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I. Blue Chip Investing

While there is no universal definition of blue chip stocks, the term is generally understood to represent large, well-established companies that tend to be leaders in their respective industries and enjoy brand recognition in the marketplace. These characteristics typically result in competitive advantages and economies of scale, which may make blue chip companies better able to withstand cyclical downturns. This paper documents blue chip stock performance in recent years and seeks to identify the fundamental drivers of the quality nature of their earnings and balance sheets. Furthermore, it argues that blue chip companies, as a group, have undergone changes that make them especially well-positioned to face the challenges of economic and market cycles.

II. Blue Chip Companies—A Decade of Attractive Stock Performance

Due to their size, strength and stability, blue chip stocks tend to deliver attractive performance compared to the broader market (Russell 1000® Index). This can be seen by using the top 200 companies by market capitalization in the index (Russell Top 200® Index) as a proxy for blue chips and examining their value-weighted returns against the Russell 1000 Index. Over the last 10 years, blue chip stocks have posted slightly higher returns along with lower investment risk relative to the broader large-cap universe.

Chart 1: Return and Risk, 10-Year Period

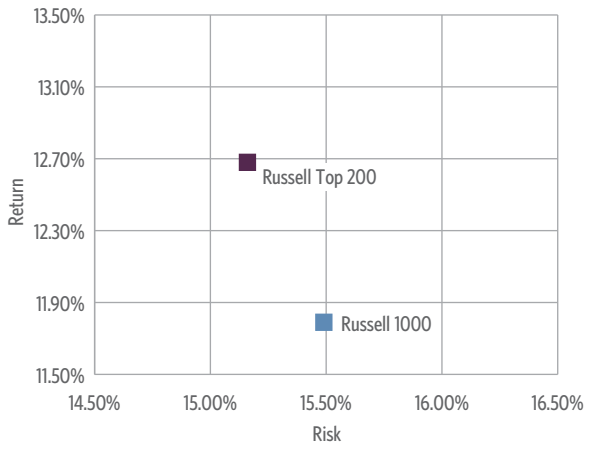
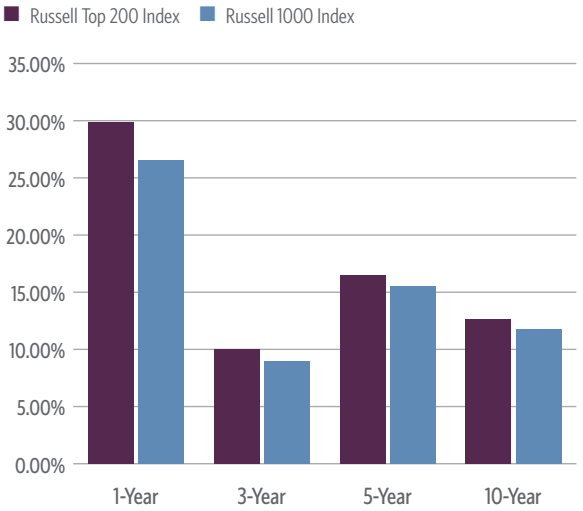


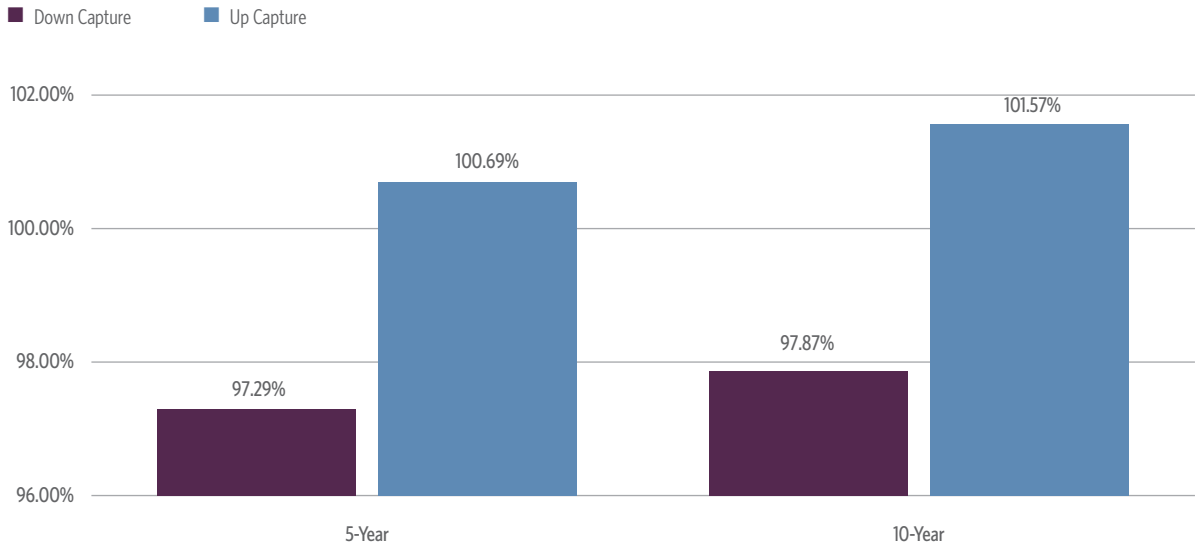
Chart 2: Trailing Annualized Returns



As of 12.31.2023. Source: S&P Capital IQ, Guggenheim, Bloomberg. Return is compound annual total return and Risk is annualized standard deviation. See Appendix for details on calculation methodology.

The outperformance of blue chip stocks over the broader market has been consistent over various trailing periods within the last 10 years, including a strong showing in the most recent twelve months. Looking at down-market and up-market captures confirms their resilience on the downside, as well as their ability to participate to the upside. This is all the more remarkable considering the U.S. equity market has enjoyed a bull run that dominated most of the last decade.

