QUALITY AMID HEADWINDS

Albin Kistler AG opinion piece
January 2026

Companies defined by quality possess enduring competitive advantages, resilient business models and consistently high returns on capital. Yet, many of these firms have recently experienced notable declines in value.

Has something fundamentally changed in their underlying strength – or is it simply a shift in how markets perceive them? This reflection explores the forces behind these recent challenges and considers what they imply for long-term investors.

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In brief
- Quality companies have sustainable competitive advantages, robust business models and an ability to deliver high returns on capital throughout economic cycles.
- The latest decline in share prices primarily reflects higher interest rates, revised expectations and shifts in capital flows – rather than any erosion in fundamental business quality.
- As a result, the current repricing is enhancing the appeal of these companies for long-term investors.

Introduction

Quality companies have been seen for many years as reliable cornerstones for long-term investment strategies. They feature a combination of structural properties, including strong market positions, solid balance sheets, and resilient business models. Despite these attributes, established Swiss quality names like Straumann, Sonova, Sika, Givaudan, and Partners Group saw a sharp downturn in value in 2025, underperforming the broader market.

This has led many investors to question whether these corrections reflect a real decline in corporate quality – or are simply a knee-jerk market reaction, a perennial feature of certain market phases.

This piece looks at what defines a quality company, why such businesses are currently facing pressure, and why – paradoxically – this climate of scepticism may open up compelling long-term investment opportunities.

What defines a quality company?

While the definition of "quality" can vary in a corporate context, long-term investors tend to agree on certain core attributes. These are less about short-term growth rates and more about the structural traits that support sustainable value creation across economic cycles.

The following section explores the dimensions of quality that are particularly significant from this standpoint – and that have proven their worth in practice:

<u>Market leadership:</u>
Strong market leadership is a key feature of quality. Such attributes are typically rooted in competitive advantages that create high barriers to entry – forming what is often referred to as a "moat".

These competitive advantages can arise from various sources. One classic example is network effects: as a global payment network operator, Mastercard holds a central role in the financial system. The value of its network grows with the number of users – both consumers and merchants – significantly raising the entry barrier for new competitors.

High switching costs can also serve as an effective moat. Apple, for instance, has built a tightly integrated ecosystem of hardware, operating systems and apps. This ecosystem fosters exceptional customer loyalty through ease of use, reliability and design – resulting in a strong reluctance to switch and, in turn, reinforcing Apple's long-term market position.

Regardless of the specific business model, the principle remains the same: companies in a dominant market position benefit from structural competitive advantages that allow them either to exercise pricing power or maintain lasting cost leadership.

<u>Management:</u>
The course for long-term corporate success is set by the management and board of directors – from strategic orientation and operational execution to capital allocation. Excellent corporate governance is characterised by three recurring features: dependable engagement with key stakeholders, a long-term strategic focus, and a corporate culture that combines ambitious goals with grounded, transparent communication.

Even the best companies are not immune to missteps or external pressures. But it is precisely during difficult market phases that leadership quality becomes evident. Outstanding management teams do not resort to hasty policy shifts or short-term profit maximisation – they remain calm and focused, make transparent decisions, and allocate capital with discipline, always keeping an eye on long-term competitiveness and sustainable value creation.

Geberit illustrates these principles well. For many years, the sanitary specialist has combined a clear strategic direction with strong continuity in leadership. The integration of Sanitec required courage and led to a temporary dilution of margins – but it was implemented consistently and gradually developed to match the Group's high level of profitability. Even during the COVID-19 pandemic, this long-term mindset was evident. Rather than making short-term cuts, Geberit retained its workforce, invested purposefully in training and prepared its operations for the subsequent recovery. This combination of strategic clarity, disciplined capital management and responsible employee engagement is a hallmark of high-quality corporate governance.

<u>Financing and balance sheet structure:</u>
Sound financing is a core attribute of quality – it determines whether a company can maintain its strategic agility even in periods of heightened uncertainty. In downturns or in response to external shocks, high levels of debt can quickly become a strategic burden. High-quality companies therefore maintain solid balance sheets, adequate liquidity and a level of debt that aligns with the nature of their business model.

The following principle applies: the more cyclical a company's earnings, the larger its financial safety buffer needs to be. Firms with highly volatile profits require robust equity and liquidity reserves to weather extended downturns – without being forced to compromise on operational or strategic decisions. By contrast, companies with stable earnings throughout the cycle have greater financial flexibility and can make more effective use of leverage.

