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USI CONSULTING GROUP

Market & Legal Update

DECEMBER 2022 REVIEW

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

MARKET UPDATE | Markets in December End the Year on a Sour Note

For the year, U.S. stocks fell, as the Dow Jones Industrial Average dropped 6.9%, the S&P 500 lost 18.1%, and the tech-laden NASDAQ shed 33%. For overseas performance in 2022, the EAFE index ended the year with a 15% decline, its largest since 2018, and the MSCI Emerging Market Index fell 20.1%. In Asia, Hong Kong's Hang Seng Index and mainland China's Shanghai Composite both ended the year down 15%, and Japan's Nikkei 225 lost 9.4% for the year.

December capped the worst year in more than a decade for global equities and bonds. During the month, the performance of US equities reversed course from posting gains in the prior two months, with declines across U.S. markets, with technology shares dropping 8.2% during the month. In contrast, bonds fell marginally during December.

Although the Consumer Price Index increased 7.1% year over year through November (far more than the target 2.0%), it was the smallest 12-month increase since December 2021. Accordingly, the market took these as signs that inflation is moderating, and the Fed responded (as planned) by only raising interest rates 50 basis points on December 13th versus the 75 basis points it had the last four times. This softening pressure on US interest rates helped fuel weakness in the dollar, thus aiding the performance of foreign stocks, as December was a brighter month for overseas equites.

Despite the modest decline for bonds in December, fixed income investors suffered severe losses in 2022, as the Bloomberg U.S. Aggregate Bond Index fell 13% for the year on rising interest rates. In fact, the yield on the 10-year Treasury Note closed out 2022 with its largest one-year yield gain on record (dating back to 1977). Since bond prices move inversely with yields, bonds failed to serve as a portfolio ballast during 2022's volatile equity markets, requiring investors to reassess their risk tolerances.

The surprise losses in bonds during 2022 were driven by the Fed's aggressive rate increases to fight abnormally persistent high inflation. Due to supply chain disruptions and geopolitical strife, inflation has proved to be higher and stickier than most economists predicted. The price of many goods rose considerably in 2022, as food, energy, and housing costs all increased by double digits in 2022. Although the slowing of price increases has reduced the pressure on interest rates hikes, the Chairman of the Federal Reserve, Jerome Powell, said that the central bank is not likely to consider lowering interest rates until officials are certain that inflation is slowing toward the Fed's goal of 2% sustained inflation.

Market Return Indexes	Dec. 2022	Q4 2022	YTD 2022
Dow Jones Industrial Average	-4.1%	16.0%	-6.9%
S&P 500	-5.8%	7.6%	-18.1%
NASDAQ (price change)	-8.7%	-1.0%	-33.1%
MSCI Eur. Australasia Far East	0.1%	17.3%	-14.5%
MSCI Emerging Markets	-1.4%	9.7%	-20.1%
Bloomberg High Yield	-0.6%	4.2%	-11.2%
Bloomberg U.S. Aggregate	-0.5%	1.9%	-13.0%
Yield Data	**Dec. 2022**	**Nov. 2022**	**Oct. 2022**
U.S. 10-Year Treasury Yield	3.88%	3.70%	4.10%

Chairman Powell outlined three decisions facing the Fed regarding future rate policy decisions;

1. How quickly to raise?
2. How high to raise?
3. How long to stay at an elevated level?

With its succession of supersize moves in a brief period, the Fed has given itself "room" to slow the rise in rates or modify how quickly it raises rates. However, as the Fed nudges the funds rate up it must be careful not to impose too much restraint on spending and thus tip the economy into a recession before inflation heads back toward its 2% target.

These concerns underscore the difficulty the Fed has in meeting its dual mandates of maximum employment and stable prices. As the Fed raises interest rates to tame inflation (i.e., stable prices), it also raises the risk of recessionary-driven job losses (i.e., full employment). However, it is still too early to tell whether the Fed can successfully strike this balance.

Looking Ahead for 2023

The prospect of higher rates in 2023 has reduced the outlook for corporate profits, as higher interest costs and softening demand are expected to weigh on results. In turn, these higher rates reduce the current value of future profits (as measured by the price/earnings ratio), especially among growth stocks.

As it stands now, earnings forecasts are mixed. Recent top-down forecasts (sector/industry/company) predict S&P 500 earnings per share (EPS) of around $200 for 2023, while bottom-up forecasts (company/industry/sector) are approximately $235. By comparison, S&P 500 EPS estimates for 2022 have converged to $220 per share. Therefore, future corporate profits are uncertain, as earnings are projected to either (a) decline by roughly 9% or (b) increase by 7%, depending on your perspective.

Despite the prospect of smaller rate hikes by the Fed, bond investors remain relatively pessimistic, as the yield curve inversion persists. On December 30th, the 2-Year Treasury Note yielded 4.41% whereas the 10-Year Note yielded 3.88%. An inverted yield curve (shorter term bonds yielding more than longer term bonds) suggests future economic conditions to be weaker and thus interest rates would eventually need to decline to support growth. When inflation is high and the unemployment rate low, monetary tightening is considered the most appropriate approach. However, the yield curve is currently suggesting that economic recession is the likely outcome of this policy.

