Is Defensive the New Offensive?

Durable growth and a coiled spring of potential returns

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Key Takeaways

- Defensive stocks have quietly outperformed over time, meeting key metrics like consistent earnings and dividend growth, low valuation multiples, and strong total returns. We think these businesses have proven resilient in challenging markets and may offer steady, durable earnings growth while being undervalued compared to the broader market
- Defensive sectors like utilities, staples, and healthcare are trading at multi-decade lows relative to the S&P 500 and European indices, while market enthusiasm is concentrated in AI-driven stocks. This significant valuation gap creates a "coiled spring" effect, offering the potential for strong relative upside if valuations normalize, driven by steady fundamentals rather than speculative trends
- Defensive stocks can provide stable cash flows, consistent dividends, and reliable earnings growth, making them attractive in absolute terms but particularly so in momentum-heavy markets dominated by speculative narratives like AI. We think their resilience positions them as a compelling investment for compounding returns over time, particularly if market leadership shifts and their weight in broad market indices normalizes

If asked to identify a stock that has achieved over a 500% total return, compounded earnings at an annualized growth rate of 10% or greater, traded at an earnings multiple of less than 15x, and maintained or raised its dividend for over 20 consecutive years, what names come to mind?

If you answered Microsoft, Apple, Alphabet, or Nvidia, you would only be partially correct. While each of these gilded tech names met at least one of those criteria, none satisfied all four metrics at the same time.

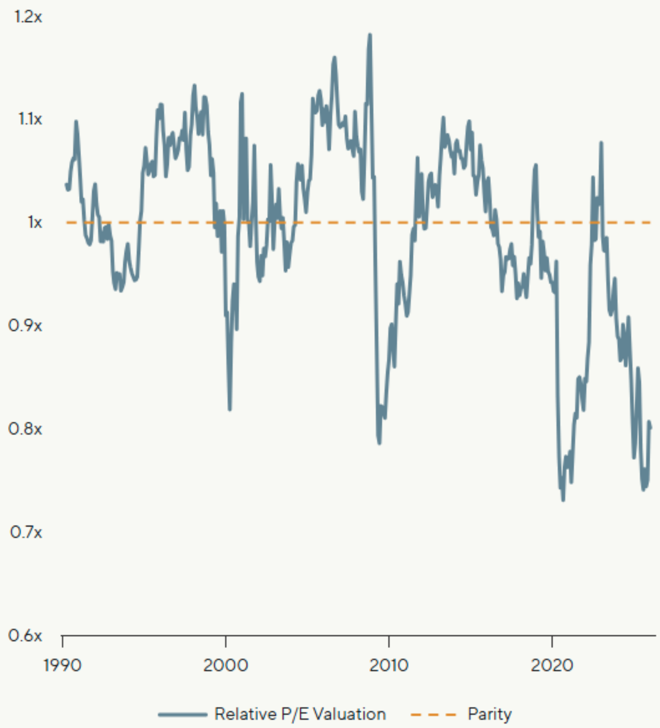
The companies that did were relatively boring, unglamorous staples and insurance names, like Kroger and Allstate. These businesses were not only durable in difficult markets but compounded through them, generating outstanding long-term returns for some investors while others seemed distracted by the market's loudest theme.

Today, that distraction is AI. When one narrative becomes the market's primary engine—with headlines, capital flows, valuations, and index weights all pointing in the same direction—we have found that opportunity often builds quietly where most investors are ignoring. Today, we believe the classically defensive areas within developed markets not only offer the potential for steady returns but also present a true "coiled spring" setup.

