Deep Dive

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Boring is Beautiful: The Quality Factor in Indian Markets

Indian equities structurally rewards "quality" and the evidence is very hard to ignore. The reasons are distinctly Indian; (i) promoter-dominated ownership, (ii) corporate governance dispersion and (iii) wide earnings variability mean that disciplined selectivity carries a durable edge. Quality portfolios, which are, screened on ROE, low debt/leverage and earnings stability, have consistently delivered superior returns with shallower drawdowns. In a market where growth is abundant, but earnings integrity is scarce, quality is not a style preference, it is a structural advantage.

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Executive Summary: What is Quality Factor?

Factor investing identifies persistent, pervasive characteristics of securities that explain differential returns across stocks over time. Quality is one of the most academically well-grounded of these factors. Unlike momentum (which is purely price-driven) or value (which focuses on cheap multiples), "quality" targets companies with demonstrably superior business fundamentals.

One of the most officially accepted academic framework, articulated by Asness, Frazzini and Pedersen, defines a quality company as one that is Safe, Profitable, Growing and Well Managed (here). The MSCI / NSE Quality Index framework, operationalises this through three core descriptors:

PROFITABILITY *Return on Equity (ROE)*	**FINANCIAL SAFETY** *Debt-to-Equity Ratio*	**EARNINGS STABILITY** *EPS Growth Variability*
Measures the efficiency with which a company generates earnings from shareholder equity. A persistently high ROE indicates durable competitive advantage.	Reflects the balance-sheet discipline of management. Low-leverage companies are better placed to withstand credit cycles and economic shocks.	Rewards predictability. Companies with consistent earnings trajectories command premium valuations and suffer fewer drawdowns.

The NSE applies this framework across its family of Quality strategy indices, including the Nifty100 Quality 30, Nifty200 Quality 30, and Nifty500 Quality 50. The Nifty100 Quality 30 selects the top-30 quality companies from the Nifty100 universe; the Nifty200 Quality 30 draws from a broader mid-to-large-cap pool; and the Nifty500 Quality 50 extends coverage across the full large, mid-cap and small-cap spectrum.

Methodology

The Quality factor in India, has delivered a compelling and durable return premium in Indian equity markets. With factor-based investing gaining rapid traction in India through mutual funds and ETFs, the "Quality" style offers investors a transparent, rules-based path to superior risk-adjusted returns with lower drawdown and portfolio churn.

Table - 1: NSE Quality Index Construction & Methodology

Index / Metric	Quality Index	Broader Markets Index (Nifty50, Nifty 500 etc.)
Primary Quality Screen	ROE, D/E, EPS Variability (5yr)	Market Cap Weighted
Rebalancing Frequency	Semi-Annual	Quarterly
Constituent Count	30 – 50 stocks	50 – 500 stocks
Weight Cap per Stock	5% maximum	Typically uncapped
Pledged Promoter Shares	Excluded (>20%)	No restriction
Illiquidity Filter (based on ADTV and Turnover Ratio)	Bottom 10th percentile excluded	Standard liquidity

"Quality Factor" Performance Overview: Global Markets and India

Globally, MSCI's analysis confirms that quality indexes have outperformed their parent benchmarks by around 100-300 basis points since 1994, with lower drawdowns and higher sharpe ratio. During periods of elevated market volatility, "Quality" tends to outperform, underscoring its defensive character.

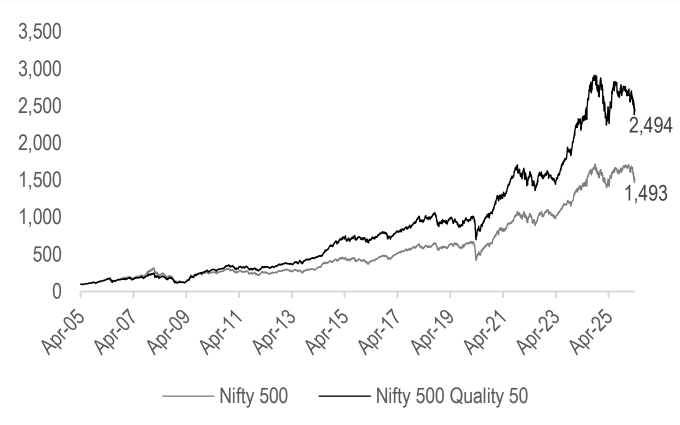
Table - 2: MSCI Quality Strategy Performance (in USD, since 30 June, 1994)

