

Quick Take: Has Quality Changed Its Stripes?

May 2025

Quality stocks historically have been defensive

- Higher quality stocks, i.e., stocks with consistent earnings and healthy balance sheets, are generally viewed as less risky than the broader market.
- Indeed, historically, quality stocks have typically outperformed during market downturns—although not to the same extent as low-beta stocks (see drawdown chart, top).

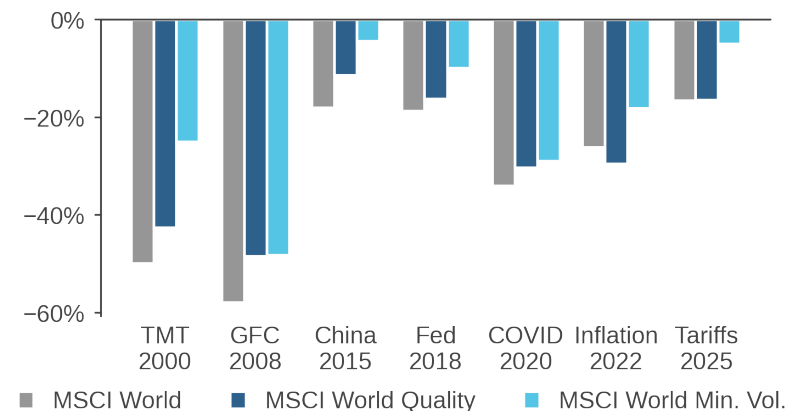
Over recent years, they have become riskier

- But post-COVID, the defensive properties of quality have been less compelling: the MSCI Quality Index underperformed over both major drawdown periods in 2022 and earlier this year.
- In fact, the composition of quality in recent years has shifted towards higher-beta names, as exemplified by the “Magnificent Seven,” causing quality to become more market-like (lower chart).
- While that beta tilt helped quality outperform during periods of exuberance, it proved detrimental during downturns.

By comparison, low-beta stock have provided greater protection

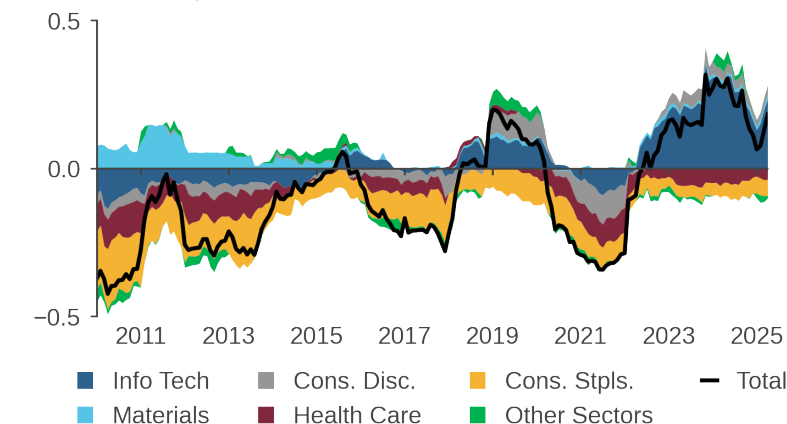
- Low-beta stocks have provided consistent and more significant drawdown protection (upper chart).
- This year, in particular, they have benefitted from risk mispricing, i.e., returns of low-risk stocks have exceeded what their betas would predict.
- While quality’s defensive character recently has been hamstrung by rising beta, the intersection of high-quality with low-beta has continued to deliver protection, outperforming both lower-quality and higher-beta stocks during drawdowns.

Returns During MSCI World Drawdowns:* Quality vs. Low Volatility



Market Sensitivity of High-Quality Stocks** has Risen

Market Sensitivity score versus overall cross section**



* Performance for each index calculated over peak-to-trough drawdown for MSCI World (with daily returns).

** Market sensitivity reflects standardized (mean-zero) market beta. High-quality stocks represent top quintile of MSCI World by profitability. Both measures were obtained from a commercially available risk model.

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