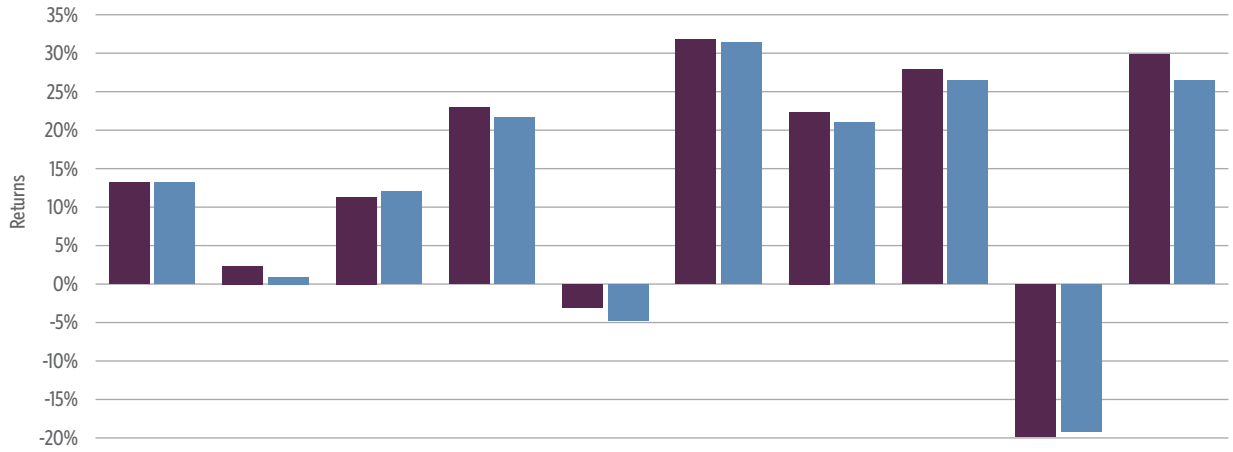
Chart 3: Down-Market and Up-Market Captures



As of 12.31.2023. Source: S&P Capital IQ, Guggenheim, Bloomberg. See Appendix for details on calculation methodology.

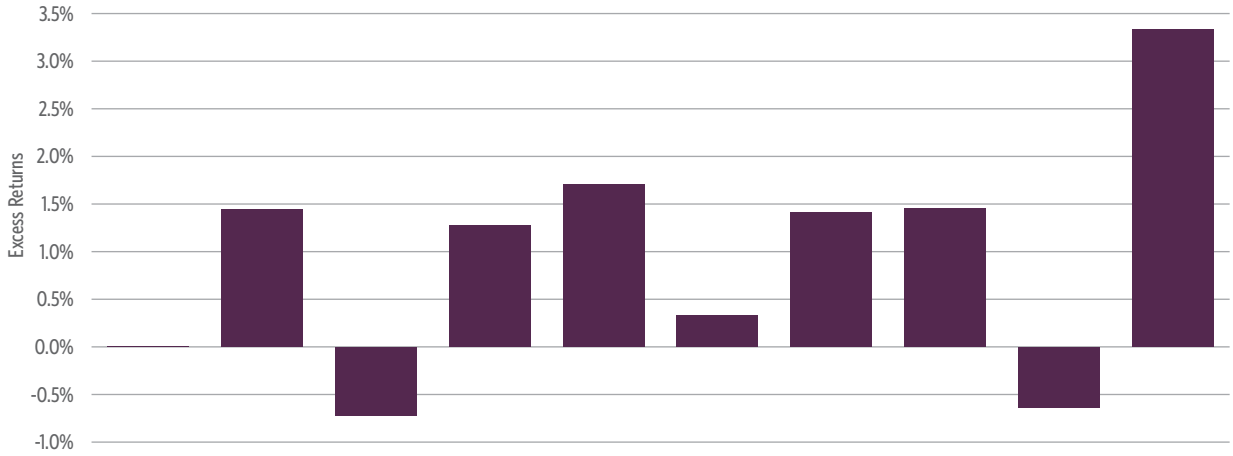
A closer look at calendar year returns reveals that blue chips outperformed the Russell 1000 Index eight out of the last 10 years and four of the last five years. While there was underperformance in 2022, it is worth noting the positive excess returns during the other years with lower returns (such as 2015 and 2018), underscoring the ability of blue chip stocks to generally weather weaker equity markets.

Chart 4: Calendar Year Returns



	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Russell Top 200	13.25%	2.35%	11.32%	22.95%	-3.08%	31.75%	22.36%	27.88%	-19.79%	29.83%
Russell 1000	13.24%	0.91%	12.04%	21.68%	-4.79%	31.42%	20.95%	26.43%	-19.15%	26.50%

Chart 5: Russell Top 200 Index Excess Returns over Russell 1000 Index

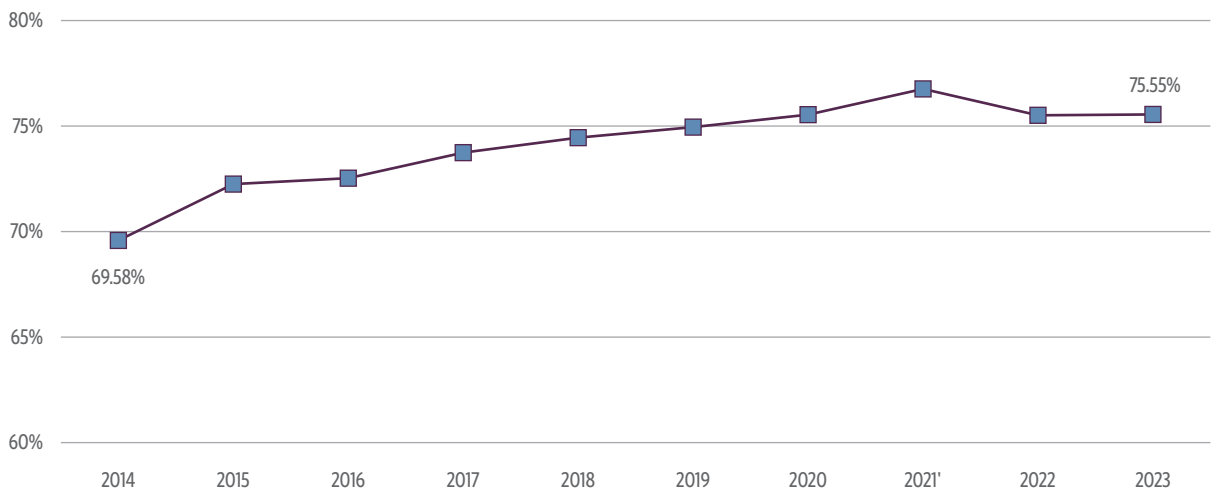


2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
0.01%	1.44%	-0.72%	1.28%	1.71%	0.33%	1.41%	1.45%	-0.64%	3.33%

As of 12.31.2023. Source: S&P Capital IQ, Guggenheim, Bloomberg. See Appendix for details on calculation methodology.