Index / Metric	All-Country World Index		Developed Markets		Emerging Markets	
	MSCI ACWI Quality	MSCI ACWI	MSCI World Quality	MSCI World	MSCI EM Quality	MSCI EM
Annualized Returns	11.8%	8.7%	12.1%	8.9%	7.6%	6.6%
Sharpe Ratio	0.67	0.45	0.69	0.47	0.33	0.28
Maximum DD	49.6%	58.1%	48.0%	57.5%	62.9%	65.1%

Source: MSCI, HDFC TRU. Priced as on 27 Feb, 2026.

We note that these dynamics also translate directly to the Indian setting (refer Figure 1 below).

Figure - 1: NSE Quality Strategy (Nifty500 Quality 50) Cumulative Curve (re-based to 100, since 1 April, 2005)



Source: NSE, HDFC TRU. **Data Period:** 1 April, 2005 to 27 March, 2026.

On a rolling return basis, Quality portfolios consistently outperformed the market for longer investment horizons. Rolling returns analysis was conducted to eliminate recency bias in performance. Figures in Table 3 below shows number of instances of outperformance of "Quality factor" with respect to the NIFTY 500 index.

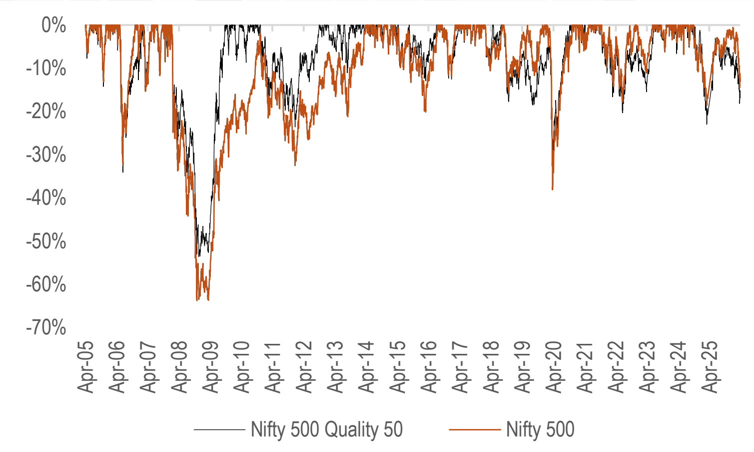
Table- 3: NSE Quality Strategy Rolling Returns Performance (April' 05 – March'26)

Investment Period	No. of Observations	Nifty500 Quality 50 outperforming Nifty 500 (% instances)			Total Instances of Outperformance (%)
		Outperformance (<0%)	Outperformance (0-5%)	Outperformance (>5%)	
1-year	4,960	40%	15%	45%	60%
3-years	4,463	30%	33%	37%	70%
5-years	3,967	24%	41%	35%	76%
7-years	3,471	16%	53%	31%	84%
10-years	2,727	6%	55%	38%	94%

Source: NSE, HDFC TRU. **Data Period:** 1 April, 2005 to 27 March, 2026.

A drawdown is the peak-to-trough decline during a specific period of an investment. Our analysis suggests that " Quality" portfolios record lower drawdowns compared to the broader market (e.g. Nifty500), resulting in relatively better performance during periods of market correction.

Figure - 2: NSE Quality Strategy (Nifty500 Quality 50) Drawdowns materially lower vs. the broader market (Nifty 500)

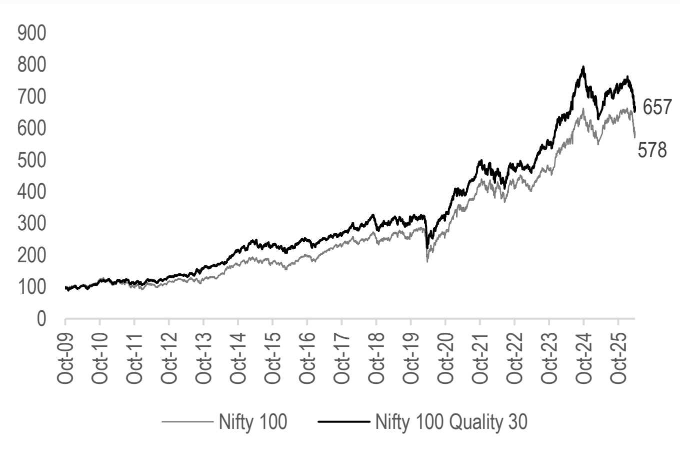


Source: NSE, HDFC TRU. **Data Period:** 1 April, 2005 to 27 March, 2026.