AN UNDERAPPRECIATED OPPORTUNITY

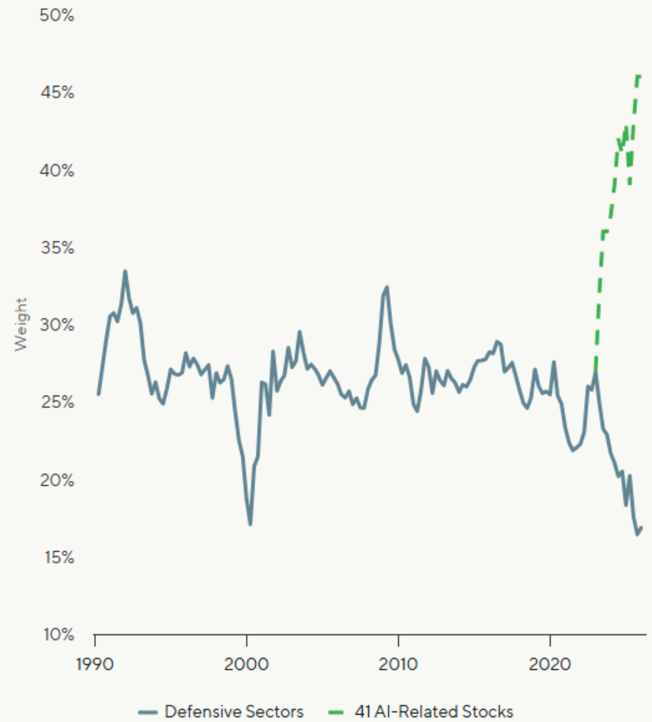
A broad swath of defensive stocks is currently trading near multi-decade lows on key relative measures, notably their relative forward P/E and weight in the S&P 500. Meanwhile, index concentration has surged: today roughly half of the S&P 500's market cap is tied to AI-related exposure, and the "Mag 7" alone represent approximately 35% of the index. This rally, supercharged since ChatGPT's release in November 2022, has reshaped the index and widened the valuation gap versus defensives to create an opportunity we rarely see.

The Great Divergence: Large-Cap Defensives Relative Valuations



Source: GQG Partners LLC (chart); Empirical Research Partners (data). Data for the time period from 30 March 1990 through 31 December 2025. Capitalization-weighted data relative to the largest 750 stocks in the US. Defensives defined as businesses in the healthcare, consumer staples and utilities sectors. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

S&P 500 Defensive Sectors vs AI Weight



GQG Partners LLC (chart). Bloomberg (data). Data for the time period from 30 March 1990 through 31 December 2025. Defensives defined as businesses in the healthcare, consumer staples and utilities sectors. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

To characterize our view of a coiled spring setup, one helpful theoretical lens grounded in nearly 40 years of history is the relationship between defensives' share of the S&P 500 and their coincident relative performance. Empirically, every 1% change in defensives' share in the S&P 500 has tended to align with roughly 10% of relative performance. With defensives today representing about 17% of the S&P 500 versus a long-term average of 26%, that 9% gap implies a potential relative upside of 90% if the composition were to revert to the long-term average. While we do not underwrite that outcome, we view it as optionality on top of returns we believe are already achievable and attractive on fundamentals alone.

To be clear, we never buy anything on the basis of mean reversion. Our process is rooted in assessing business quality, visibility, and durability of earnings, and what we view as a reasonable path for generating high-single-digit to low-double-digit returns. That said, when gaps get this wide, we believe it is impossible to ignore that any normalization has the potential to be additive—and markets rarely normalize "politely."

While the market is captivated by flashy technology, we are more galvanized than ever about staying true to our philosophy: high-quality businesses with durable earnings power at defensible valuations. In our view, the opportunity today is not chasing what has already been bid up, it is about owning what meets our minimum hurdle rate on fundamentals and can rebound sharply when capital rotates, concentration breaks, and valuations mean-revert. The current dispersion between defensives and the broader market does not just suggest upside; it suggests the potential for a swift, powerful snapback when the story changes, in our opinion.

