MARKET DECLINE

USI CONSULTING GROUP

Market & Legal Update
AUGUST 2023 REVIEW

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

MARKET UPDATE | Five Month Streak of Markets Advancing Stalls in August

Equity markets declined overall in August despite trading upwards the last few trading days of the month as the market continues to weigh in on the path of interest rates by the Fed. Recession fears have appeared to ease with the yield curve inversion less pronounced than it was earlier in the year along with better-than-expected economic news and corporate profits. Nevertheless, the Dow Jones Industrial Average, S&P 500, and NASDAQ each declined by about 2% in August. Foreign stocks fell and continue to lag U.S. stocks with the MSCI EAFE Index declining by 3.8% and the MSCI Emerging Market Index down 6.2%. Bonds also declined with longer-term rates rising (bond prices fell) during the month with the Bloomberg U.S. Aggregate Index falling by 0.6%.

Market Return Indexes	Aug 2023	YTD 2023	2022
Dow Jones Industrial Average	-2.0%	6.4%	-6.9%
S&P 500	-1.6%	18.7%	-18.1%
NASDAQ (price change)	-2.2%	34.1%	-33.1%
MSCI Eur. Australasia Far East (EAFE)	-3.8%	10.9%	-14.5%
MSCI Emerging Markets	-6.2%	4.6%	-20.1%
Bloomberg High Yield	0.3%	7.1%	-11.2%
Bloomberg U.S. Aggregate Bond	-0.6%	1.4%	-13.0%
Yield Data	**Aug 2023**	**July 2023**	**June 2023**
U.S. 10-Year Treasury Yield	4.09%	3.96%	3.81%

The U.S. Commerce Department provided several critical economic updates regarding July and August results. First, it was reported that the Consumer Price Index rose slightly to 3.2% in July (from 3% year over year in June) and Core PCE Index rose by 3.3% from 3%. Both results were in line with expectations and did not result in unexpected market volatility following the announcements. Employment figures showed employers added 3.1 million jobs over the last year including 187,000 jobs added for August. The unemployment rate rose to 3.8% from 3.5% as more people joined the workforce. Average hourly earnings rose 4.3% during the month, slightly down from 4.4% last month. The better wages support improved consumer spending which has led economists to raise third quarter growth projections. According to S&P Global Market Intelligence, the economy could grow at a 4% annual rate during the third quarter compared to 2.1% during the second quarter. The Fed has a dual mandate for supporting employment and **s**table prices in the economy and the preferred targets are 2% for inflation and 4% for unemployment, a level at which it could remain neutral to rate policy.

Markets declined in August with the Conference Board's consumer confidence index plunging during the month (by nearly 7%) whereas analysts were expecting it to slightly increase. The index measures Americans' assessment of current economic conditions and their outlook for the next six months. A pullback in the index could be a sign that consumer spending could slow down. Further, while job openings remained robust with 8.8 million jobs available, it represented a decline of 338,000 jobs available from the prior month, a sign that the labor market could be tightening. The 8.8 million jobs available represented the lowest level since March 2021.

The Kansas City Fed held its annual Jackson Hole Symposium between August 24th and 26th which provides the Fed's outlook on important U.S. and global economic issues. The key topic was "Structural Shifts in the Global Economy" and included Jerome Powell, Chair of the U.S. Federal Reserve as well as his counterparts from Europe (Christine Lagarde), England (Ben Broadbent), and Japan (Kazuo Ueda). The market's reaction to the meeting was that the Fed could hold rates steady at its next meeting in September but continue to leave the door open for further rate hikes if inflation does not cool further.

With S&P 500 companies reporting Q2 2023 results, just under 80% exceeded their earnings growth targets and about 70% exceeded their revenue targets. Interestingly, earnings growth for S&P 500 companies has been declining since the end of the third quarter of 2022. That was about the same time the market was at its lowest level in the year 2022. This illustrates how markets are forward-looking, expecting and correctly anticipating a slowdown, due in part to the Fed's approach to aggressively raising rates to slow inflation and growth. However, from Q1 through Q3 in 2023, earnings for S&P 500 companies have not declined as much as expected and have been coupled with better forward guidance, as well as stronger than expected economic news, helping markets rebound.