How does the "Quality Style" perform across Market Capitalizations in India?

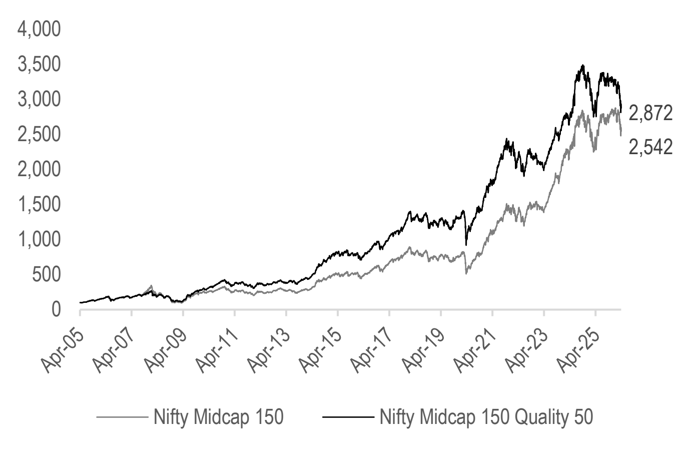
While the preceding charts and tables clearly demonstrate that the "Quality" factor tends to outperform the broader diversified market (e.g. Nifty 500) over longer horizons, both on a cumulative and rolling basis. We note that, Quality also outperforms across various market capitalizations (i.e. large, mid & small-caps), in the longer-term.

Figure - 3: NSE Large-Cap Quality Strategy Performance (re-based to 100, since 1 October, 2009)



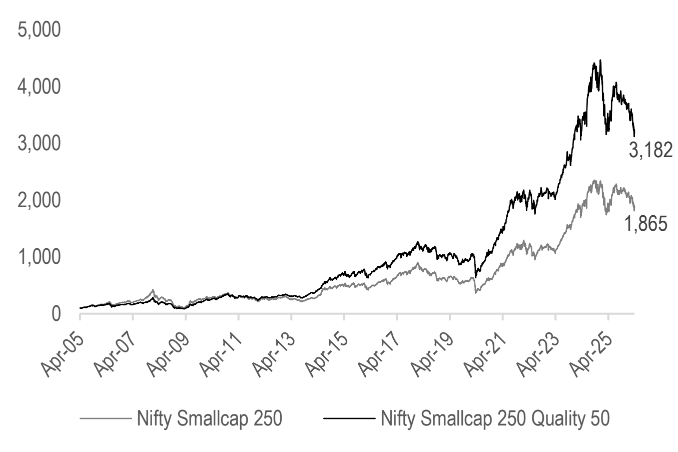
Source: NSE, HDFC TRU. **Data Period:** 1 October, 2009 to 27 March, 2026.

Figure - 4: NSE Mid-Cap Quality Strategy Performance (re-based to 100, since 1 April, 2005)



Source: NSE, HDFC TRU**. Data Period:** 1 April, 2005 to 27 March, 2026.

Figure - 5: NSE Small-Cap Quality Strategy Performance (re-based to 100, since 1 April, 2005)