This financial strength provides the foundation for disciplined capital allocation. Sustainably successful companies take a long-term view in how they deploy their cash flow – investing organically, making selective acquisitions and returning capital to shareholders. At the same time, they regularly assess their business portfolio and consistently divest activities that no longer meet strategic or return expectations. What matters most is their ability to create long-term value across multiple cycles through consistent and strategic use of capital.

<u>Sustainability in corporate earnings:</u>
A defining hallmark of quality is the ability to steadily increase profitability over time. In the long run, a company's value – and with it, its share price – will track its operational performance, even if short-term market volatility temporarily obscures the picture.

This long-term profit trajectory is largely driven by structural factors: a presence in growing markets, the ability to gain market share, and sufficient diversification across geographies and business lines. But it is not just growth that matters – the quality of that growth is equally important. The goal is not expansion at any cost, but profitable growth.

At the same time, technological change poses one of the biggest challenges to the durability of existing business models. Disruptive developments can rapidly undermine entrenched market positions and reshape entire industries. Quality companies are those that detect such risks early, adapt their business models accordingly, and channel their innovative capacity in targeted ways to remain competitive over the long term.

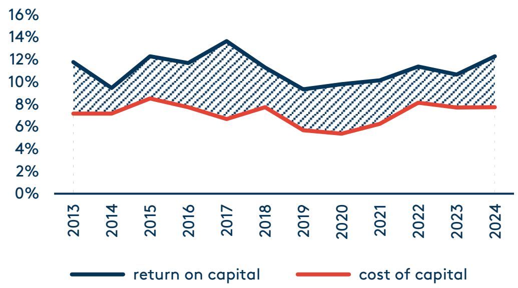
Alphabet provides a strong example of this. Google's dominant role in the search engine market generates highly profitable, recurring advertising revenue – enabling large-scale investment in cutting-edge technologies, particularly in artificial intelligence and its integration into core product lines. At the same time, it has strategically diversified its business model over the years – most notably by building a leading cloud platform. As a result, the company has evolved from a primarily ad-driven model into a broadly positioned technology group with multiple structurally attractive revenue streams. This strongly enhances the reliability of future earnings – and is a defining trait of a quality company.

<u>Return on capital:</u>
Return on capital is a precise measure of corporate quality, as it reflects how efficiently a company converts invested capital into operating profit. Economic value is created only when returns consistently exceed the cost of capital – a trait that many quality companies demonstrate over extended periods.

A persistently high return on capital is rarely accidental. More often, it stems from structural competitive advantages – as discussed in the section on market leadership. These advantages create a "moat" that shields companies from competitive pressures and helps prevent above-average returns from quickly being eroded down to the cost of capital. By "sustainable", we mean performance across the entire cycle – even if individual years may show temporary fluctuations.

For long-term investors, the key is not a single year's result, but the stability of returns across cycles and the company's ability to deploy capital consistently in ways that generate value. Return on capital is therefore the distilled result of the quality characteristics outlined earlier – and one of the most reliable indicators of long-term value creation.

Fig. 1: How quality creates value – Givaudan's return on capital over time



Source: Bloomberg, own presentation.

Why are quality companies currently under pressure?

Despite their structural strengths, many quality companies have clearly underperformed the broader market in recent quarters. This can be attributed to a combination of macroeconomic factors, valuation resets and shifting capital flows.

<u>Higher interest rates:</u>
Long-term interest rates – particularly in the US – have remained persistently high. Rising rates reduce the present value of future earnings, which tends to put pressure on equity valuations.

Many quality companies are known for their stable cash flows and strong planning reliability. However, part of their valuation reflects expectations that profits will continue to grow steadily for many years. It is precisely this long-term component that is most sensitive to interest rate increases. As rates rose, the value of future profits declined – leading to a reduction in the valuation premium these companies previously commanded.

<u>Unfulfilled profit expectations:</u>
Profit expectations for many structurally growing quality companies were especially high in the years following the pandemic. But in today's increasingly complex macro environment – marked by trade tensions, economic slowdowns in key markets, and geopolitical instability – some companies struggled to fully meet these ambitious forecasts. Even temporary drops in demand or delays had an outsized negative impact on share prices under these conditions, resulting in a clear reduction in valuation premiums.

In addition, the US dollar depreciated sharply against the Swiss franc in 2025 – falling by more than 10%. As the United States is, alongside Europe, the main sales market for many Swiss quality companies, this currency movement had a noticeable impact on reported profits. Companies such as Sika, Sonova and Straumann – each of which generates roughly one-third of its revenue in the US – were forced to revise their profit expectations downward, adding pressure on the share price.