With this outperformance, the biggest companies have grown even bigger: the market capitalization of the Russell Top 200 Index companies as a percentage of the Russell 1000 Index has increased from approximately 70 to 75.5 percent over the last decade. The largest among the large-cap companies, blue chips now have an even more significant influence on the main market benchmark indices, providing an investment experience that is representative of the broad market, with less of a bumpy ride and more downside protection.

Chart 6: Market Cap of Top 200 (% of Russell 1000 Index)



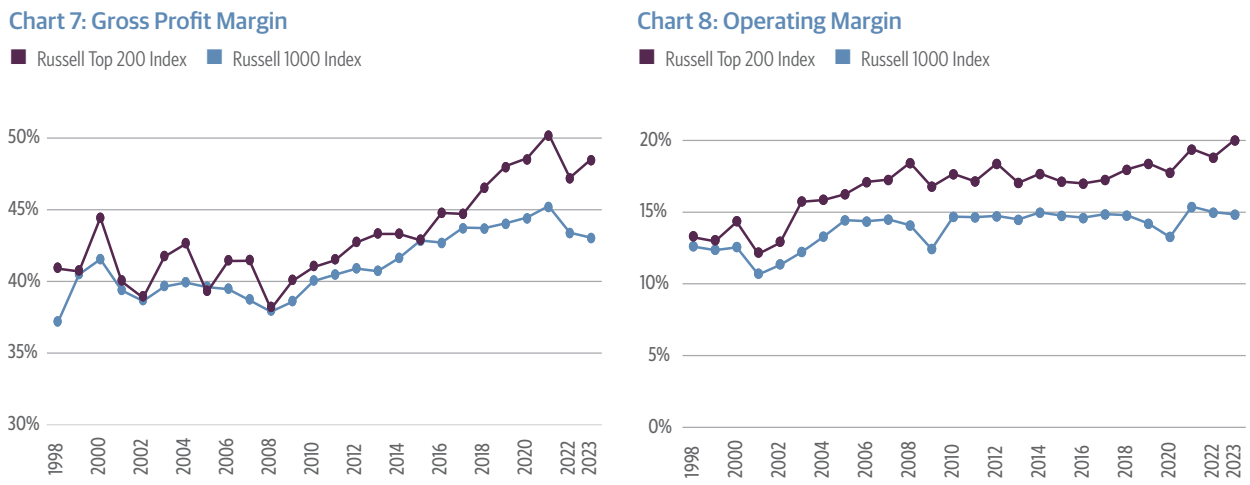
As of 12.31.2023. Source: S&P Capital IQ, Guggenheim, Bloomberg. See Appendix for details on calculation methodology.

III. Blue Chips: Quality Investing

Guggenheim believes the characteristics that define blue chip stocks – large, industry leaders with recognizable brands – tend to translate into sizable and stable earnings, as well as relatively healthy balance sheets with lower leverage and more abundant cash balances. In other words, blue chip companies typically score high on "quality" metrics. Looking at some of these metrics over time, and in relation to the broader large-cap universe, also helps shed some light on the fundamental drivers of blue chip stock performance.

Strong profitability metrics may signal the presence of a competitive advantage for blue chips. More specifically, this suggests there are economic "moats" that produce barriers to entry, discouraging competition. In turn, these factors may manifest themselves in extended periods of high and stable returns on blue chip companies' equity.

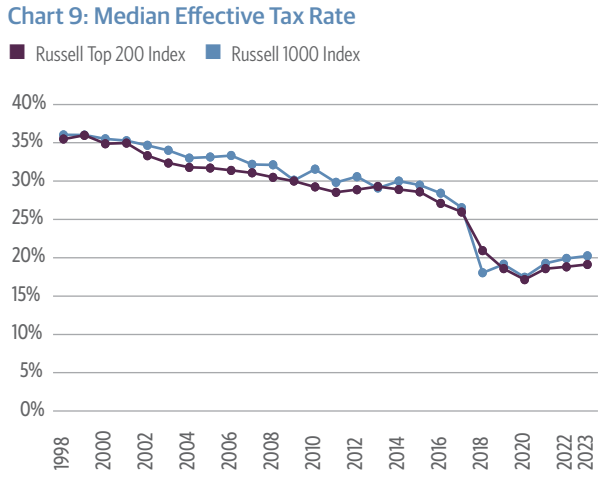
Gross profit margin has a traditional place in economic theory as the purest indicator of market power.[1] The figure below shows that the Top 200 companies have delivered, on the aggregate, consistently higher margins than other large-cap companies, with a gap that appears to be widening over the last decade in the aftermath of the financial crisis and the Great Recession. The comparison of operating margins shows similar consistency, with an average difference of close to 3 percent in favor of blue chip companies in the period since 1998.