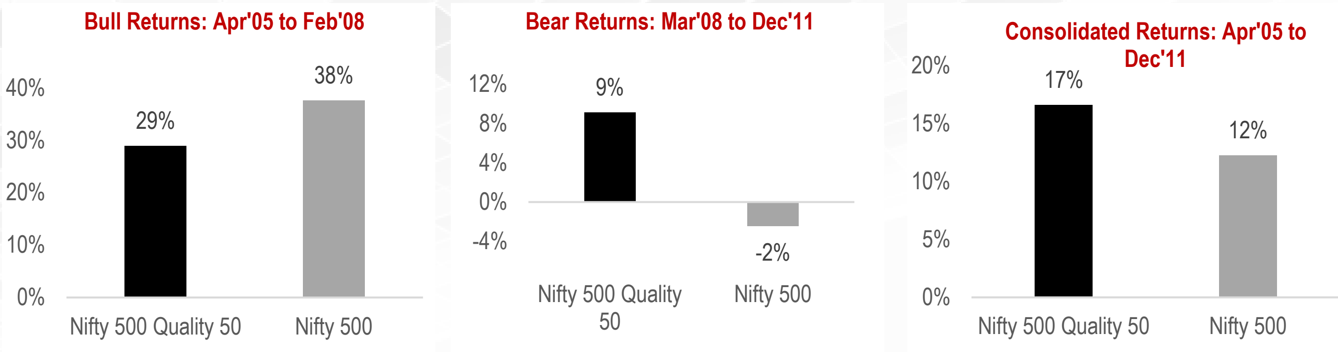


Source: NSE, HDFC TRU. **Data Period:** 1 April, 2005 to 27 March, 2026.

Assessing the performance of "Quality Factor" across Market Regimes / Cycles (since 2005)

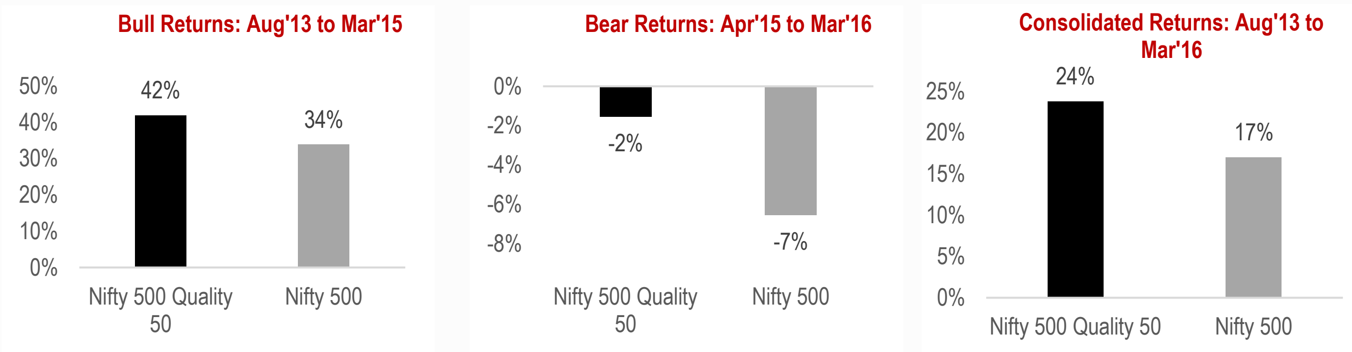
We now examine how the "Quality" factor impacts returns throughout a specific market cycle. For this analysis, we evaluated the period from April 2005 to March 2026, dividing the timeframe into four distinct market cycles. Each cycle was further categorized into bull and bear phases, resulting in a total of four bull and four bear phases. Notably, as the bear phase of the fourth cycle is currently ongoing, our data for this final period concludes on March 27, 2026. **Our analysis was conducted on the Nifty500 Quality50 Index vs. the Nifty 500 Index.**

Figure - 6: Market Cycle 1 (CAGR Return %, Apr'05 – Dec'11)



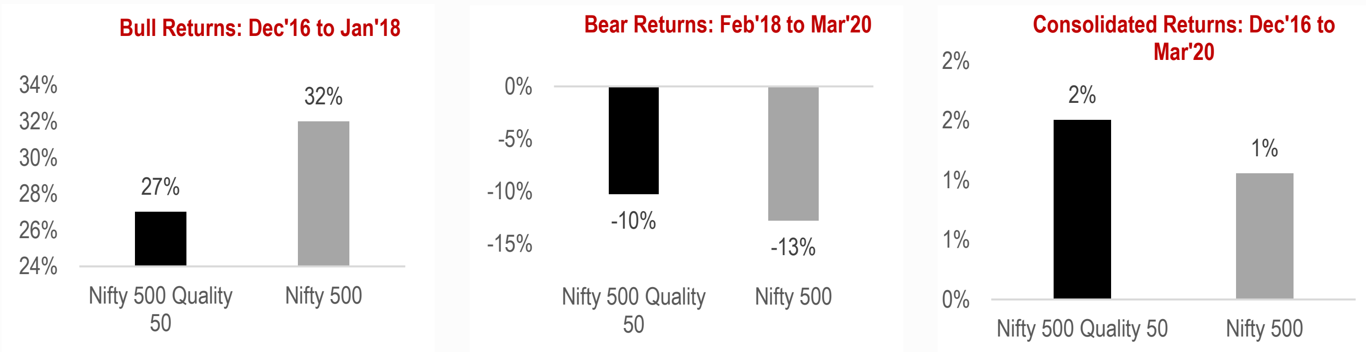
Source: NSE, HDFC TRU.

