ALL ABOUT BLUE CHIPS

FOCUS ON

Blue chip stocks—shares of large-cap, market-leading companies with a solid track record of delivering earnings and cash flow growth—should be a core component in most investors' portfolios. However, their underperformance compared with small-caps over the past decade has led some investors to reduce their exposure to this segment of the equity market.

Blue chip companies' stocks have lagged their smaller peers since 2000, and some investors have reduced their exposure to the market's highest-quality stocks as a result. But a stretch of underperformance is no reason to overlook the potential rewards of investing in some of the world's most prominent corporations. In fact, these companies offer qualities that can help drive long-term returns for a diversified equity portfolio. "We believe the high-quality companies that we seek to purchase are attractive and could conceivably perform well even if the economy experiences only a modest recovery," says Larry Puglia, lead portfolio manager of the T. Rowe Price Blue Chip Growth Fund (TRBCX).

WHAT ARE BLUE CHIP STOCKS?

The term "blue chip" stocks originated in the 1920s, when a writer for Dow Jones, Oliver Gingold, made a comment while at a brokerage firm about going back to the office to write a story on "those blue chip stocks" trading at $250 a share or more. Gingold was referring to the most valuable chips in poker. Today, blue chips generally are considered to be large-cap companies with established products, well-known brand names, and a long history of solid financial performance. "They have outstanding business models and leading market positions," explains Puglia. "Several key characteristics we look for in a blue chip company include: a seasoned management team that can effectively allocate capital and manage expenses; steady revenue, cash flow, and earnings growth; and strong fundamental underpinnings." Because of their size, blue chip companies can benefit from economies of scale, have the resources to invest in superior technology, and typically have diverse revenue streams from a variety of products and services. Many of these corporations are in businesses with high barriers to entry, such as

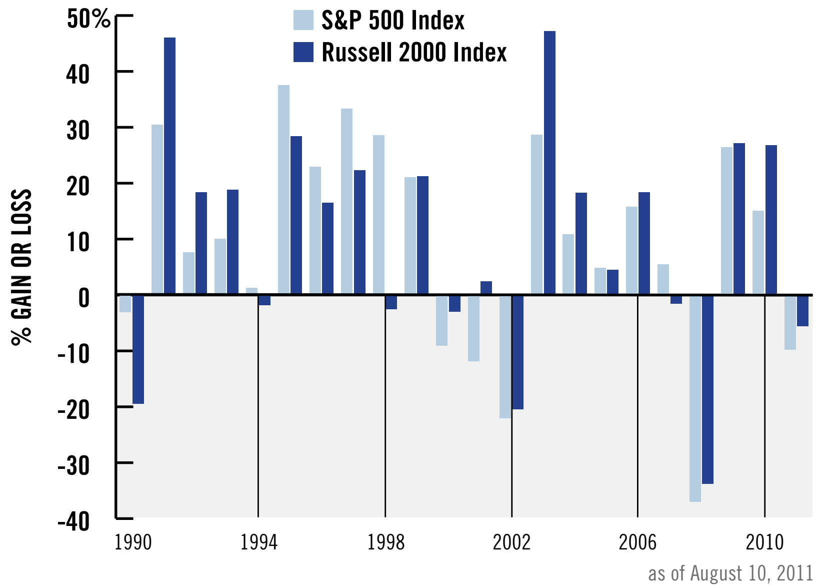
Top 10 Holdings* of the T. Rowe Price Blue Chip Growth Fund

*As of July 31, 2011.

PHOTOGRAPH FROM GETTY IMAGES

Blue Chips vs. Small-Caps

Over the long term, blue chips and small-caps each have taken turns leading the market. As shown in the table, the stocks in the S&P 500 Index significantly outperformed small-caps in the Russell 2000 Index between 1995 and 1999. Since then, blue chips have trailed smaller stocks, which may be setting the stage for a period of large-cap leadership.



This chart is for illustrative purposes only and does not represent the performance of any specific security. It is not possible to invest directly in an index. Past performance cannot guarantee future results.

expensive start-up or research and development costs, which are prohibitive for smaller firms and make it difficult for competitors to gain market share. Additionally, these companies often have significant financial advantages, including large cash reserves and relatively little debt. "Many of the large-cap growth companies that we favor have solid balance sheets, generate steady cash flow from their business, and have access to low-cost financing," remarks Puglia. "This advantage can help them to weather tough economic environments and opportunistically invest in new products or businesses."

PERFORMANCE HISTORY

As shown in the chart above, small-cap stocks have outperformed large-caps for more than a decade. In 2010, for example, the S&P 500 Index, a benchmark for the performance of blue chip stocks, rallied an impressive 15%. However, U.S. small-caps, as measured by the Russell 2000 Index, gained almost 27%. Results over the longer term are not as disparate as they were in 2010. For the 10-year period ended July 31, 2011, small-caps outperformed large-caps on average by almost 4% per year.

THE REACH OF BLUE CHIPS

As market leadership tends to cycle between large- and small-caps, historical performance suggests that blue chip stocks may be poised to generate better relative returns. Large-caps typically have outperformed small-caps as bull markets mature. The current bull market began in March 2009—about two and a half years ago—and, true to form, small-caps have had a healthy advantage on large-caps during that time. The bull market that began in 1991 provides an example of a fairly typical cycle: Small-caps led blue chips for the first three years, then large caps outperformed for the rest of the decade.

From a fundamentals perspective, we believe that blue chip valuations currently are attractive relative to smaller stocks. For example, as of July 31, 2011, the average price-to-earnings ratio—a company's current share price compared with its earnings per share—for the stocks in the S&P 500 was 13.1, compared with 18.1 for the average stock in the Russell 2000 Index. In addition to their more reasonable valuation characteristics, blue chips can provide exposure to markets around the world. This multinational reach allows blue chip companies to access the world's fastest-growing markets, such as Brazil, China, and India. Greater geographic and currency diversification also may help smooth revenues and income if the U.S. market falters. Of course, diversification cannot assure a profit or protect against loss in a declining market.

STAYING INVESTED

It's uncertain if or when blue chip stocks will assume market leadership. Therefore, maintaining exposure to both large- and small-caps is a sound investment strategy for equity investors. Rebalancing a portfolio at least once a year helps consistently to maintain the appropriate stock exposure to both large and small companies.

Please note that growth stocks can have sharp price declines due to decreases in current or expected earnings and may lack dividends that can help cushion their share price in a declining market. Small-cap stocks are more volatile than large-cap stocks but offer greater return potential.

To learn more about the **T. Rowe Price Blue Chip Growth Fund (TRBCX)**, visit **troweprice.com/bcg.**

Call 1-800-541-8803 to request a prospectus, which includes invetsment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.
T. Rowe Price Investment Services, Inc., distributor.