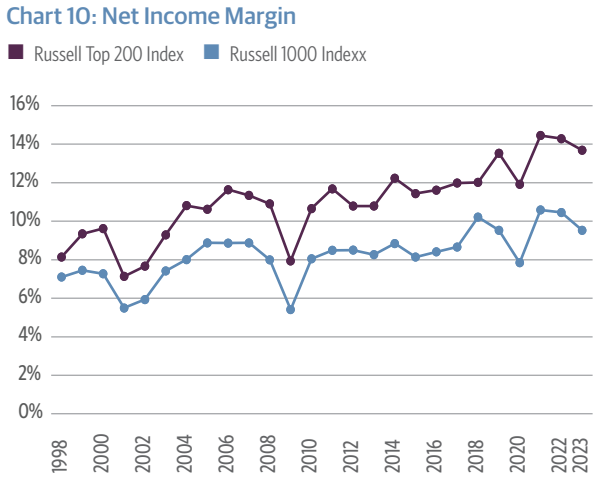


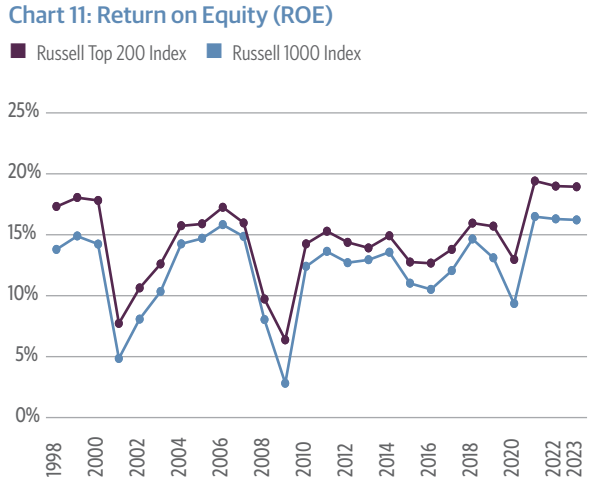
As of 12.31.2023. Source: S&P Capital IQ, Guggenheim. See Appendix for details on calculation methodology.

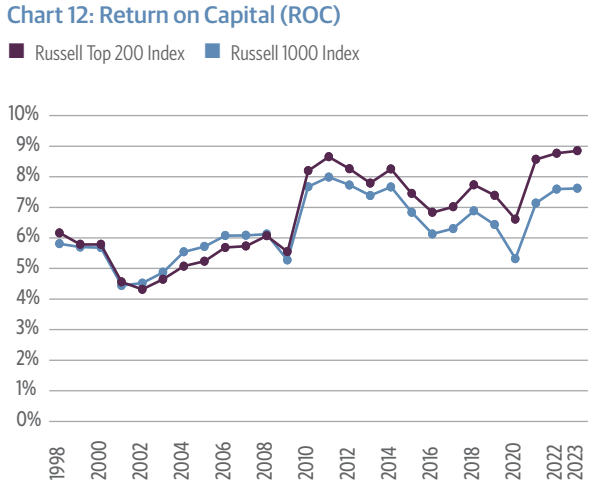
Along with competitive advantage, substantial economies of scale also likely contribute to the margin outperformance of the largest companies, owing to stronger bargaining power with suppliers and better cost management. Not to be underestimated is the decrease in the median corporate effective tax rate, which fell from around 36 percent at the end of 1998 to about 19 percent by 2023, also contributing to the increase of net income margins. Overall, as expected, this translated to consistently higher return on investment for blue chip companies over the period under analysis.

1 See also Novy-Marx, "Quality Investing"





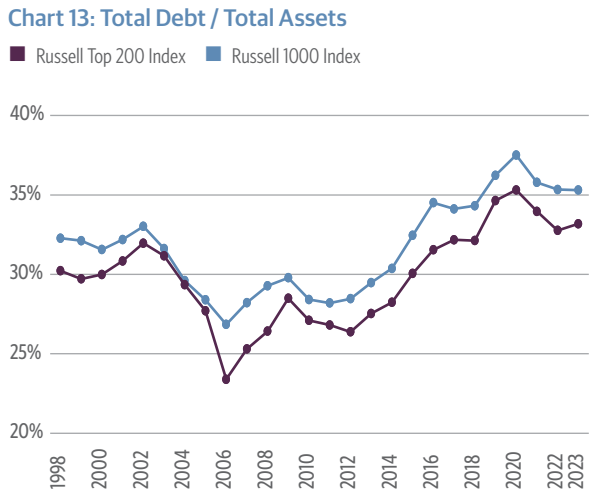


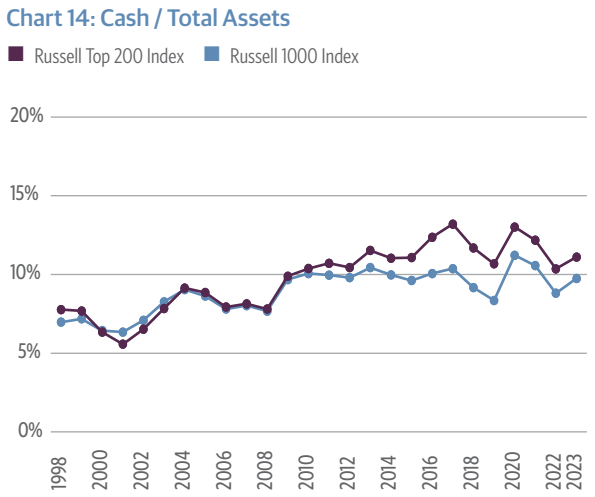


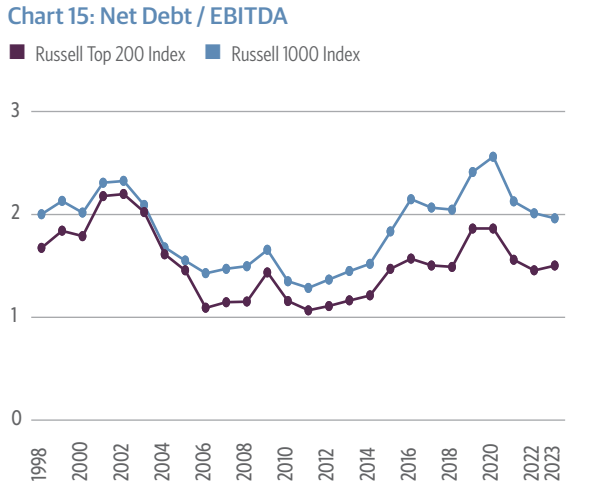
As of 12.31.2023. Source: S&P Capital IQ, Guggenheim. See Appendix for details on calculation methodology.

