USI CONSULTING GROUP

Market & Legal Update

JANUARY 2023 REVIEW

Stay on top of the latest market developments and legal and regulatory updates that may affect your business.

MARKET UPDATE | Markets Start The Year Off With A Bang

Following a rough 2022, investors were cautiously optimistic that 2023 would bring better returns for both the equity and fixed income markets. Indeed, since 1926, equity and fixed income markets had only been down in the same calendar year three times: 1931, 1969 and 2022. Accordingly, with such an atypical year out of the way, some expected 2023 to bring better results. With January in the books, so far so good. But as we have become well aware, there's a long way to go. That said, investors are certainly happy with the solid start, as the S&P 500 Index surged 6.2%, the Dow Jones Industrial Average added 2.8%, and the tech-heavy NASDAQ jumped almost 11.0% for its best start since 2001. Internationally, the MSCI EAFE Index added 8.1% while the MSCI Emerging Market Index gained slightly less, at 7.9%. The bond market also rebounded nicely, as the Bloomberg Aggregate Index tacked on 3.1% and high yield bonds, as measured by the Bloomberg High Yield Index, jumped 3.8%.

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As has been the case for much of the last year, inflation and the Fed's response to inflation have been the primary drivers of the markets. As such, in mid-January, when December's inflation figures were released, markets reacted quite favorably to the results. Headline inflation posted its largest monthly decline, -0.1%, since early in the pandemic (April 2020), and on a year over year basis was up 6.5%, its smallest annual increase since October 2021. A steep drop in gasoline prices was a big driver in the lower inflation number, as prices fell 9.4% in December.

As inflation rose to the highest levels since the early 1980s the Federal Reserve hiked rates from near zero at the beginning of 2022 to 4.25%, the highest level in 15 years. However, as inflation has moderated since peaking last June, the expectation is that the Fed will take its foot off the gas in terms of tightening, as there is now only a 25-basis point rate hike expected on February 1st. The Fed is attempting to navigate a soft landing on its rate policy to slow down the economy and inflation without tipping the economy into recession.

Unfortunately, as inflation fears are starting to subside, recession fears are starting to intensify. The U.S. economy grew at a better-than-expected 2.9% annualized pace in the fourth quarter, as an increase in government spending and private investment aided growth. However, consumer spending, which accounts for 68% of GDP, weakened from the previous period. As rate hikes typically operate on a lag, meaning their real impact may not be realized until much later, consumer spending numbers may continue to deteriorate. If the consumer starts to falter, or even reduces spending substantially, growth will be adversely impacted, possibly sending the U.S. into a recession.

Market Return Indexes	Jan. 2023	Q4 2022	2022
Dow Jones Industrial Average	2.8%	16.0%	-6.9%
S&P 500	6.2%	7.6%	-18.1%
NASDAQ (price change)	10.7%	-1.0%	-33.1%
MSCI Eur. Australasia Far East (EAFE)	8.1%	17.3%	-14.5%
MSCI Emerging Markets	7.9%	9.7%	-20.1%
Bloomberg High Yield	3.8%	4.2%	-11.2%
Bloomberg U.S. Aggregate Bond	3.1%	1.9%	-13.0%
Yield Data	**Jan. 2023**	**Dec. 2022**	**Nov. 2022**
U.S. 10-Year Treasury Yield	3.52%	3.88%	3.70%

While the economy is facing numerous headwinds in 2023, markets have remained somewhat resilient, with a solid fourth quarter and a good start to the year in January. Fed action in response to future inflation readings will be a big driver of markets going forward, and while it's likely that inflation will slow in 2023, achieving the Fed's 2% target will be a multi-year process. Moreover, corporate earnings, and maybe more importantly forward-looking guidance from corporations, will also have a significant impact. So far, in January at least, earnings have been better than expected. While inflation, corporate earnings, and other economic data are highly unpredictable, the equity and fixed income markets are as well. As such, staying the course with your investments is typically the best course of action.

LEGAL UPDATE | SECURE 2.0 Act Brings Major Retirement Plan Changes

On December 29, 2022 (the "Enactment Date"), the SECURE 2.0 Act of 2022 ("SECURE 2.0") was signed into law. SECURE 2.0 is an enhancement to the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 ("SECURE Act") and includes both mandatory and optional changes to the rules governing various types of retirement plans, such as defined benefit plans, 401(k) plans, 403(b) plans, governmental 457(b) plans, and Individual Retirement Accounts ("IRAs"). The changes under SECURE 2.0 are substantial and complex, covering a wide range of provisions with various effective dates. Most of the changes begin in 2024 or later, but a few provisions are effective this year or became effective as early as the Enactment Date.