With Q2 earnings in the rearview mirror, the markets will look towards the CPI release in mid-September and the next FOMC meeting to be held between September 19th and 20th to help further determine the future path of interest rates. Stock prices as measured by their price-earnings (PE) ratio are trading above their historical norms as analysts expect earnings growth for S&P 500 companies to accelerate in the third quarter of 2023 and reach double-digit earnings growth in 2024. Companies would need to continue exceeding earnings growth targets and provide upbeat forward guidance for the markets to continue advancing. Of course, inflation also needs to continue showing signs of cooling for the Fed to discontinue raising rates and potentially reducing them in 2024.

LEGAL UPDATE

WELCOME RELIEF AND GUIDANCE ON THE MANDATORY ROTH CATCH-UP REQUIREMENT

On August 25, 2023, the Internal Revenue Service issued Notice 2023-62, providing eagerly anticipated relief and guidance relative to the SECURE 2.0 requirement that participants with wages exceeding $145,000 must make catch-up deferrals as (after-tax) Roth catch-up deferrals. The relief came in the form of a two-year administrative transition period, meaning that plan sponsors, recordkeepers and payroll providers now have until 2026 to get systems in place to administer this change that was scheduled to take effect in 2024.

In Notice 2023-62, the IRS addressed several issues concerning plan sponsors and practitioners, including the following:

IGNORE CONGRESS' DRAFTING ERROR

As noted in a prior **USICG Market & Legal Update,** when enacting SECURE 2.0, Congress inadvertently deleted Code Section 402(g)(1)(C) and thereby technically eliminated catch-up deferral contributions effective for taxable years beginning after December 31, 2023. The IRS made it clear that, despite this unintentional drafting error, catch-up contributions would continue to be allowed.

IRS ANNOUNCES TWO-YEAR ADMINISTRATIVE TRANSITION PERIOD

Section 603(c) of SECURE 2.0 provided that mandatory Roth characterization of the catch-up deferrals of high-wage earners take effect for taxable years beginning after December 31, 2023. Also as noted in a prior Market Legal Update, many retirement plan providers, practitioners, and industry groups had written the Department of Treasury requesting a delay in the effective date for required Roth treatment of catch-up deferrals of certain high-wage earners, given the lack of guidance and the many administration and implementation challenges associated with this change.

In Notice 2023-62, the IRS announced that it will regard the first two taxable years beginning after December 31, 2023, as an administrative transition period with respect to the requirement that plan administrators designate catch-up contributions made on behalf of certain eligible participants as Roth contributions. Accordingly, for 2024 and 2025, for certain eligible high-wage earners, plan administrators need not characterize catch-up deferral contributions as Roth contributions. Further the IRS will treat a plan that does not provide for designated Roth contributions as satisfying SECURE 2.0 during the administrative transition period.

FUTURE IRS GUIDANCE UNDER CONSIDERATION

There remain many unanswered questions about the implementation of mandatory Roth treatment of catch-up deferrals of certain high wage earners. Notice 2023-62 raises four further topics about which the IRS eventually intends to issue guidance.

- Mandatory Roth treatment would not apply to the catch-up deferral contributions of individuals who do not receive FICA wages in the prior year (*e.g.,* partners, other self-employed individuals or State or local government employees whose services are excluded from Social Security).
- A plan administrator and employer would be permitted to treat an election by an affected participant to make catch-up contributions on a pre-tax basis as an election to make the same contribution as a designated Roth contribution. This override election would be permitted even if the plan provided for what is often referred to as a "spillover" election, where excess deferral contributions or discrimination test failures were automatically recharacterized as a catch-up contribution by option of the plan terms. This guidance is necessary because the law currently requires that a participant designate a contribution as a Roth contribution at the time the election is made.
- With respect to multiple employer plans (including multiemployer plans), that a plan administrator should not aggregate eligible participant's FICA wages with one employer with the FICA wages of another participating employer when applying the $145,000 limitation (as adjusted after 2023).
- The IRS asked without suggesting an answer whether to require plans with affected participants to offer Roth deferrals and whether a plan could deny affected participants catch-up deferrals and not offer Roth.

The IRS has asked for practitioner comments on these issues as well as regarding other potential questions or problems raised by this SECURE 2.0 provision.

How USI Consulting Group (USICG) Can Assist

The USICG team can help answer any questions that you have regarding SECURE 2.0. Both the IRS and the DOL are expected to issue additional guidance regarding the SECURE 2.0 provisions and 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. The USICG team is always available to help plan sponsors with documents, compliance, and other matters, including those discussed here.

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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.

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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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