CONSISTENCY BEATS TRENDY

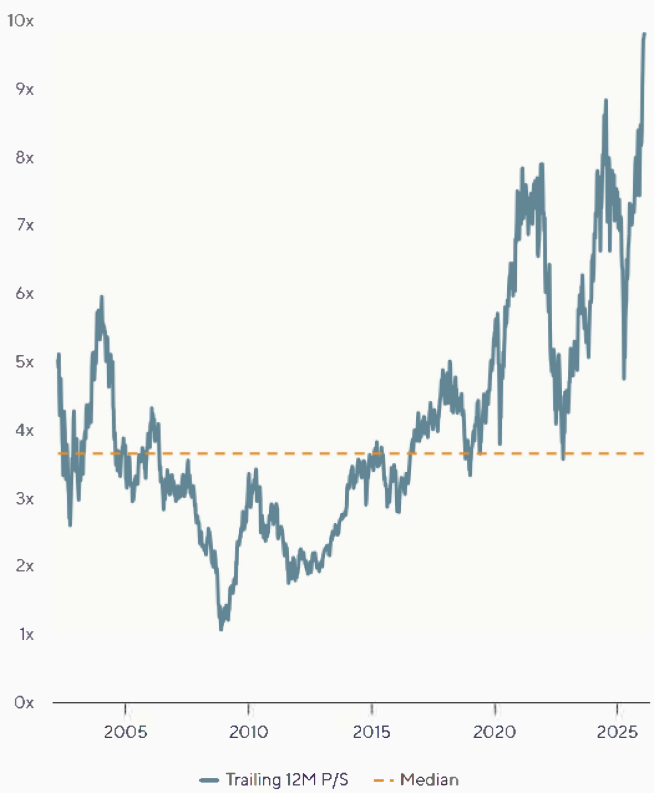
Defensive stocks offer steady growth, high visibility, and attractive returns through dividends and buybacks, making them resilient investments often overlooked by the market.

While their growth may not match the rapid revenue or earnings expansion seen in companies like Nvidia or early-stage software businesses, it is consistent and almost formulaic. For instance, utilities like Duke Energy project long-term EPS growth of 5% to 7% through 2029 coupled with a ~4% dividend yield, delivering a total return potential of around 9% to 11% with minimal valuation risk, in our view.[1]

But in momentum-heavy markets, steady and visible cash flows do not capture attention the way big promises of future profitability do. This is further underscored by the fact that AI narratives have been driving the market frenzy. Semiconductors, cloud, and data center infrastructure businesses—among the most cyclical industries in the world—have become irresistible magnets for capital, as we have discussed at length in our Dotcom on Steroids series.[2] Investors seem to be willfully ignoring their inherent cyclicality, chasing businesses trading at sky-high valuations on peak margins tied to AI trends with little regard for near-term profitability. Many names in these industries are now 'priced for perfection,' in our opinion, leaving no margin for error and setting the stage for significant disappointment when the inevitable CapEx spending slowdown arrives. We feel the disregard for these businesses' historical boom-and-bust cycles is nothing short of reckless. But, as history shows, narrative-driven momentum can keep markets disconnected from fundamentals far longer than logic suggests, as seen in past bubbles including the dotcom era of the 1990s.

Valuation of the 30 Largest US Semiconductors...

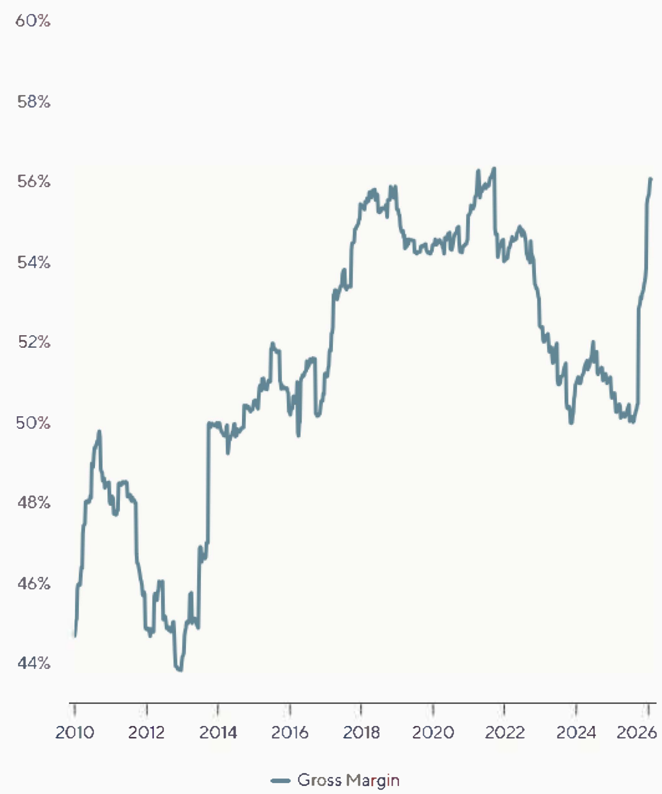
Philadelphia Semiconductor (SOX) Index Trailing 12M Price to Sales



Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 5 April 2002 through 30 January 2026. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

And Their Profitability

Philadelphia Semiconductor (SOX) Index Forward 12M Gross Margins



Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 1 January 2010 through 30 January 2026. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

The dotcom bubble reached its height in early 2000, a time when US tech stock valuations were soaring, relying heavily on the promise of profitability rather than hard earnings. These valuations were fueled by a belief in the transformative power of the internet and favorable monetary conditions but overlooked traditional, yet frankly quite basic, fundamentals.

