Market & Legal Update

AUGUST 2024 REVIEW

USI CONSULTING GROUP

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

MARKET UPDATE | Fed Green Lights Rate Cuts on the Horizon

The Fed provided a clear signal at its annual meeting in Jackson Hole, WY that it is prepared to start cutting rates with the first rate cut all but certain to occur on September 18 at the next Federal Open Market Committee meeting. The Fed aggressively raised rates 11 times from March 2022 to July 2023 and is on a path to bring rates down as inflation continues to cool from a 40-year high reached two years ago. The equity and bond markets experienced volatility during the month with the jobs report and headline inflation reported for July, yen/dollar carry trade, and continued earnings announcements for U.S. stocks. For the month, the S&P 500 gained 2.4%, NASDAQ increased 0.7%, and the developed overseas MSCI EAFE Index returned 3.3%. Bond yields fell during the month as incoming economic data supported the case for a September interest rate cut, and as result the Bloomberg U.S. Aggregate gained 1.4%.

Market Return Indexes	Aug 2024	YTD 2024	2023
Dow Jones Industrial Average	2.0%	11.8%	16.2%
S&P 500	2.4%	19.5%	26.3%
NASDAQ (price change)	0.7%	18.0%	43.4%
MSCI Eur. Australasia Far East (EAFE)	3.3%	12.0%	18.2%
MSCI Emerging Markets	1.6%	9.6%	9.8%
Bloomberg High Yield	1.6%	6.3%	13.4%
Bloomberg U.S. Aggregate Bond	1.4%	3.1%	5.5%
Yield Data	**Aug 2024**	**July 2024**	**June 2024**
U.S. 10-Year Treasury Yield	3.91%	4.09%	4.36%

The Fed has a dual mandate to support the U.S. economy with full employment and stable prices. The Fed pivoted their focus from inflation to employment during August as the unemployment rate drifted higher from 3.7% at the beginning of the year to 4.3% at the end of July. While there were 114,000 jobs added during July, it was 35% lower than economists expected. The lower number of new jobs combined with the labor force participation rate increasing to 62.7% for July, contributed to unemployment moving higher.

However, the lower-than-expected new hirings shocked the markets with the S&P falling 1.8% after the announcement. The S&P fell by 3% on the next trade date of August 5, its worst drop since September 2022, as Japan's Nikkei 225 fell more than 12%, its worst day since October 19, 1987, otherwise known as Black Monday. The Japanese Yen surged by 2.8% vs the U.S. dollar since the Japanese central bank was poised to start raising rates whereas most developed countries such as the U.S. were in the process of cutting rates. Black Monday was when the U.S. stock market declined by 22.6% in a single day, the largest one day decline ever.

The Fed has a dual mandate to support the U.S. economy with **full employment** and **stable prices**

The key concern for the past few years has been the possibility of a recession from the aggressive rate hikes and the first sign of recession is typically weakness in the job market. However, weekly jobless claims that followed the unemployment report supported the labor market is performing in line or better than expectations resulting in the S&P 500 gaining 8.6% since the low on August 6 and the Dow setting a new all-time high during the month.

The Fed received good news with the Consumer Price (CPI) Index at 2.9% for July, down from 3% year-over-year for June. The July report of 2.9% was the smallest 12-month increase since March 2021. The CPI rose 0.2% during the month with 90% of the July monthly increase due to shelter (housing, apartments) which rose 0.4%. Energy was unchanged and food increased 0.2% during the month, the same as the prior month. The CPI report provided comfort to the Fed that inflation was cooling ahead of the August 22-24 meeting in Jackson Hole. The Core Personal Consumption Expenditures (PCE) held steady increasing by 2.5% in the 12 months through July, matching the June figure and beating the 2.6% gain expected by economists polled by Reuters.

Earnings for S&P 500 companies reporting their latest quarterly results (e.g., second quarter) remained strong overall and ahead of analyst projections. According to FactSet, over 90% of S&P 500 companies have reported their quarterly results and over 75% reported positive earnings per share surprise (earnings growth that exceeded analyst expectations) and about 60% reported a positive earnings surprise. For the quarter end, earnings growth was projected at 10.9% whereas earnings growth was projected at 9% ahead of the quarter-end period. A 10.9% actual growth rate would mark the highest year-over-year earnings growth rate reported since the fourth quarter of 2021. Earnings growth moving higher, and above analyst expectations can support higher stock prices based upon fundamental valuations such as price/earnings (P/E) ratios. However, the P/E ratio for S&P 500 companies is high compared to historical measures. During August 2024, the forward P/E for the S&P 500 was at 21.0 vs the five-year average of 19.4 and 10-year average of 17.9 according to FactSet.