Last month we issued a Retirement Plan Spotlight which summarized **some key provisions of SECURE 2.0.** Since the changes are too numerous to cover in a single update, in the coming months we will provide a series of updates where we will focus on certain provisions in greater detail. This month we are focusing on some of the provisions that went into effect as of the Enactment Date or in 2023.

Summary of Provisions (Part 1)

Upon Enactment | December 29, 2022

Self-Certification of Hardship Withdrawals*

Effective for plan years beginning on or after the Enactment Date, 401(k) and 403(b) plan administrators may rely upon an employee's certification of the need for a hardship withdrawal, the amount needed, and that no alternative resources are available. Similar certifications may be used for unforeseeable emergency distributions under governmental 457(b) plans.

Treasury regulations identify seven safe-harbor reasons for financial hardship distributions. Prior to SECURE 2.0, while the IRS guidance permitted an employee to self-certify that they have met one of the safe-harbor conditions for a hardship withdrawal, the hardship distribution could not be made unless the plan administrator collected the source documentation for review and could substantiate the hardship request.

Under SECURE 2.0, at the option of the employer, the plan administrator may rely on a participant's self-certification that a financial hardship exists. The employer, in that case, is not required to collect the source documents to substantiate the request.

In accordance with the provision, the IRS can issue regulations that set forth the exceptions to the plan administrator's ability to rely on the employee's self-certification where the plan administrator has actual knowledge to the contrary of the employee's self-certification. The IRS is also authorized to issue regulations regarding procedures for addressing cases of employee misrepresentations.

Employer Contributions Treated as Roth Contributions*

Qualified retirement plans (e.g., 401(k) plans), 403(b) plans, and governmental 457(b) plans) may allow participants to designate fully vested employer matching or nonelective contributions as Roth contributions. If so designated, such contributions must be included in the participant's taxable W-2 income.

Historically, only employee elective deferrals could be permitted to be made as Roth contributions and employer contributions could only be made on a pre-tax basis. In addition, plans could (and still can) allow employees to make in-plan Roth conversions of the pre-tax employer contributions.

Under SECURE 2.0, employers have the option to treat vested employer contributions as Roth contributions, for which the employee is taxed in the year of contribution.

USI Consulting Group Comment: *Although this SECURE 2.0 provision was effective as of the Enactment Date, we anticipate there will be additional guidance from the IRS on the operational compliance of this provision, as well as the income tax implications.*

*optional

2023

Increase In Required Beginning Date for RMDs

The statutory Required Minimum Distribution ("RMD") age is increased to age 73 for individuals who attain age 72 after December 31, 2022. The RMD age will further increase to age 75 for individuals who attain age 74 after December 31, 2032.

If a participant reached age 72 on or before December 31, 2022, their RMD age remains age 72. The RMD age increase under SECURE 2.0 only applies to participants who turn age 72 after December 31, 2022.

Although SECURE 2.0 raises the statutory RMD age, a plan is permitted to have an earlier required minimum distribution age than the statutory age. However, any distribution that is made earlier than the statutory RMD age will not be treated as an RMD for income tax purposes, including the ability to roll over distributions received prior to the statutory RMD age.

Reduction of Excise Tax for Failure to Take RMDs.

Effective for taxable years beginning after the Enactment Date, the excise tax penalty for the failure to take RMDs is reduced from 50% to 25%. However, if a taxpayer corrects the shortfall during a two-year correction window after the RMD should have been made, the tax is further reduced to 10%.

USI Consulting Group Comment: *While a reduction in excise tax penalties is always a welcome change, some have speculated that due to the reduction, the IRS will be less likely to waive the reduced fees in the same manner the IRS was previously willing to waive the 50% penalty under certain circumstances.*

How USI Consulting Group (USICG) Assists

The USICG team can help answer any questions that you may have regarding SECURE 2.0 and its optional and required changes to your plan. Both the IRS and the DOL will be issuing additional guidance regarding SECURE 2.0 provisions and some of the deadlines indicated above may change due to such guidance. As soon as additional information becomes available, we will provide updates to inform you about such guidance and its impact on plan compliance and administration.

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Retirement Resources for You

The USICG team is happy to assist employers with all retirement plan compliance matters and changes in the market, including those discussed here, to help you mitigate risk and financial impact to your organization.

To learn more, please contact your local USICG representative, visit our Contact Us page or reach out to us at information@usicg.com.

Find the address and telephone number of your local USI Consulting Group office here.

Follow USICG on LinkedIn to stay up to date with retirement news!

For previous market and legal commentaries please click here.

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An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The 10 Year Treasury Yield is the interest rate the U.S. government pays to borrow money for a 10-year period. In addition to influencing how much the government pays to borrow over this time-frame, the 10-year Treasury Yields also determines how much investors earn by investing in this debt and it is a good indicator of investor sentiment

The higher the yield, the better the economic outlook.

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