disciplined capital allocation will eventually – inevitably – win out over time.

Yes, quality underperformed in a few calendar years. But the underperformance was quotational, not fundamental. The intrinsic value of high-quality businesses doesn't swing with market sentiment. What changes is how long the market chooses to ignore it.

And that's why quality can sometimes feel unrewarding in the short run. It is, by design, an approach rooted in modest expectations and contrarian patience – both of which run counter to investor psychology in euphoric bull markets. But when reality reasserts itself – through volatility, crisis, or simply mean reversion – quality shows up not as a comeback artist but as the constant that never left.

The quiet compounding

Behind every multi-year market winner lies a set of traits that rarely make headlines:

- Products that don't need deep discounts to sell.
- Margins that don't need leverage to look attractive.
- Earnings that don't rely on capital injections to grow.
- Managements that don't need to dazzle because they deliver.

These are the hallmarks of quality. While they don't always deliver excitement, but they do deliver resilience. And in the end, it's resilience – not brilliance – that drives compounding.

The character of a business matters more than its size. And that character is defined not just by what the business earns, but how it earns it – how durable those earnings are, how capital-efficient the model is and how wisely those earnings are redeployed.

So, what should you take away from this?

Rather than chase what's currently leading the pack, you would do well to ask: what kind of businesses can keep growing, through cycles, while protecting capital along the way?

The answer, more often than not, leads back to quality.

This doesn't mean allocating exclusively to quality. But it does mean

Quality stays the course while others falter

After a decade of style churn, quality proves its staying power once again

Year	Nifty 500 Value 50 TRI	Nifty 500 Momentum 50 TRI	Nifty 500 Low Volatility 50 TRI	Nifty 500 Quality 50 TRI	Nifty 500 TRI
2015	-8.1	11.0	7.7	8.3	0.0
2016	23.3	-1.6	1.9	0.5	4.7
2017	47.0	69.5	31.7	33.6	37.7
2018	-26.4	-10.9	7.2	-2.0	-1.6
2019	-13.9	8.6	8.2	1.8	8.6
2020	8.1	20.9	24.1	27.3	17.7
2021	54.7	76.9	20.1	29.1	31.0
2022	23.2	-7.6	7.3	-2.8	4.3
2023	62.6	47.7	33.4	42.0	26.9
2024	19.3	26.5	16.0	23.0	16.0

Source: NSE

recognising its role as the backbone of a portfolio. Not just for the higher probability of compounding wealth but for the lower probability of permanent capital loss.

Quality doesn't surge. It endures. It doesn't time the cycle. It transcends it.

If you're wondering whether it's time to go back to quality, the truth is – you should never have left. ☑

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