Then came the dotcom crash and bear market aftermath (March 2000 to October 2002), and that is when defensive stocks in the S&P 500 outperformed significantly, with some even gaining in absolute terms despite broader market declines.

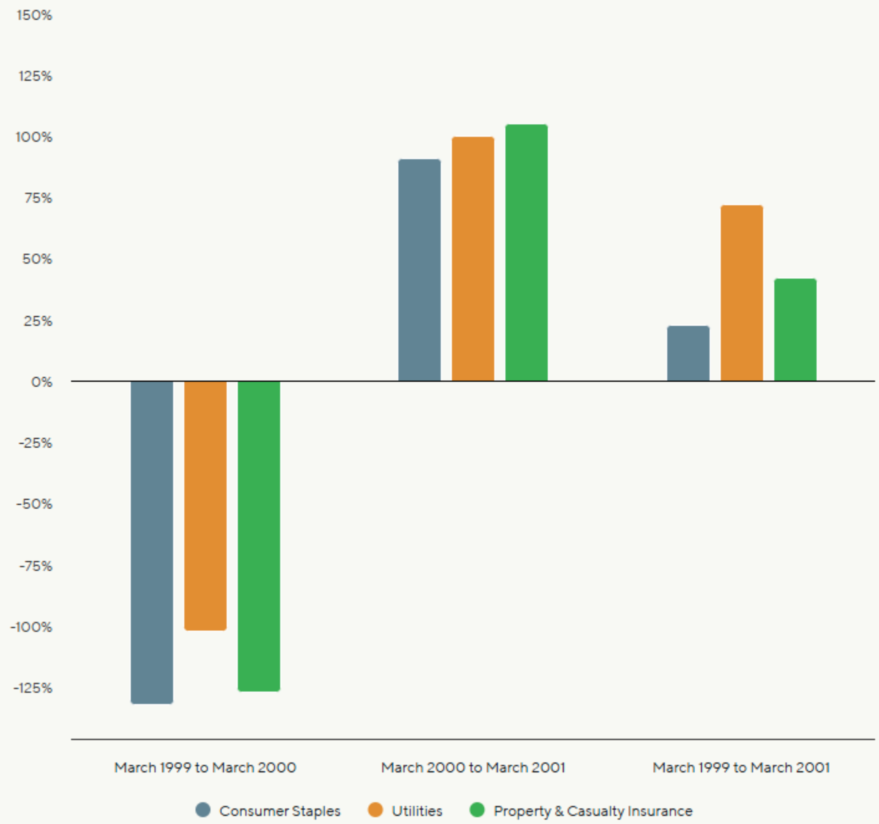
While the S&P 500 index took around seven years to recover its peak value (until mid-2007, before another crash) and the tech-heavy Nasdaq took 15 years, defensive stocks experienced minimal losses and, as such, did not have a significant recovery period. For example, during the dotcom crash the S&P 500 plummeted 49% from peak-to-trough, but the consumer staples sector delivered 11.2% annualized returns, "a stunning outperformance of approximately 33 percentage points annually versus the broad market."[3]

Companies like Procter & Gamble, Coca-Cola, and Altria Group held their stock prices while businesses tied to the internet craze imploded, with Altria surging over 100% by December 2000 from the March 2000 market peak. Utilities as a basket generated nearly 50% total returns over that same period.

History does not repeat itself, but it rhymes, and so we feel excited about the opportunity to capture outsized absolute returns within defensives given their potential of generating an asymmetric payoff if the AI bubble unwinds.