Although continued strong economic data and tight labor market conditions will add to inflationary pressures and higher rates, these factors can also drive corporate earnings growth. Therefore, if the Fed can stabilize inflation at 2.0% with fewer and more moderate rate increases while the global economy continues to recover, including China, an "earnings recession" in stocks may be avoided. Of course, a "soft economic" landing or a "Goldilocks Scenario" for the global economy would likely require a resolution to the Ukraine-Russia and European energy crises. To that end, best wishes for you and yours in 2023!

LEGAL UPDATE | 2023 Retirement Plan Compliance Update

Kick off the new year by marking your calendars with important compliance requirements. To set your retirement plan up for success, we have summarized some key 2023 action items and deadlines pertaining to single employer tax-qualified plans.

Required Retirement Plan Amendments

There are no required plan amendments for 2023.

In 2022, the Internal Revenue Service (IRS)extended the deadlines for amendments required under the Setting Every Community Up for Retirement Enhancement (SECURE) Act, the Bipartisan American Miners (Miners) Act and certain provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Generally, these amendments are required to be adopted by the end of the 2025 plan year. You can find detailed information on these extended deadlines in our **August 2022** and **October 2022** Market & Legal Updates.

In addition, the most recent Required Amendments List issued by the IRS on November 22, 2022 (Notice 2022-62) did not identify any required amendments for individually designed qualified and 403(b) plans.

SECURE Act Amendment & CARES Act Amendment

EXTENDED DEADLINE FOR MOST PLANS IS NOW

December 31, 2025

Tools and Resources for Retirement Plan Sponsors

Plan sponsors do have 2023 compliance deadlines that occur in the normal course of retirement plan administration, as set forth below. In addition, new 2023 cost-of-living limits that apply to retirement plans are also described below.

2023 Retirement Plan Compliance Calendars

Plan sponsors can access further guidance on the regular administrative compliance deadlines in our calendars:

2023 Cost-of-Living Adjustments

The IRS publishes cost-of-living adjustments (COLA) applicable to defined benefit and defined contribution plans on an annual basis basis. Access the 2023 adjustments **here**.

Recommended Action for Retirement Plan Sponsors in 2023

USI Consulting Group (USICG) recommends that plan sponsors **conduct periodic self-audits of their retirement plans.**

There are many benefits of self-audits, including:

- Finding and correcting an operational error as early as possible keeps the costs of correction lower than if the error is found later or discovered on an audit by the IRS or the Department of Labor (DOL)
- Plan sponsors have the opportunity to establish and implement administrative processes that avoid errors and provide defenses to inquiries from a subsequent IRS or DOL audit
- Self-audits may reveal potential plan design changes that could be advantageous to the plan sponsor and/or participants

Here's a reminder of some of the questions plan sponsors can ask themselves in a self-audit:

1. Does the plan document reflect how the plan is currently being administered? For example, are in-service distributions that have been permitted accurately reflected in the plan document?
2. When was the last time your benefits and payroll teams reviewed the wage types to confirm they are properly included in or excluded from the definition of compensation used for plan purposes?
3. Have there been organizational changes (e.g., acquisitions, spin-offs, mergers) that affect the plan's operation and/or the plan terms?
4. Does your plan's loan policy accurately reflect how loans are administered?
5. Are deposits of employee contributions, such as salary deferrals and loan repayments, timely deposited into the plan? For more detail, see our **November Market & Legal Update**.
6. Does the plan's process for finding missing or nonresponsive participants and beneficiaries comply with the most recent DOL guidance?
7. Are the plan's applicable annual compliance tests being conducted?
8. Has the plan's Form 5500 been accurately and timely filed?

The following are some steps that may assist you in answering the questions posed above. For a self-audit, a plan sponsor may want to:

1. Summarize plan provisions and have both human resources and payroll employees participate in reviewing and highlighting pertinent provisions;
2. Review any administrative processes that implement these plan provisions;
3. Delegate plan processes to appropriate personnel and/or service provider to optimize accountability; and
4. Choose a sampling of participants and retirees, including newly eligible employees. Review entry dates, deferral elections and/or employer contributions, and, if applicable, matching contributions, loans, hardship withdrawals, other in-service distributions, post-employment termination distributions and required minimum distributions to ensure they comply with plan provisions.

Once you have completed and documented the results of a 2023 self-audit of your plan(s), the self-audit process will be easier to undertake in ensuing years.

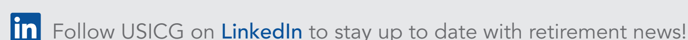
Your retirement plan may have additional compliance requirements that are not listed here. USICG can assist with your retirement plan compliance matters, address your concerns and answer any questions you may have.

How USI Consulting Group Can Help

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.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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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