A **10.9% actual growth rate** would mark the highest year-over-year earnings growth rate reported since the fourth quarter of 2021

Of all the companies reporting earnings, the Nvidia report on August 28 was likely the most watched due to its interconnectivity to artificial intelligence (AI). Although the company beat on earnings and growth estimates and provided strong guidance, the stock fell the next day due to the high expectations and strong year-to-date growth of the stock, which gained more than 150% this year and for a brief period was the largest stock in the S&P 500 (it currently ranks as third behind Microsoft and Apple). Nvidia and other large technology companies have become disproportionately large weights within the S&P 500 due to their stock price gains since the fourth quarter of 2022.

Fed funds futures have currently priced in 1% of rate cuts between now and the end of the year. For September 18, the current probability of a 0.25% cut is at about 68% and a 0.5% cut is 32%. Earlier this year, there was the possibility of perhaps one or even zero rate cuts in 2024 after inflation briefly moved higher from the beginning of the year through March. The Fed's march to lower rates can be aided by unemployment holding steady near their preferred 4% target while inflation continues to drift lower towards their 2% target. The Fed funds rate is at 5.25% to 5.5% whereas inflation has cooled to 2.5% to under 3% based upon PCE or CPI measures. A neutral Feds fund rate would be between 3% and 4% if inflation was at the 2% target level. Therefore, the Fed has plenty of dry powder to cut rates to support growth and help mitigate further weakening in the job market. The Fed will await the monthly unemployment report for the month of August to be released on September 6 and the CPI report for August on September 11 as the final key data to review ahead of their FOMC meeting on September 18 to determine the path of interest rates going forward.

LEGAL UPDATE

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IRS Provides Required Minimum Distribution Guidance to Address Recent Law Changes

On July 19, 2024, the IRS released final and proposed regulations providing guidance on changes to the Required Minimum Distribution (RMD) rules that were put into law by the SECURE Act (2020) and SECURE 2.0 Act (2022). RMDs as you probably know are the mandatory annual withdrawals that must be distributed from an IRA, 401(k), 403(b), 457(b) or any other qualified retirement plan when a participant reaches a certain age or upon the death of a participant. **The two SECURE Acts made significant changes to RMD rules, including:**

- Increasing the age at which RMDs must begin, first from 70½ to 72, and then to 73 in 2023, with the beginning RMD age moving to 75 in 2033.
- Eliminating the concept of stretch IRAs for most non-spouse beneficiaries relating to deaths that occurred after 2019 (2021 for governmental plans).
- Eliminating the requirement that a participant in 401(k), 403(b) and governmental 457(b) plans would need pre-death RMD on his or her Roth accounts.
- Enacting changes impacting defined benefit plans and annuity payouts.
- Decreasing the penalty for failing to take an RMD from 50% down to 25%, and in some cases down as low as 10%.

Some of the detailed clarity that the regulations provided for include the following:

Applicable Age

To address the transitional increase in the RMD age, the IRS created a new term called "applicable age". Essentially, this is the age the RMD must begin based on the year a plan participant or IRA owner was born.

Birth Date	Applicable Age
Born before July 1, 1949	70½
Born on or after July 1, 1949 but before January 1, 1951	72
Born in years 1951-59	73
Born in 1960 or later	75

The regulations generally provide that the required RMD beginning date is April 1 of the calendar year following the calendar year in which the employee reaches the applicable age. For RMDs from an employer plan, an employee who is not a five percent owner can continue to extend the required beginning date until April 1 of the year following termination of employment.

Eliminating Stretch IRAs and the New 10 Year Rule for Post-Death Distributions

Prior to the passage of the first SECURE Act, designated beneficiaries of an IRA were permitted to satisfy RMD requirements by taking distributions over their own life expectancies, so long as they commenced distributions by the end of the year following the death of the IRA owner. This "stretching" worked for money in qualified plans as well; the designated beneficiary generally just needed to move the account into an inherited IRA. If a designated beneficiary did not start the life expectancy installments by the end of the subsequent year, the beneficiary locked into taking all the money out as a taxable distribution by the end of the 5th year after the death of the owner.

In coordination with the elimination of stretch IRAs the SECURE Act added Code subparagraph 401(a)(9)(H) which is applicable to beneficiaries of owners who died after 2019. This subparagraph extended the required distribution period from five to ten years and applies the rule to all designated beneficiaries regardless of whether RMDs had already commenced at the time of death. This subparagraph also introduced the concept called "eligible designated beneficiary" (EDB).

