

PHILLIP MUTUAL BERHAD

Company No. 200201002746 (570409-K)

Tel: (603) 2783 0300 | Fax: (603) 2166 6417

Webpage: www.phillipmutual.com | E-mail: phillipmutual@phillipcapi.com.my



Understanding Quality Investing and Why It Matters?

What is Quality Investing? Investors who advocate a quality approach to investing prefer high-quality companies that generate free cash flow and a reasonable return on equity. Aside from that, investors consider other aspects of the business such as management stability, the uniqueness of the business model, and product reliability. [While we previously discussed various investment styles](#) such as Value, Growth, Dividend, ESG, Size, Momentum and Quality, this article will specifically focus on Quality Investing.

Investors are increasingly focusing on the concept of quality when making investment decisions. Compared to value or growth investing, quality investing, arguably, tends to receive less attention. While value and growth stocks can be defined using financial metrics, identifying quality stocks requires a more nuanced approach that takes into account a company's overall business fundamentals, its competitive landscape, and long-term consumer trends.

One popular variation of quality investing is "**quality at a reasonable price**" (QARP)". This strategy seeks to identify high-quality companies that are currently undervalued by the market, offering investors the opportunity to buy them at a reasonable price.

While the criteria used to identify a "quality" company can differ, some shared attributes typically include: -

- 1. Strong financials:** Companies that possess a robust financial position, characterised by a low level of debt, a healthy balance sheet, and strong cash flow, are typically regarded as being of higher quality when compared to those with weak financials.
- 2. Sustainable business model:** Companies possessing a sustainable business model and a strong competitive advantage are better positioned to maintain their market position and generate consistent profits over time.
- 3. Consistent earnings growth:** Investors are typically more attracted to companies that have a track record of consistent earnings growth, as this is indicative of the company's ability to sustain its growth in the future.
- 4. Management quality:** Companies with competent management team that have a proven track record of making sound business decisions are generally considered to be of higher quality.

Using Quality Investing as a Strategy to Navigate Market Volatility

The global equity markets are currently experiencing significant uncertainty in the face of sticky inflation coinciding with US rate tightening fallout in the banking sector. As global growth is projected to slow down faster than anticipated, the yield curve is predicted to enter a bull steepening mode later this year. Consequently, there is a reasonably high probability of a considerable correction in global equities, as the market is yet to factor in an impending recession. Despite the possibility of Asia being affected by the global equity correction, the economic and earnings cycle for Asia is looking positive, with an early upcycle underway and earnings downgrades reaching a bottom. Moreover, the market is currently anticipating a decrease in interest rates in the near future, which would result in lower borrowing costs for both consumers and businesses. This development is generally perceived as positive news for equity valuation.

On the local front, while we expect the market to remain challenging in the first half of 2023, due to rising operating costs, higher interest rates, and slower global growth, we believe the downside will be limited by the local bourse's undemanding valuations and China's reopening of the border. Malaysia's growth fundamentals remain encouraging,

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with firm domestic consumption, a stable labour market, sustained current account surplus, revival of construction projects, and expansion of primary sectors thanks to elevated global commodity prices and modest external trade activities.

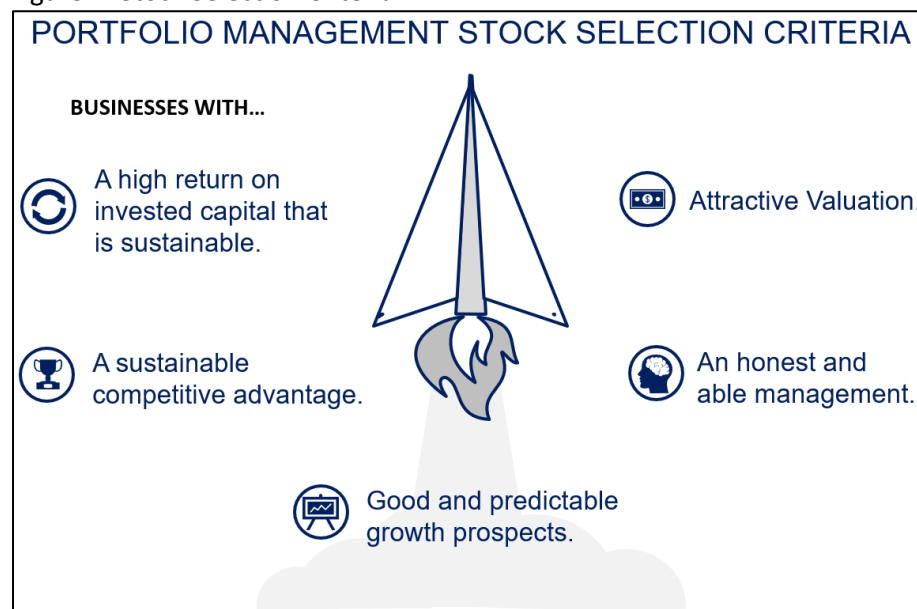
Quality investing can be a valuable strategy for investors to navigate market uncertainty, as it involves identifying companies with resilient business models, strong financials, and competent management teams. Companies possessing these attributes often have a significant competitive advantage and may be better equipped to achieve sustained growth over time. This approach helps investors to investors to minimise potential losses during times of market volatility or economic uncertainty, potentially reducing the impact of market downturns on their portfolios.

Our Investment Approach and Offerings

At the core of our investment approach is a focus on stocks with strong fundamental characteristics, such as sustainable business models and consistent earnings. Additionally, we place significant emphasis on evaluating the management team of a company, as we believe that competent and visionary leaders are crucial for the long-term success of a business. Consequently, we only invest in companies where we have confidence in the competence and reliability of their management team.

This investment approach allows us to navigate through the challenging periods of market volatility and unexpected events, while maintaining a focus on delivering consistent returns to our investors over the long term. We strive to build resilient portfolios that can weather the storms and provide stable growth for our investors.

Figure 1: Stock Selection Criteria



Source: PMB

Phillip Mutual Berhad offers a comprehensive list of local and global unit trust funds that may suit your investment preferences and financial goals. For local funds, our recommendation is as below:

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Lipper Category	PMB Funds
Equity Malaysia Income	Phillip Dividend
Equity Malaysia	Phillip Recovery Phillip Dana Aman * Phillip Master Equity Growth
Equity Malaysia Sm&Mid Cap	Phillip Pearl
Fixed Income (Malaysia)	Phillip Dana Murni *
Balanced Fund (Malaysia)	Phillip SELECT Balance

Note: * indicates Syariah

For global funds, our recommendation is as below:

Lipper Category	PMB Funds
Equity Global	Phillip Global Stars
Equity China/Greater China	Phillip Focus China
Balanced Fund (Asia Pacific)	Phillip AsiaPac Income

Our investment portfolio focuses on quality companies that possess strong fundamentals, including stable earnings and a promising future outlook, and are led by capable management teams. Please click on the [link](#) to learn more or email us at phillipmutual@phillipcapital.com.my if you require any further information.

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