Figure - 7: Market Cycle 2 (CAGR Return %, Aug'13 – Mar'16)



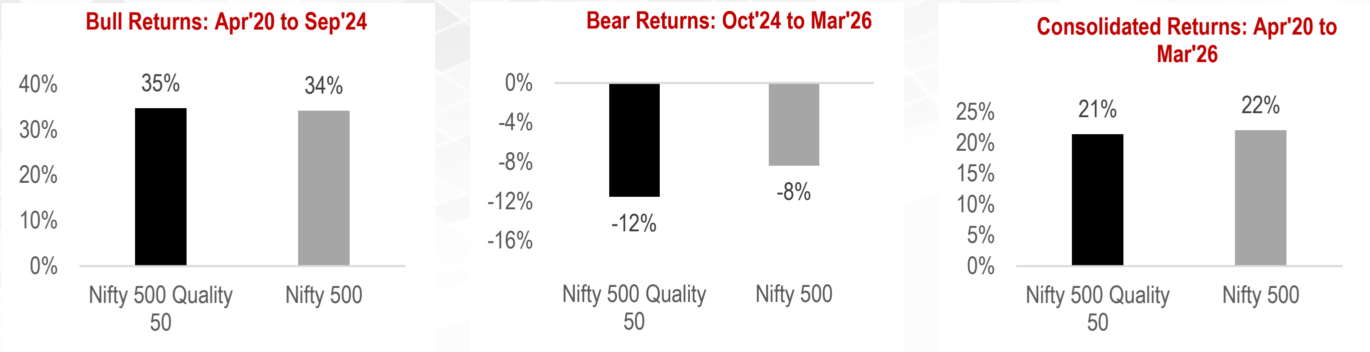
Source: NSE, HDFC TRU.

Figure - 8: Market Cycle 3 (CAGR Return %, Dec'16 – Mar'20)



Source: NSE, HDFC TRU.

Figure - 9: Market Cycle 4 (CAGR Return %, Apr'20 – Mar'26)



Source: NSE, HDFC TRU.

Key Results / Takeaways:

- During bull phase, across cycles analyzed above, quality companies tend to underperform the broader market in a bull run.
- During the bear phase, quality companies had lower drawdowns and outperformed the broader market by wide margins (ex- the post COVID-19 cycle).
- However, on a consolidated basis and across a full market cycle, returns of top quality companies are significantly higher as compared to the broader market.
- The only outlier is the April 2020 to March 2026 cycle (4^{th} cycle), which followed a prolonged sideways market and just prior to this cycle, Quality had outperformed Value by a historic margin, pushing the Quality-to-Value ratio to >2.
- Bull cycles typically begin with high-quality companies trading at a significant premium. However, as economic growth accelerates, lower-quality firms often deliver higher returns by benefiting from rapid margin expansion, deleveraging through equity raises, and aggressive P/E expansion. This dynamic reverses during bear phases, where lower-quality companies face sharper margin contraction, rising leverage, and severe multiple compression. In contrast, high-quality companies demonstrate fundamental resilience and lower P/E volatility, allowing them to consistently outperform over the full duration of a market cycle.
- Above results are consistent with studies in other markets which suggest higher returns for high quality companies over the long run. If anything, above results suggest that the quality premium in India could be substantial. This is possibly because of the wide difference in quality between the top and bottom companies.

Risks and Considerations

While the Quality factor has delivered structural outperformance, investors should be aware of the following:

- **Factor Cyclicality:** Quality, like all factors, can underperform for extended periods. In strongly risk-on environments, particularly early bull cycles following sharp drawdowns; lower-quality, high-beta stocks can outperform. The 2023 Indian small- and mid-cap rally, for instance, saw a broad-based surge that temporarily disadvantaged quality screens.
- **Valuation Risk:** India already trades at a premium to most global emerging markets. Within India, quality companies typically command further valuation premiums. Investors entering at peak multiples face the risk that valuation reversion offsets the fundamental quality premium.
- **Sector Concentration:** Quality screens in India tend to overweight consumer staples, IT services, and Industrials sectors with historically high and stable returns on equity. This can result in meaningful active sector bets relative to a market-cap-weighted benchmark.