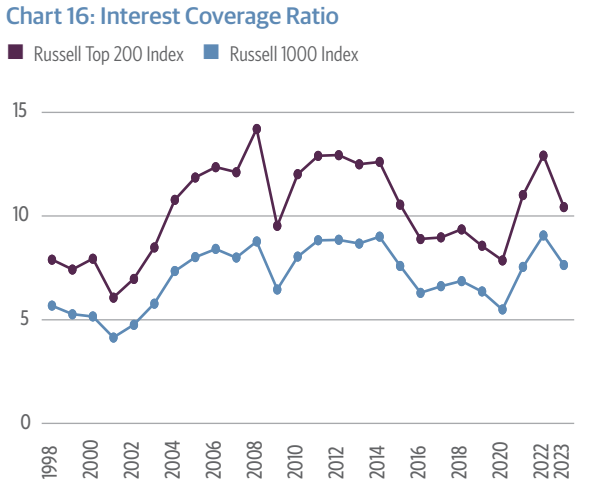
Another component of the "quality-package" that blue chip companies can deliver is less reliance on debt financing (and better ability to service it, when needed), which in turn results in lower leverage and more liquid balance sheets. Over this same period, debt-to-assets ratios have indeed been consistently lower for the largest companies. Even more remarkable is the observation of cash balances as a percentage of total assets. While the last 20 years or so have seen a general trend toward companies sitting on larger amounts of cash relative to their assets, the difference in cash balances between blue chips and the broader large-cap universe has considerably widened over the last decade.

Lower leverage and stronger earnings also contribute to favorable debt-to-earnings and interest coverage ratios, which may signal the ability of the largest companies to pay off and service their debt with profit generated from current operations. This is especially relevant in an environment with rising interest rates, which can considerably hurt companies with large amount of debt. Indeed, this dimension of balance-sheet strength contributed to the resilience of these companies during the Federal Reserve's latest hiking cycle. More generally, in the event of attractive business growth opportunities, the strength of blue chip company balance sheets potentially gives them additional edge in the form of easier and cheaper access to funding. One disadvantage



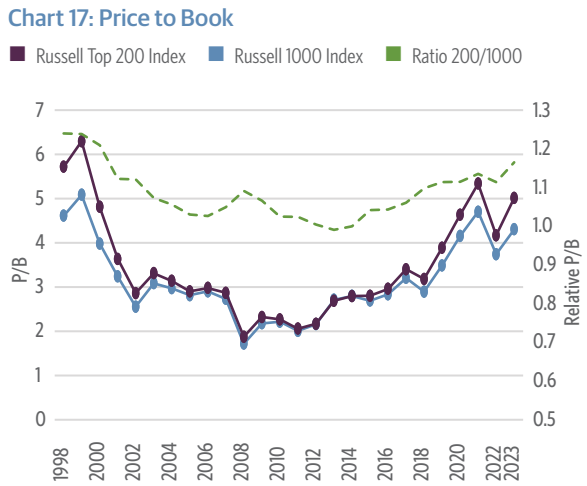


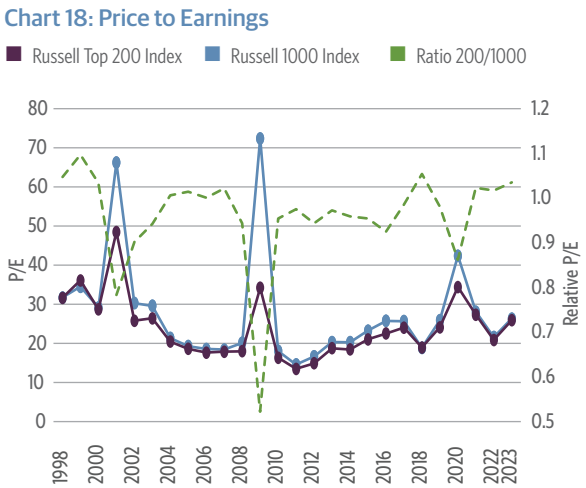




As of 12.31.2023. Source: S&P Capital IQ, Guggenheim. See Appendix for details on calculation methodology.

typically associated with blue chip companies is that they can be relatively expensive, as the market pays a premium for brand recognition and liquidity. A comparison of aggregate Price-to-Book (P/B) ratios for the Russell Top 200 Index companies vs. Russell 1000 Index companies shows that the former group is priced at a slight premium. To the extent that the choice of book value might understate fundamental value, given the increasing importance of intangible assets in recent years, we also look at price-to-earnings (P/E). Here, the comparison reveals blue chip earnings have been priced at a discount vs. the broader large cap universe for most of the last decade. The relative P/E as of the end of 2023 stands at 0.99, only slightly above the period average of 0.91. Overall, valuations of blue chip companies are not unattractive relative to the broader large cap segment.





As of 12.31.2023. Source: S&P Capital IQ, Guggenheim. See Appendix for details on calculation methodology.

IV. Blue Chips: The Way Forward

The observations on earnings and balance sheet quality of blue chip companies over the last couple of decades provide a backdrop that is consistent with and can explain their stock performance in the same period.

Another look at the largest companies, highlighting a few trends, suggests they are likely to be even better positioned, as a group, to help investors face the challenges and take the opportunities of changing market environments.

Changing Sector Composition

Comparing the sector weights of the Russell Top 200 Index companies a decade ago to the end of 2023, there is a noticeable shift away from sectors that are more traditionally associated with blue chip companies.[1] The groups with the largest drain are energy, consumer staples, and industrials.

This shift resulted in a significantly larger representation from information technology, and communication services. In short, not only did blue chips become "bigger," but also "techier." The recent transition of companies like Alphabet and Meta to the communication services sectors contributed to this trend. Guggenheim believes that blue chip companies show the potential to be more growth-oriented than before, while preserving the quality characteristics that are generally expected of them.