Dotcom's Boom and Bust

Relative performance leading into- and out-of dotcom



Source: GQG Partners LLC (chart). Bloomberg (data). Returns represented as total excess returns relative to the Nasdaq 100 Index. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

NAMES THAT BRING THIS OPPORTUNITY TO LIFE

While we are not valuation-driven investors, we do believe valuations matter, particularly over the three- to five-year investment horizon we target, especially when they trade at extremes as they do today.

As we touched on earlier, defensive sectors like US utilities have been showing faster, more consistent, and more predictable earnings growth than they have in years. Yet, surprisingly, utilities are still trading at a meaningful discount to the S&P 500. This is despite delivering earnings growth that is historically in line with the broader index, in addition to boasting a solid ~3% dividend yield. We think this means that utilities should continue to meet our objective of compounding capital at a high-single-digit to low-double-digit rate, driven by earnings and dividends alone, without meaningful valuation compression risks.

In the same vein, consumer staples also look more attractive than they have in quite some time. Here is why: during COVID, these companies gained favor as consumer behavior shifted toward spending on essentials like food-at-home and other goods to a level that came to dominate consumers' wallet share for several years—while discretionary spending, largely tied to services, took a back seat. But when that trend started to unwind, it created years of relative underperformance for staples compared to the index.

Staples Wallet Share Has Normalized

Source: GQG Partners LLC (chart). JP Morgan Chase (data). Data for the time period 31 January 2010 through 30 November 2025.

Seeing this underperformance, many investors may have soured on staples, perhaps assuming there is something fundamentally wrong with the sector. The loudest critics point to structural challenges like shifting demographics, the rise of private-label brands, or even GLP-1s. All valid trends at the margin, but we think the real story is much simpler: it is about cyclical normalization. In our view, select high-quality staples businesses have returned to high-single digit EPS growth and are now leaner, more focused, and positioned to thrive. Take Kroger, now trading at an approximate 12x EPS for fiscal year 2027, where we see a long-term earnings growth opportunity of 6% to 7% paired with a consistent dividend yield of 2.5%.

Kroger, in our view, is priced well below its fair value. It is benefiting from a low multiple, accelerating store openings in fast-growing markets, and new leadership which we believe is poised to guide the company successfully into the future.

We think insurance names also offer an attractive risk-reward profile, including stocks like traditionally 'boring' property and casualty insurers such as Allstate. Over the past five years, Allstate delivered an annualized total return of around 17%, beating the S&P 500's 14% return over the same period. What is even more striking is that Allstate pulled off this outperformance while its valuation multiples declined from nearly a 17x peak back in 2023 to about 8x by early 2026—even in the middle of an AI-driven bull market.

'Boring' Allstate beats 'Hyped' S&P 500

Allstate Corp vs S&P 500 total return last 5 years

Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 3 February 2021 through 30 January 2026. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

To put it in pragmatic terms: ask a group of people to compare the perceived value of ChatGPT to auto insurance. While most people pay for and would pay more for auto insurance—even if rates increase or they lose their job—very few pay for ChatGPT, and far fewer would pay more if its price went up.[4] That willingness to pay, especially in tougher conditions, is the quiet edge we feel that 'boring' insurers offer in markets as topsy-turvy as this.

DEFENSIVES AT MULTI-DECADE LOWS EVEN IN EUROPE

Sectors like staples, healthcare, and utilities in Europe are, in our view, also offering an analogous "coiled spring" setup, with valuations at or near 20-year troughs relative to the MSCI Europe Index. The opportunity is not simply that Europe is cheap; it is that defensives have been de-rated for years, leaving a starting point that already discounts a lot of bad news, in our opinion.

Mind the Valuation Gap

Forward 12M P/E Spread between MSCI Europe Consumer Staples Index and MSCI Europe Index

Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 6 January 2006 through 30 January 2026. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

As with the US, we feel European staples are beginning to get their mojo back in that they are benefiting from growth both on and off the continent. Companies like Unilever, British American Tobacco, and Danone, with significant emerging markets exposure, are particularly well positioned, in our view. Even though consumption growth in emerging markets has slowed from past levels, it is still expected to outpace developed markets, giving these companies a more reliable growth tailwind compared to most developed market cyclicals.

