

**Key Takeaways**

- Quality stocks have delivered superior risk-adjusted returns across nearly three decades, outperforming a majority of the most well-known factors such as value, growth, or high dividend.
- 2025's underperformance of quality may not have been a surprise after witnessing the speculative growth around artificial intelligence (AI) and the future of technology during the year.
- Gateway's quantitative approach to quality investing combines systematic factor optimization with broad market exposure and income generation through the use of index options.

**The Road Less Traveled**

The endless debate in factor investing usually focuses on growth vs value. However, there is an often-overlooked third factor that offers decades of compelling performance: quality. As investors move into 2026, the quality factor may take center stage in a way not seen since the Global Financial Crisis.

In a world of headlines about the hottest artificial intelligence or latest tech, quality companies might seem less-than-flashy. Instead, they embody something increasingly rare: durability. Quality businesses generally have fortress-like balance sheets with strong fundamentals such as consistent profitability, strong return on equity and assets, and the kind of cash flow generation that helps weather any economic storm.

Think of quality investing as choosing the well-engineered highway over the scenic but treacherous mountain road. It may not offer the same adrenaline rush, but it can get you to your destination—reliably, safely, and often faster than you would expect.

**Stick to the Plan**

During 2025, the S&P 500® Quality Index returned 13.43%. As some may expect, quality underperformed both growth and momentum in 2025 as spending on AI-powered technology names higher. In 2025, the S&P 500® Momentum Index and the S&P 500® Growth Index returned 26.86% and 22.18%, respectively. With technology firms at such a high concentration in the S&P 500® Index, quality also underperformed the broad market return of 17.88% in 2025.

If the past year taught investors anything, it was that quality – as demonstrated by the S&P 500® Quality Index - does not always win in the short term. Lagging performance in 2025 may not have been a surprise after witnessing the robust and speculative investments into AI and along with the general unpredictable future of technology. The question for investors is not whether quality will participate in every rally, but whether it delivers superior risk-adjusted returns across full market cycles – and it has. On a rolling 12-month basis, quality has outpaced other factors at least half of the time (versus momentum) and up to 70% of the time (versus value).

Data shows that during the period of January 1995 to December 2025, quality equities not only outperformed the broad market but also most well-known factors. It did so with less risk than most – the low-volatility factor provided the lowest level of risk, followed by min-vol, as one might expect. The quality factor provided the highest Sharpe ratio and level of alpha compared to the S&P 500® Index during the period while capturing about 97% of the market upside compared to 80% of its downside.

**Tech Drove Winning Factors in 2025**

Source: Bloomberg, L.P.



**Quality Outperforms Over the Long-Term**

Jan. 1995 to Dec. 2025 | Source: Bloomberg, L.P.



**Quality Has Reduced Risk Relative to Broad Marketing and Many Factors**

Jan. 1995 to Dec. 2025 | Source: Bloomberg, L.P.



Past performance does not guarantee future results. Data sources: Bloomberg, L.P. and Morningstar Direct<sup>SM</sup>. Data based on monthly returns, unless noted otherwise. Gateway does not provide tax advice. Tax treatment and rates can and do vary over time. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her investment and/or tax advisors.

### Practical Application: Gateway's Approach

Gateway has developed a disciplined, quantitative approach to quality investing through its Quality Income strategy. The strategy combines two key elements:

#### Quality Equity Portfolio

Using the S&P 500® Index as the investment universe, the strategy employs an optimization process to maximize the portfolio's overall Quality Score. This results in a highly diversified portfolio emphasizing companies with:

- Established profitability track records
- Significant cash flow generation and high return on sales and assets
- Strong fundamental metrics across all sectors with minimal leverage and robust balance sheets
- Diversified exposure across sectors

#### Options Overlay

The equity portfolio is paired with an index option-based strategy designed to generate consistent monthly income while potentially reducing volatility. This dual approach seeks to deliver both long-term growth and current income.

- Systematically harvests monthly option cash flow, driven by market volatility
- Writes a series of one-month, near-the-money index call options on half of the portfolio with expirations each week
- Provides unhedged equity market exposure on 50% of the portfolio, offering potential for greater upside potential

### The Bottom Line

Quality investing is not about predicting overnight winners or chasing revolutionary technology—it is about systematically investing in businesses that have exhibited financial excellence and operational resilience. So far, 2026 has come with elevated valuations, evolving monetary policy, and heightened uncertainty. The durability offered by quality investing may be the resilience that investors need in their portfolios. Quality may sit out on shorter-term speculative races, but for investors focused on growth over the long-term, it may offer something increasingly rare: a sustainable edge based on financial fundamentals rather than market narratives.

#### Important Information

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For more information and access to additional insights from Gateway Investment Advisers, LLC, please visit [www.gia.com/insights](http://www.gia.com/insights).

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