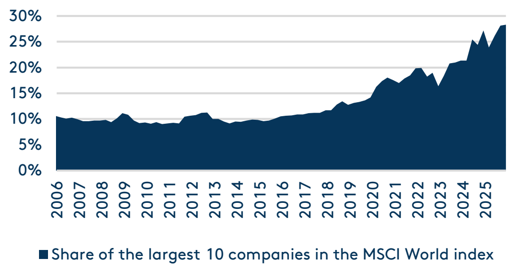
<u>Capital reallocation in favour of Big Tech and AI:</u>
Another major factor behind the weaker share price performance of many quality companies relative to the general market was the pronounced shift in capital towards a handful of large technology firms seen as primary beneficiaries of the AI boom. By the end of 2025, the technology sector[1] made up roughly one-third of the MSCI World Index – an unusually high, historically elevated share.

At the same time, stock market concentration rose sharply: the ten largest companies accounted for nearly 30% of the index weighting and were responsible for around 36% of the global stock market's total return in 2025. As a result, many quality companies with solid – but less spectacular – growth profiles, including numerous Swiss names, were left outside the dominant investment narrative and

[1] While companies like Alphabet and Meta are formally classified as "communication services", they are typically grouped under the broader tech umbrella in this context.

significantly underperformed, despite their sound fundamentals.

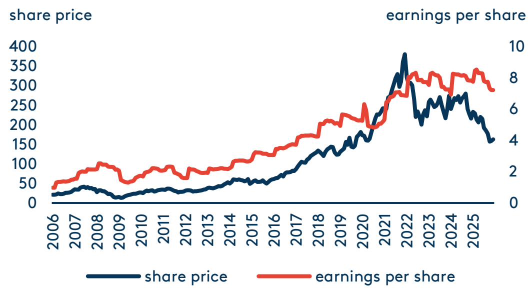
Fig. 2: Increasing concentration in the global equity market



Source: FactSet, own representation.

Altogether, these factors led to a significant reduction in the valuation premiums that many quality companies had long enjoyed relative to the broader market. This shift is less a reflection of structural weakness in their business models than of a temporary rebalancing of capital flows, expectations and investor sentiment. As the chart below illustrates using Sika as an example, the recent revaluation is not primarily the result of declining operating performance – but rather of a temporary disconnect between share price movements and earnings growth.

Fig. 3: Sika: Share price and earnings performance

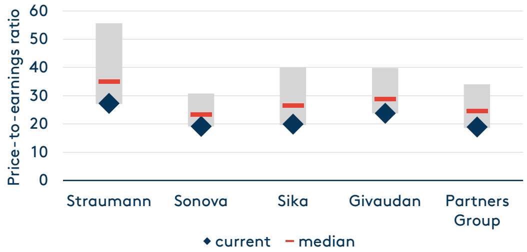


Source: FactSet, own representation.

Why quality companies are now attractively valued

The factors outlined above have led to market corrections in many quality stocks that go beyond what is justified by underlying fundamentals. As a result, many of these companies are now trading at valuation levels that look attractive by historical standards. This is illustrated in the chart below, which compares the current valuations of selected quality companies with their respective historical valuation ranges.

Fig. 4: Valuation of selected quality companies by historical comparison



Explanation: current valuation relative to the valuation range of the past ten years (5th–95th percentile).

Source: FactSet, own representation.

This development reflects less a weakening of business models than a temporary disconnect between market prices and operational fundamentals. In many cases, the key drivers of quality companies – particularly cash flows, returns on capital and competitive positioning – have held up far better than their share prices suggest.

From a long-term perspective, this has improved the entry point for investors. Historically, some of the most attractive investment opportunities have emerged when quality companies came under valuation pressure due to external factors and heightened uncertainty – rather than because of any erosion in their competitive strengths. For patient investors, such phases often create favourable conditions to benefit from these companies' rising profitability over the long term.

Conclusion: patience is one of the key virtues of the successful investor

Quality companies generate value over years and decades – not from quarter to quarter. Their strength lies in sustainable competitive advantages, resilient earnings power and the ability to grow capital over the long term. Short-term share price movements often fail to reflect these qualities adequately.

Viewed through a long-term lens, the recent price corrections across quality companies are less a signal of fundamental weakness than a reflection of a more challenging macro environment, revised expectations and temporary shifts in capital flows. While valuations have come down significantly, core elements – such as business models, market positions and return on capital – remain intact.

This creates a compelling starting point for long-term investors. Those willing to withstand temporary price volatility and focus on enduring earnings power – rather than short-term market narratives – now have an opportunity to invest in companies of exceptional quality at valuation levels that would have seemed unthinkable just a few years ago.

Over extended periods, one principle has repeatedly proven true: quality prevails in equity markets – not in a straight line, but reliably over time. Those who remain patient and confident during such moments often pave the way for above-average future returns.

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