This resilience and adaptability are why we remain confident in staples, even amid concerns about the potential impact of GLP-1s. One may argue that these concerns are already priced in, given valuations are at a substantial discount compared to the broader market and their historical levels. While the claim that GLP-1s could impact consumer staples may hold some truth, in our view the market is being overly punitive and is ignoring these companies' proven resilience and adaptability. Staples giants like Unilever and Danone have faced shifting trends before—from the backlash against sugary drinks to the rise of health-conscious eating—and emerged stronger by innovating. We think their massive advertising and innovation budgets, retailer partnerships, and control over prime shelf space give them a competitive edge over would-be new entrants. If GLP-1s shift consumption toward high-protein or functional foods, we believe companies like Danone, with expertise in dairy and nutrition, are well positioned to capitalize. And when indulgent categories like soda faced scrutiny, staples leaders reinvented with zero-sugar options and creative packaging, reigniting growth.

To be clear, we have also made the opposite call on staples when the risk-reward was unfavorable. In the summer of 2016, we wrote a paper titled "Do Multiples Matter?" on the sector's valuation risks as we felt investors were overpaying for perceived safety near the start of what became a decade-long period of underperformance. This matters because it underscores that we are not dogmatic: today's setup looks the opposite to us, with defensives de-rated to levels that make the asymmetry more compelling.

European bank valuations, by contrast, tell a very different story. While there are some solid franchises we like, the broader sector remains constrained by limited loan growth, especially since valuations in parts of the complex have inflated to their highest levels post the Global Financial Crisis.

The continent's macro backdrop matters. Economic data is not getting better across European markets in a way that supports a broad, cyclical re-acceleration: unemployment rates in the UK, Germany, France, and Australia have moved higher versus three years ago, and housing in many markets looks worse, not better. Without clear economic tailwinds, it is hard to identify what will drive sustained improvement in credit demand, balance-sheet growth, and most importantly, earnings growth going forward.

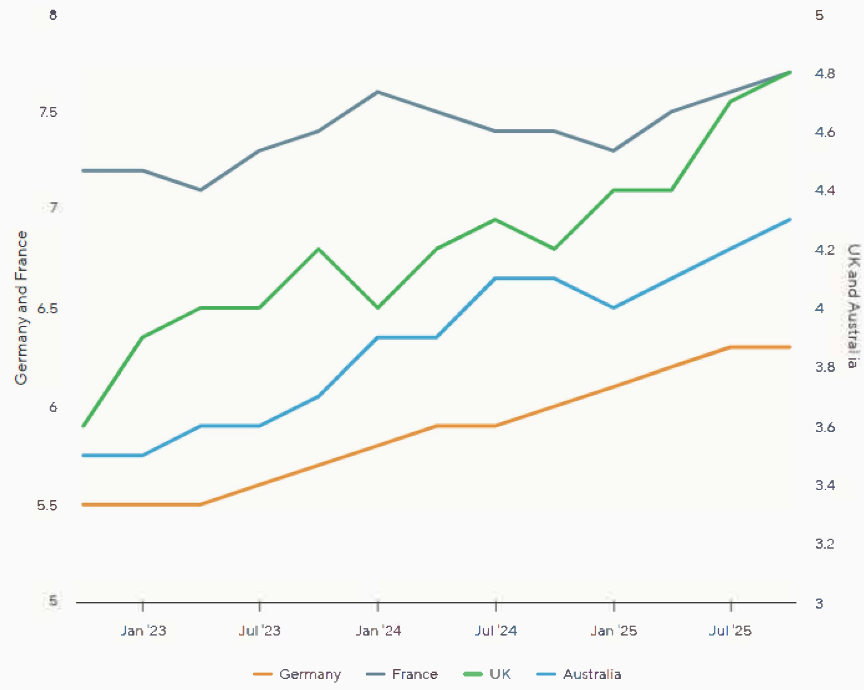
MSCI Europe Banks: High Valuations, Low Loan Growth

Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 1 January 2009 through 31 January 2026. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

Germany is a useful reality check on the European growth debate. As recent reporting has highlighted, the German economy has been stagnant for roughly three years and corporate stress appears increasingly broad-based, with rising insolvencies and notable closures across sectors.[5] An environment like that is not the backdrop you want to rely on for a continent-wide bank re-rating that requires stronger loan growth; it is a backdrop we feel where stable cash flows purchased at washed-out valuations can become relatively more attractive.

