Blue Chips

In times of market uncertainty, many investors start looking for equity investments that represent stability and safety. Certainly one place to look is at so-called “blue chip” stocks.

What is a blue chip today?

Just being big and dominant is no longer a guarantee that a company is blue chip quality. A blue chip today is most often found in the mature investment sectors, such as banking, insurance, and the equities of large-cap, “old economy” industrial sector giants. The S&P TSX 60 or the Dow Jones Canada Titans 40 are indexes whose basket of stocks are largely blue in colour.

Their shared attributes are investment stability, the quality of their tangible assets and value measured by the strength of a relatively low debt balance sheet, their long and predictable revenue and earnings track record in good and bad times and competitive dominance in their respective markets. Such companies can usually show a long record of steady dividend payouts and a reputation for dependable (some might say conservative) management practices. Most blue chip investments are leaders in their industry and their products and services often possess wide “brand” recognition.

Blue chips tend to maintain value in both good and bad markets. But in bull markets where growth is king, they tend to get overshadowed and overlooked. For that reason, blue chip investments fell out of favour with investors during much of the last decade. They could not promise either excitement or high returns compared with the more nimble growth stocks.

Renewed interest

Now, some investors are re-considering their position on blue chips. They are once again making room in their portfolio for the kinds of equity investments that their fathers used to buy. For the Advantaged Investor, there is the possibility that some overlooked blue chips may be undervalued and trading at attractive prices.

For some investors, blue chips may be an attractive way to achieve a higher level of safety in their portfolio’s equity allocation. But homework is required. While size, history and reputation are good guides to blue chips, they do not guarantee future performance. A big, well-established corporation could be in its final years at the top. It could be the dominant player in a declining industry. It could be facing new competitors with an entrenched management team unable to cope much longer with changes in its market. Investors should work with their investment advisor to undertake the proper analysis of likely investment choices.

Understated value

Clearly, blue chips are unlikely candidates for growth investors seeking above average returns in a short period of time. But blue often possess understated value that could make them a superior investment over time.

One of the chief advantages of blue chips is their dual investment value. As equities, their share price appreciates with earnings growth, albeit at a lower rate than a growth stock. Then there’s the dividend income which most blue chips are likely to payout to investors. Over the long term, the combination of gradual stock price appreciation and regular dividend income (made all the more attractive if there is a dividend re-investment program), can give blue chip investments a very reasonable long-term rate of return.

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