1 For this decomposition. Real Estate companies are included in the Financials sector.

Chart 19: Russell Top 200 Index Companies Sector Weights 2014

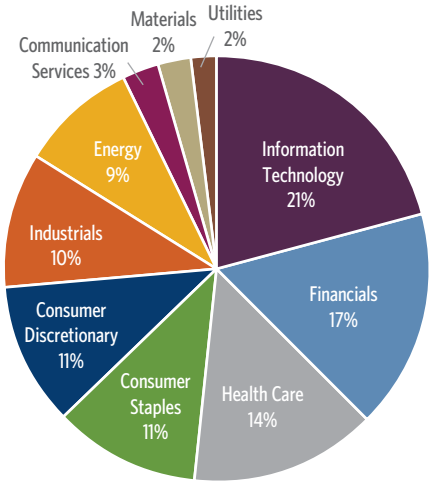
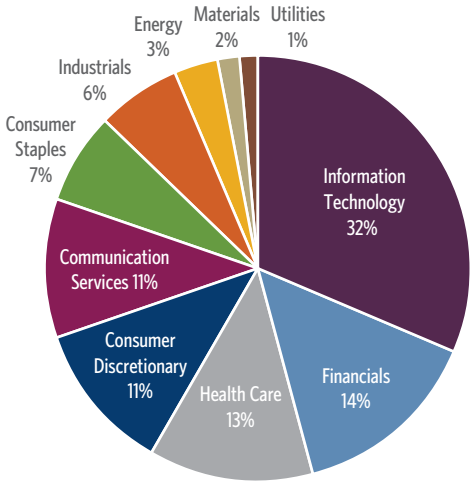


Chart 20: Russell Top 200 Index Companies Sector Weights 2023



	Information Technology	Financials	Health Care	Consumer Staples	Consumer Discretionary	Industrials	Energy	Communication Services	Materials	Utilities
2014	21%	17%	14%	11%	11%	10%	9%	3%	2%	2%
2023	32%	14%	13%	7%	11%	6%	3%	11%	2%	1%

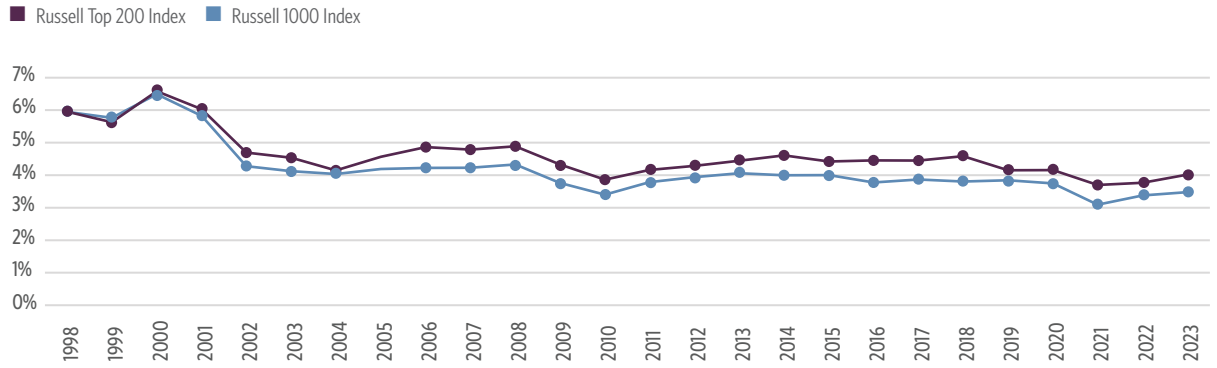
As of 12.31.2023. Source: S&P Capital IQ, Guggenheim. Real Estate companies are included in the Financials sector.

Capital-light?

In the past, it was common to associate blue chips with industrial behemoths and plenty of physical capital. Data suggests companies have become more capital-light compared to a couple of decades ago: tech companies with very little in way of physical assets have emerged to take more market share, and incumbent firms are changing to adapt to these new competitors.[1] The median ratio of capital expenditure-to-revenue for the Russell Top 200 Index decreased from around 6 percent at the end of 1998 to less than 4 percent at the end of 2023.[2] This trend is certainly not exclusive to the largest companies—indeed, capital expenditures are still relatively higher than in the broader large-cap universe. It is, however, striking enough that the trend is essentially the same. The bottom line: This is now a group of nimbler companies, potentially better suited to respond to challenges presented by economic and market cycles.

1 McAfee and Brynjolfsson, "Machine Platform Crowd." **2** S&P Capital IQ, Guggenheim 12.31.2023

Chart 21: CapEx as % of Revenue

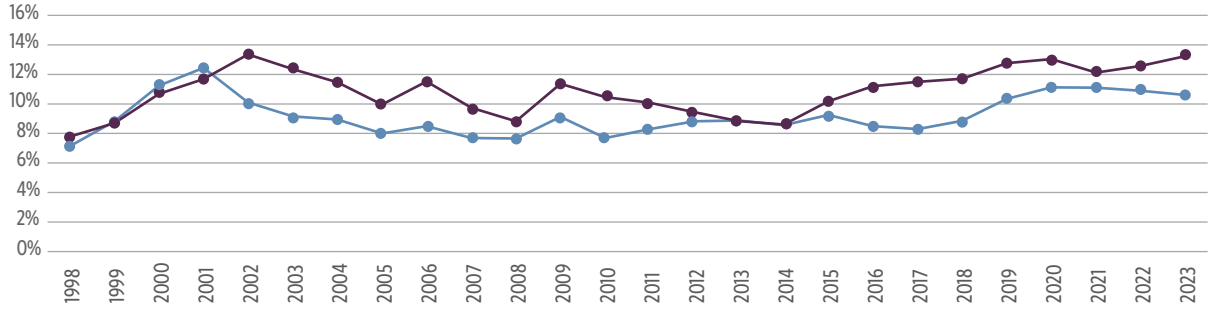


As of 12.31.2023. Source: S&P Capital IQ, Guggenheim, Bloomberg.