The regulations define the following individuals as EDBs:

- The surviving spouse
- A child that has not reached age 21
- A disabled individual
- A chronically ill individual
- An individual that is not more than 10 years younger than the participant/IRA owner

Under the regulations, there are separate rules for the following three beneficiary types to comply with RMD requirements for post-death distributions. The three types (1) EDBs, (2) designated beneficiaries that are not EDBs and (3) non-living entities, such as trusts and estates; this is referred to as not having a designated beneficiary.

EDB satisfy RMD requirements by taking post-death distributions over the following periods:

- Participant/IRA owner Died before Required Beginning Date (RBD) – the EDB can choose to have the account paid over the EDB's life expectancy, but the EDB must commence by December 31 of the calendar year following the year the participant/owner died. If the spouse is the sole EDB the spouse can opt to defer taking RMDs until December 31st of the calendar year the participant owner would have attained applicable age. If the first required post-death installment is missed the entire account must be paid out within 10 years of the participant/owner's death.
- Death after RBD – the RMD payout must continue to be paid at least as rapidly as the participant/owner was receiving RMDs, but if the EDB is younger than the participant/owner at the time of death, the EDB can use their own life expectancy to calculate RMD amounts each year. This "at least as rapidly rule" is generally carried over to all situations where RMDs had commenced at the time of death.
- Once a child reaches age 21, they are no longer an EDB and the 10-year rule is applied from that date.

A designated beneficiary that is not an EDB satisfies RMD requirements by taking post-death distributions as follows:

- Participant/IRA owner Died before RBD-the entire account must be distributed by December 31st following the 10th anniversary of the participant/owner's death.
- Death after RBD – the RMD must continue to be paid out at least as rapidly in the same manner as an EDB, but the entire balance must be distributed by December 31st following the 10th anniversary of the participant/owner's death.

When the named beneficiary is a trust or other non-living entity that does not qualify as a see-through trust the RMD requirements on post-death distributions must follow these rules:

- Participant/IRA owner Died before RBD -the entire account must be distributed by December 31st following the 5th anniversary of the participant/owner's death.
- Death after RBD – the RMD must continue based upon the life expectancy of the participant/owner.

Roth Accounts No Longer Subject to Pre-Death RMD

Effective in 2024 under SECURE 2.0, Roth accounts in 401(k), 403(b) and governmental 457(b) plans are no longer subject to pre-death RMD. If an account is made up of Roth and pre-tax accounts, the Roth portion is not used in determining the RMD; likewise a distribution of a portion of the Roth account will not satisfy the RMD for the pre-tax portion of the account.

For the purpose of determining post-death RMDs, accounts in retirement plans that are solely made up of Roth amounts will be treated as if the participant had died before RMDs had commenced.

Defined Benefit Plan and Annuity Provisions

When both SECURE Acts changed the age "70½" reference for RBD determinations, section 401(a)(9)(C)(iii) of the Code which requires an actuarial increase from age 70½ until the participant retires, for those working past age 70½, was not changed. Many DB plan sponsors wanted clarification on this matter because many plans require commencement of benefits at age 70 ½ in order to avoid actuarial increases. The final regulations make it clear that plans can keep this language that requires commencement at age 70 ½.

The final regulations also contain several technical provisions relating to encouraging defined contribution plans to offer life annuity products by making it easier to coordinate and to aggregate annuity payouts to satisfy a participant's RMD requirement.

Big Changes in the RMD failure Excise Tax

SECURE 2.0 reduced the excise tax penalty for failing to take an RMD from 50% down to 25%. Additionally, the excise tax may be reduced to 10% for taxpayers who receive a corrective distribution and file a return reflecting the distribution within 2 years or before being notified by the IRS of this matter, whichever comes first.

The final regulations provide for two new automatic waivers of that excise tax:

- An EDB who has not satisfied the RMD requirements may elect the 10-year payout rule as late as December 31st of the 9th calendar year following the calendar year of the participant's death, provided that the entire account is distributed to the EDB by December 31 of the 10th calendar year following the year of the participant's death.
- When a participant dies without taking a RMD for the calendar year of death, the beneficiary must take the RMD attributable to the year of the participant's death no later than later of the beneficiary's federal individual income tax filing deadline (including extensions) for the tax year containing the calendar year of the participant's death or the end of the following calendar year.

How USI Consulting Group (USICG) Can Assist

USICG will continue to monitor these regulations and any other regulatory developments affecting retirement plans. The USICG team is available to answer any questions you may have regarding your retirement plan, including any questions on the topic discussed here.

To learn more, please contact your local USICG representative.

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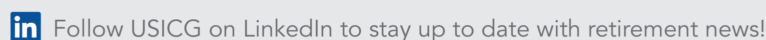
Retirement Resources for You

USI Consulting Group's team of experts 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.



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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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