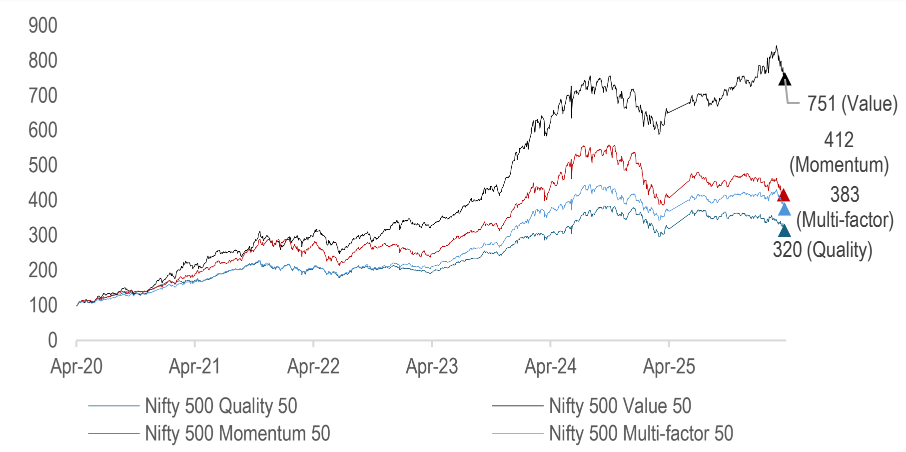
Our View

We view the current environment, characterised by heightened global uncertainty as a particularly constructive entry point for Quality-oriented India equity allocations. The factor's inherent defensiveness, combined with India's structural long-term growth story, creates a compelling combination of resilience and participation.

We recommend that investors consider Quality factor exposure both as a standalone smart-beta allocation and as a lens for stock selection. Stocks with demonstrated quality discipline, measurable through high ROE, low leverage, and earnings stability, have historically delivered superior downside protection while capturing an adequate share of market upside.

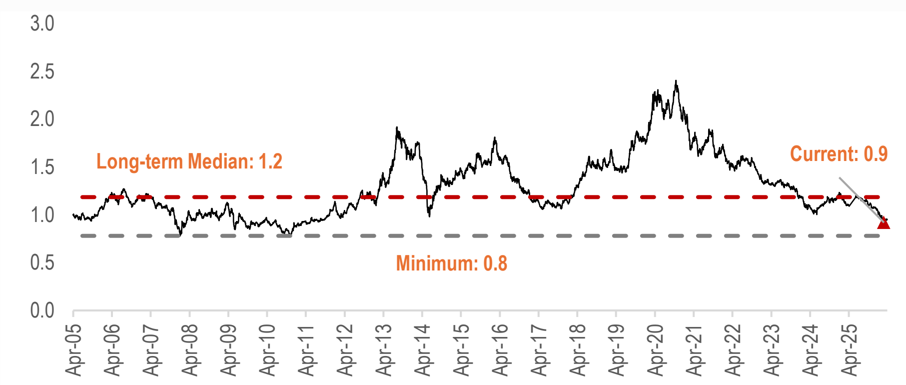
The Quality factor is one of India's most robust and academically validated return premia. A well-implemented quality tilt provides superior risk-adjusted returns, lower drawdowns and a natural corporate governance screen. With an expanding universe of passive and active vehicles now available, Quality deserves a strategic allocation in most long-horizon Indian equity portfolios.

Figure - 10: Since April-2020 (post COVID-19 era), Value style has led the Indian equity market followed by Momentum, while Quality has materially lagged, but we now anticipate a shift toward mean-reversion…



Source: NSE, HDFC TRU. **Data Period:** 1 April, 2005 to 27 March, 2026.

Figure - 11: …Quality and Value historically have exhibited an inverse relationship, with Quality-to-Value Ratio now at a multi-year low… further strengthening the case for Quality



Source: NSE, HDFC TRU. **Data Period:** 1 April, 2005 to 27 March, 2026.

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