Research & Development on the Rise

Looking at data on research and development ("R&D") expenses over the last decade, there is a notable divergence between blue chips and the broader large-cap group. The largest companies engaging in R&D appear to have ramped up those investments at a faster pace. This ratio reached a peak value of over 13 percent by 2023,[1] close to the highest it has been in the period under consideration. The data suggests we are witnessing another significant acceleration within the blue chip group during the years following the COVID pandemic. It was already noted that the competitive advantage that can come from blue chips' brand recognition has resulted in large and steady returns. Without continued investment, however, those advantages wither through time. The ongoing willingness of blue chip companies to reinvest in their businesses to drive future growth appears to be another dimension that makes them special. Now, especially in consideration of the changing composition of the blue chip group (more technology and consumer oriented), the upward trend in R&D bodes well for expected returns going forward, as it contributes precisely to the stock of intellectual-property capital that is instrumental to network effects[2] and brand loyalty.

Chart 22: R&D as % of Revenue



As of 12.31.2023. Source: S&P Capital IQ, Guggenheim, Bloomberg.

1 S&P Capital IQ, Guggenheim 12.31.2023. **2** Network effects are a phenomenon that arise in markets where the value a consumer derives from a product increases with the number of users of that product, thus potentially perpetuating an existing position of competitive advantage.

In Conclusion: Why Blue Chips Now?

Blue chip stocks continue to exhibit the traits they are known for. They have historically been industry leaders with competitive advantages and economies of scale, that maintain relatively high profitability and operating performance metrics, while generating steady returns on investment. They also generally have stronger and more liquid balance sheets via lower debt, higher interest coverage and higher cash holdings, all contributing to blue chip companies' ability to withstand economic downturns. Blue chip stocks have delivered attractive performance per unit of risk than the broad large-cap universe over the last decade, they have shown resilience to weaker environments, as expected, but also favorable upside participation in what has mostly been a bull market.

Guggenheim believes that blue chip investing is a valuable proposition going forward, arguably even more so than in the past. Looking at blue chip companies as a group, they still possess the characteristics that make them safer, quality investments, but they are undergoing a transformation, both in sectoral composition and capital structure, that makes them better positioned to take advantage of growth opportunities.

Economic moats in the form of branding, network effects, and intellectual property are especially valuable in the current environment, all of which is good news for technology and consumer firms with these characteristics. The blue chip universe is increasingly represented by these sectors, making it well poised to reap the benefits. As was demonstrated during the COVID crisis, markets have rewarded companies that are able to invest and reconfigure their business to react to changing risk landscapes. Perhaps more than ever before, blue chip companies are large enough, and now flexible enough, to meet these challenges and thus keep generating steady returns on capital for an extended period of time.

References

McAfee, A. and Brynjolfsson, E. (2017). Machine, Platform, Crowd: Harnessing Our Digital Future. W. W. Norton & Company.

Novy-Marx, R. (2014). Quality Investing, Working Paper.

Appendix

Sources

Total returns (Price return + Dividend yield) are calculated on monthly basis (Source: Bloomberg)

Financial and balance sheet metrics for Russell 1000® Index and Russell Top 200 Index constituents are sourced from the CIQ SQL DB and based on the latest data available for the respective components as of the last working day of December every year (and on a quarterly basis in some instances). S&P GICS sectors for the index components are mapped point in time for the rebalance, based on the last working day of December every year.

Definitions

Index Definitions:

Russell Top 200® Index measures the performance of the largest cap segment of the US equity universe. The Russell Top 200® Index is a subset of the Russell 3000® Index. The Russell Top 200® Index is constructed to provide a comprehensive and unbiased barometer for this very large cap segment and is completely reconstituted annually to ensure new and growing equities are included.

Russell 1000 Index is a subset of the Russell 3000 Index and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. It is reconstituted annually to ensure new and growing equities are included.

Indexes are unmanaged, it is not possible to invest directly in an Index, and its returns do not include payment of any sales charges or fees which would lower performance.

Return and Risk Performance Metrics

Compound annual return is the geometric average of an investment's yearly total returns over a given period. With monthly returns, it is calculated as:

Return = (Ending Value/Beginning Value) ^(12/N)-1; where N is the number of monthly observations.

Standard Deviation is a statistical measure for return volatility or risk. Higher standard deviation of returns signifies higher variations in the returns and vice versa.

Up-Capture is a measure of a portfolio's performance during periods when the benchmark has positive returns. An Up-Capture of more than 100% indicates that the portfolio has on average outperformed the benchmark during periods of positive benchmark returns.

Up-Capture = Average Portfolio Return in Up market months/Average Benchmark Return in Up market months

Down-Capture is a measure of a portfolio's performance during periods when the benchmark has negative returns. A Down-Capture of less than 100% indicates that the portfolio has on average outperformed the benchmark during periods of negative benchmark returns.

Down-Capture = Average Portfolio Return in Down market months/ Average Benchmark Return in Down market month

Financial and Balance Sheet Metrics

Gross Margin is Total Revenue in excess of Cost of Goods Sold (COGS), as a percentage of total revenue, calculated over last twelve months (LTM)

Gross Margin = (Total Revenue – COGS)/Total Revenue

Total Revenue and COGS are calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Gross Margin is calculated using the formula provided above for all companies in the Russell 1000 and Russell Top 200. The figure in the text charts the median Gross Margin across the companies in these two universes.

Operating Margin is the excess portion of total revenue generated after paying for operating expenses. Operating Margin is calculated as Operating Profit divided by Total Revenue, where Operating Profit is obtained subtracting all operating expenses from Total Revenue. Period considered for the calculation is last twelve months (LTM).

Operating Margin = Operating Profit (EBIT)/Total Revenue

Operating Profit and Total Revenue are calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Operating Margin is calculated using the formula provided above for all companies in the Russell 1000 and Russell Top 200. The figure in the text charts the median Operating Margin across the companies in these two universes.

Effective Tax Rate is calculated as the reported amount of income tax expense divided by Earnings before taxes. Period considered for the calculation is last twelve months (LTM).

Effective Tax Rate = Income tax Expenses/Earnings before taxes

Income tax Expenses and Earnings before taxes are calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Effective Tax Rate is calculated using the formula provided above for all companies in the Russell 1000 and Russell Top 200. The figure in the text charts the median Effective Tax Rate across the companies in these two universes.