A Dim Macro Outlook for EU and AU

Unemployment rates, last three years



Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period September 2022 through September 2025.

We would also be more cautious on parts of European industrials. With a structural slowdown in China and the possibility that the data center buildout eventually normalizes, a number of industrial business models face meaningful downside if that incremental demand impulse hits a wall—especially where there is not a second driver to take the baton. In our view, the risk is that valuations are discounting high-single digit to low-double digit secular growth that may not be sustainable once the data center cycle cools. This is why the longer-term valuation gap between defensives and cyclicals, such as utilities versus industrials, matters here.

MSCI Europe: Industrials vs Utilities, Forward 12M P/E

Source: GQG Partners LLC (chart). Bloomberg (data). Data for the time period 1 January 2006 through 24 January 2026. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

VALUATIONS SPEAK FOR THEMSELVES

Due to faster growth in parts of the MSCI Europe Index, defensive sectors like utilities, staples, and healthcare trade at steep discounts relative to the broader market. That said, utilities, in particular, offer stable cash flows and play key roles in Europe's energy transition. While there is more widespread optimism around them now, the relative valuation disconnect still helps frame why we think defensives can hold up well if macro uncertainty persists. Healthcare adds a different kind of durability, with aging demographics and structurally rising healthcare spending supporting long-run demand.

CONCLUSION

While the market's center of gravity has shifted towards one story (AI), valuations and index concentration have moved with it, widening the gap between what is "exciting" and what is simply essential. That is precisely when we prefer to own businesses whose returns are driven by durable cash flows rather than perfect expectations.

Defensives today offer that setup in both the US and Europe: reasonable relative and absolute valuations, visible earnings growth, and meaningful capital return, without requiring heroic assumptions. In our view, this is a compelling paid-to-wait profile that can compound on fundamentals alone, with embedded optionality if market leadership broadens, the data center cycle normalizes, or the crowded trade unwinds. We do not buy on mean reversion, but when gaps get this wide, any normalization can become additive to already attractive expected returns.

END NOTES

[1]Duke Energy Third Quarter 2025 Earnings Report. 7 November 2025.

[2]GQG Research. Dotcom on Steroids Part III. 18 December 2025. Dotcom on Steroids: Part II. 21 November 2025. Dotcom on Steroids. 11 September 2025.

[3]"Sectors and Stocks That Gained During the Dot-Com Bust." Red Lotus Capital. 2 November 2025.

[4]Claburn, Thomas. "OpenAI's ChatGPT is so popular that almost no one will pay for it." The Register. 15 October 2025.

[5]"Germany's Economy is so Bad Even Sausage Factories are Closing." The Economist. 15 January 2026.

DEFINITIONS

Earnings Per Share (EPS) is a measure of a company's profitability, calculated by dividing quarterly or annual income (minus dividends) by the number of outstanding stock shares.

The P/E (Price-to-Earnings) ratio is a valuation metric that measures a company's current share price relative to its earnings per share (EPS), indicating how much investors are willing to pay for $1 of earnings. A high P/E ratio can indicate a company is overvalued, or that investors have high hopes for future growth. Conversely, a low P/E might suggest the company is undervalued or that it is expected to underperform.

The P/B (Price-to-Book) ratio compares a company's market capitalization to its book value (net assets), indicating whether a stock is overvalued or undervalued relative to its accounting value.

The P/S (Price-to-Sales) ratio measures a company's market value relative to its revenue. It indicates how much investors pay for $1 of sales, with lower ratios often signaling potential undervaluation.

Forward earnings are a company's projected net income for a future period, typically the next 12 months or upcoming fiscal year, based on analyst consensus or management guidance.

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The **S&P 500 Index** is a float-adjusted market cap weighted equity index of stocks of 500 leading companies in the United States.

The **Nasdaq 100 Index** includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology.

The **MSCI Europe Index** captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe. The index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

The **Philadelphia Semiconductor (SOX)** is a capitalization-weighted index comprising the 30 largest U.S.-traded companies primarily involved in the design, distribution, manufacture, and sale of semiconductors.

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