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The CIO expects positive returns in its 2024 upside scenario and recommends investors manage a balanced portfolio. (Getty)

DJIA hits 40,000 - CIO favors quality bonds and quality equities

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Several indexes reached record highs recently, driven by a robust first-quarter earnings season in the US, enthusiasm for generative AI, and encouraging US economic data which indicated easing inflation and moderating growth. With the US economy moving back into better balance, the Chief Investment Office (CIO) recommends investors take an active approach to diversify portfolios across asset classes, regions, and sectors.

On 16 May 2024, the Dow Jones Industrial Average (DJIA) rose past 40,000 for the first time. While the index closed the day below 40,000, it has doubled since the March 2020 pandemic-low and has risen from 30,000 to 40,000 in less than four years.

Reaching 40,000 is a psychological milestone, and the Chief Investment Office (CIO) believes the path higher has been supported by fundamentals. Investors remain upbeat about artificial intelligence adoption, profit growth expansion beyond the "Magnificent 7," the potential for a soft landing for the US economy, and Fed rate cuts beginning in 2024.

This month marks the 128th anniversary of the DJIA, which started in 1896 with 12 industrial companies. Over the years, the composition of the DJIA has changed significantly. General Electric was the longest-standing original member, but no original companies remain today. The index now includes 30 companies from nine different sectors, excluding Real Estate and Utilities. Often seen as an economic barometer of the U.S. economy, alongside the S&P 500, the DJIA includes three companies from the group known as the "Magnificent 7." However, unlike the S&P 500 Index, the members are weighted

based on the trading price per share, rather than market-capitalization. As a result, the largest-technology stocks are less represented in the DJIA than they are in the S&P 500.

CIO believes the rally has been well-supported and expects positive returns in its 2024 upside scenario.

- **A positive outlook for earnings growth.** The first quarter earnings results and guidance provided us with greater conviction for our view of 9% earnings growth for the S&P 500 in 2024, with earnings growth broadening out beyond the large-cap growth companies. Our most preferred sectors remain Information Technology, Health Care, and Industrials. If inflation pressures ease more quickly or profit growth is stronger, CIO thinks the S&P 500 could reach 5,500 by the end of the year, in our upside scenario.
- **The US economy is on a soft landing path,** supported by recent US economic data.
 - **Inflation is cooling.** Both headline and core consumer inflation data for April, as reported by the Consumer Price Index (CPI), came in at the lower end of consensus forecasts and rose at the slowest annual pace in three years. Core goods prices continued their deflationary trend, while core services including shelter and auto insurance continue to rise at an unusually rapid pace. In the months ahead, CIO expects to see service prices cooling off, helping to keep overall inflation on a downward trend.
 - **The labor market appears to be in better balance.** Earlier this month, the labor report for April showed a smaller-than-expected increase in employment growth, a higher unemployment rate, and wage growth that is at its lowest level since June 2021. With the household savings rate already at historically low levels, CIO believes this should lead to a slowdown in consumer spending.
- **Consumer spending shows signs of slight softening.** Survey data suggests consumers are less confident in a strengthening US economy and have remained price-conscious. The Fed's latest Beige Book suggested greater consumer resistance to price hikes, and US retail sales were weaker than expected in April, with downward revisions to prior months. Still, broader measures of consumer spending, such as credit card data, suggest consumer spending is in line with trend economic growth.

Overall, while a range of economic and geopolitical risks remain, CIO believes the US economy is making progress toward a soft landing, with slower economic growth and cooler inflation allowing the Fed to cut rates twice (25bps each) this year, starting in September. CIO expects the 10-year US Treasury yield to fall to 3.85% by December 2024 in a base case scenario.

In view of this supportive backdrop, CIO favors quality bonds and quality equities for the rest of the year. And, CIO recommends investors get portfolios in balance through diversification across asset classes, regions, and sectors in order to minimize portfolio concentration and effectively manage the tension between short-term market dynamics and growing long-term wealth.

Contributor: Jennifer Stahmer, Brian Rose and David Lefkowitz.

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