Net Income Margin is the excess portion of total revenue generated after paying for all the operating and non-operating expenses, including taxes and interest incurred by the company. Net Income Margin is calculated as Net Income (excluding extraordinary items) divided by Total Revenue, where Net Income is calculated by subtracting all the operating and non-operating expenses including taxes and interest from Total Revenue. Period considered for the calculation in last twelve months (LTM).

Net Income Margin = Net Income (excluding extraordinary items)/Total Revenue

Net Income and Total Revenue are calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Net Income Margin is calculated using the formula provided above for all companies in the Russell 1000 and Russell Top 200. The figure in the text charts the median Net Income Margin across the companies in these two universes.

Return on Equity (ROE) is calculated by dividing net income by shareholder's equity. It is a profitability metric that measures the profit earned from each dollar of equity invested and thus the company's ability to convert equity investments into profits.

Return on Equity (ROE) = Net Income (excluding extraordinary items)/ Average Shareholder's Equity

Net Income is calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Average Shareholder's Equity is calculated every year, for the period ending December, based on current and prior year recent quart data, for each company in the Russell 1000 and Russell Top 200. Net Income (excluding extraordinary items) and Average Shareholder's Equity are added up for all companies in the respective universes to arrive at aggregate Net Income (excluding extraordinary items) and Average Shareholder's Equity and, finally, Return on Equity (ROE) for Russell 1000 and Russell Top 200.

Return on Capital (ROC) is calculated by dividing the after-tax operating profit by total capital invested. It is a profitability metric that measures the operating profit earned after taxes from each dollar of total capital invested and thus the company's ability to convert invested capital into profits.

Return on Capital (ROC) = After Tax Operating Profit/ Average Total Capital

After Tax Operating Profit is calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Average Total Capital is calculated every year, for the period ending December, based on current and prior year recent quart data, for each company in the Russell 1000 and Russell Top 200. After tax Operating Profit and Average Total Capital are added up for all companies in the respective universes to arrive at aggregate After tax Operating Profit and Average Total Capital and, finally, Return on Capital (ROC) for Russell 1000 and Russell Top 200.

Debt-to-Assets is a leverage ratio defined as the percentage of total assets that are financed with debt. The smaller the ratio, the smaller the degree of leverage, and vice versa. This ratio is often used to measure debt intensity and gauge the ability of a company to repay its current and future debt obligations.

Debt-to-Assets = Total Debt/ Total Assets

Total Debt and Total Assets are calculated every year, based on the current quarterly data for the period ending December, for each company in the Russell 1000 and Russell Top 200 (excluding companies from the Financials sector). Total Debt and Total Assets are added up for all companies in the respective universes to arrive at aggregate Total Debt and Total assets, finally, Debt-to-Assets for Russell 1000 and Russell Top 200.

Cash Asset Ratio is a liquidity metric used to evaluate a company's ability to meet its current financial obligations with cash and cash equivalents (i.e., its most liquid assets). Cash Asset ratio is calculated by dividing Cash and Short-term Investments by total assets.

Cash Asset Ratio = Total Cash & Short-Term Investments/ Total Assets

Total Cash & Short-Term Investments and Total Assets are calculated every year, based on the current quarterly data for the period ending December, for each company in the Russell 1000 and Russell Top 200 (excluding companies from the Financials sector). Total Cash & Short-Term Investments and Total Assets are added up for all companies in the respective universes to arrive at aggregate Total Cash & Short-Term Investments and Total Assets, finally, Debt-to-Assets for Russell 1000 and Russell Top 200.

Net Debt/EBITDA is a financial metric used to evaluate a company's ability to pay off its excess debt over cash using the profit generated from current operations before spending for growth investments. The ratio gives an indication of the number of years required to pay a company's debt using EBITDA generated every year.

Net Debt/EBITDA = (Total Debt – Cash & Short-Term Investments)/EBITDA of LTM

EBITDA is calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Total Debt and Cash & Short-Term Investments are calculated every year, based on the current quarterly data for the period ending December, for each company in the Russell 1000 and Russell Top 200 (excluding companies from the Financials sector). EBITDA, Total Cash & Short-Term Investments and Total Debt are added up for all companies in the respective universes to arrive at aggregate EBITDA, Total Cash & Short-Term Investments and Total Debt, finally, Net Debt/EBITDA for Russell 1000 and Russell Top 200.

Interest Coverage Ratio is calculated by dividing EBIT by interest expense. It is a liquidity ratio that measures the riskiness of debt-funded capital by gauging a company's ability to pay interest on its outstanding debt obligations using profit generated from its operations.

Interest Coverage Ratio = EBIT/Interest Expense

EBIT and Interest Expense are calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200 (excluding companies from the Financials sector). EBIT and Interest Expense are added up for all companies in the respective universes to arrive at aggregate EBIT and Interest Expense and, finally, Interest Coverage Ratio for Russell 1000 and Russell Top 200.

Price-to-Book (P/B) is a valuation metric used to measure a company's current market value relative to its book value. It is calculated by dividing a company's market capitalization by its shareholder's equity.

Price-to-Book (P/B) = Market Capitalization/ Total Common Equity

Market Capitalization and Total Common Equity are calculated every year, based on the current quarterly data for the period ending December, for each company in the Russell 1000 and Russell Top 200. Market Capitalization and Total Common Equity are added up for all companies in the respective universes to arrive at aggregate Market Capitalization and Total Common Equity and, finally, Price-to-Book for Russell 1000 and Russell Top 200.

Price-to-Earnings (P/E) is a valuation metric used to measure a company's current market value relative to its earnings. It is calculated by dividing a company's market capitalization by its net income.

Price-to-Earnings (P/E) = Market Capitalization/ Net Income (excluding extraordinary items)

Net Income (excluding extraordinary items) is calculated every year, for the period ending December, as the sum of the last four quarters of data to arrive at LTM figures for each company in the Russell 1000 and Russell Top 200. Market Capitalization and is calculated every year, based on the current quarterly data for the period ending December, for each company in the Russell 1000 and Russell Top 200. Market Capitalization and Net Income are added up for all companies in the respective universes to arrive at aggregate Market Capitalization and Net Income and, finally, Price-to-Earnings for Russell 1000 and Russell Top 200.

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