



## WHERE QUALITY INVESTING GOES NEXT

Francis Sempill, Head of Client Service, April 2026

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### Key takeaways

- The merits of quality stocks are potentially being overlooked in a market dominated by powerful AI narratives
- Quality stocks can be found in many industries and are well positioned to benefit from continued strong earnings growth
- Fear of widespread AI disruption is creating opportunities for quality investors, particularly in the hard-hit software sector

The market is turning a cold shoulder to quality stocks. Patient investors may wish to consider the opportunity this creates.

We believe that quality companies – those with durable earnings growth, strong profitability and robust balance sheets – can generate above-average returns over time. Yet these solid and sensible investments have lagged the market in recent years. There is now, in our view, a dislocation between the strong fundamental qualities of these businesses and the markets current assessment of their prospects.

“What is frustrating right now is that quality companies are actually doing pretty well in terms of fundamentals,” says Roy Leckie, Executive Director of Walter Scott. “When you look at the earnings growth in aggregate of the quality companies we invest in, they are at least as good as the market. But they are not being rewarded.”

Blame that lack of reward on a shift in market psychology. Dazzled by the potential of artificial intelligence, many stock buyers have stopped paying attention to such humdrum matters as fundamentals.

“Markets are now dominated by passive investors who are, by definition, valuation-agnostic,” Leckie says. “There is also a lot of corporate buying in the form of share buybacks, particularly in the US. That, too, is valuation-agnostic buying. And a lot of the retail action is much more about speculation than investing.”

The speculation is being fed by conflicting narratives around how AI will transform the economy and upend existing business models. Huge amounts of money are now chasing the latest hot take on what is to come.

"It feels wild, not like anything that I've seen in my career," says Leckie's colleague, investment manager Alan Edington. "People are voting with their feet very, very quickly. An article goes viral and suddenly software businesses are moving 20 per cent across the board in a couple of days. People are worried."

He suggests that investors take a deep breath. They should remember that it is earnings growth, not narrative, that ultimately determines share prices.

They should also remember that AI isn't everything. Quality stocks can be found in a wide variety of industries, according to the Research team at Walter Scott.

The team looks for companies with sustainable growth, high profitability and balance sheet strength, trading at the right price.

Air Liquide and Linde are good examples. They produce the specialty gases needed for everything from welding to food storage to microchip manufacturing. These industrial gases may not be glamorous, but they are vital – so much so that clients of the big two producers are happy to sign purchase contracts for 15 to 20 years. The industrial gas industry "is going to be there for a very long time," Edington says.

Other examples include O'Reilly Automotive, one of the largest specialty retailers of car parts in the United States; Mastercard, the global credit card giant; and ASML, the Dutch company that dominates the market for the incredibly complex tools needed for etching microchips with ultraviolet light.

What all these companies share is the potential to grow profits consistently and to do so through multiple cycles. No matter how AI reshapes the economy, we think they are positioned to do well.

But quality investing doesn't mean simply playing defence against AI. It also means taking advantage of the mispricings that AI turmoil is creating.

## "Nuance is being lost. The market is deciding you're either an AI winner or an AI loser, and there's not much in between"

"Markets are behaving unusually in and around the AI space," Leckie says. "Nuance is being lost. The market is deciding you're either an AI winner or an AI loser, and there's not much in between. It's pretty frustrating because our research is coming to much more nuanced conclusions."

Consider, for instance, companies that make software that acts as a management platform. Software of that type often sits on masses of proprietary customer data gathered from many years of catering to a specific industry.

These vast troves of information are becoming immensely valuable, because the accumulated data allows software providers to create specialized AI applications for that industry. Yet several software providers of this type are now being downgraded by a stock market that is convinced they will be run over by more general AI applications.

"I think the selloff we've seen in the last few months in many software businesses is creating a multi-generational buying opportunity," Leckie says. "Not in every company, but in many of them." For investors willing to bet on the long-term payoff from quality stocks, the prospects look increasingly compelling.

To find out more about why quality still matters, watch and listen to Francis, Roy and Alan discuss the topic in our latest Talking Research podcast:

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### **Stock examples**

The information provided in this article relating to stock examples should not be considered a recommendation to buy or sell any particular security. Any examples discussed are given in the context of the theme being explored.



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