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Market & Legal Update

NOVEMBER 2022 REVIEW

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

MARKET UPDATE

Markets Rally on the Potential Slowdown in Rate Increases

Global markets received positive signals from Federal Reserve Chairman Jerome Powell on the last trading day of the month, signaling a potential slowdown in rate increases as inflation pressures show signs of easing from record levels back in June of this year. The year was marked by the most aggressive rate increases in over 40 years as inflation remained elevated well above the Fed's preferred target rate of 2%. The S&P 500 was up 5.6% in November, with the market rallying 3.1% on the last trading day as well as rising 5.6% on November 10, after the Commerce Department announced the Consumer Price Index for October fell to 7.7% (from a high of 9.2% in June). International markets exceeded U.S. markets in November with the EAFE index up 11.3% and emerging markets up nearly 15%, but still trailing U.S. markets year-to-date. Bond markets had their best month of 2022 with longer-term yields falling (bond prices rise when yields fall), with the Bloomberg U.S. Aggregate Bond index up 3.7% but still having its worst year since bond records were kept in the early 1970s.

Market Return Indexes	November 2022	YTD 2022
Dow Jones Industrial Average	6.0%	-2.9%
S&P 500	5.6%	-13.1%
NASDAQ (price change)	4.4%	-26.7%
MSCI Eur. Australasia Far East (EAFE)	11.3%	-14.5%
MSCI Emerging Markets	14.8%	-19.0%
Bloomberg High Yield	2.2%	-10.6%
Bloomberg U.S. Aggregate Bond	3.7%	-12.6%
Yield Data	**November 2022**	**October 2022**
U.S. 10-Year Treasury Yield	3.70%	4.10%

The Fed aggressively raised rates in 2022 to tame inflation with four consecutive meetings of raising rates by 0.75% each, plus two other separate increases totaling 0.75%. The markets are expecting the Fed to raise the Fed Funds rate by 0.5% at the upcoming FOMC meeting between December 13 and 14. The markets have priced in the Fed Funds rate to approach 5% in 2023 from the current level of between 3.75% and 4%. The yield curve inverted to its widest gap since 1981 of 0.78% during November when comparing 2-year vs 10-year treasuries. An inverted yield curve has been a harbinger of a looming recession with about 80% predictiveness over the last 50 years. The large gap signals that the markets anticipate the Fed would need to eventually cut rates to avoid a recession and revive declining growth.

Since 2012, the Fed adopted a formal policy on Fed Fund rates by targeting levels of unemployment and inflation. Unemployment for October was at 3.7%, slightly below the long-term target of 4%, therefore the economy is healthy when measured by jobs. The Fed modified this policy in 2018 acknowledging at the time that inflation persistently was below their preferred target of 2% and provided guidance that inflation could exceed 2% for the short-term, provided that longer-term it averaged about 2%. Last year due to supply chain bottlenecks, inflation rapidly rose, and the market consensus then was the inflation was "transitory" and would abate as supply-chain issues eased. However, supply-chain issues lingered, the war by Russia broke out in March, and China continued to have strict COVID lockdowns, which resulted in nationwide protests during November. The protests were a reminder of the Tiananmen Square tragedy in 1989, when China was facing record inflation at the time. Similarly, protestors today in China are questioning the Governments' strict COVID policy, which has caused unemployment to rise to 18% for those 24 and younger.

Higher rates eventually slow global economic growth, which reduces inflationary pressures, but reduces earnings growth for corporations. S&P 500 earnings growth for the third quarter was just 2.2%, the slowest growth since the third quarter of 2020, and well below forecasts prior to the start of the third quarter. Nevertheless, about three quarters of companies beat their earnings forecasts, but mostly by slim margins. Earnings growth projected for 2023 currently stands at about 5%. Therefore, if earnings were to fall short of projections or if inflation were to rise more than forecasted, it could provide further headwinds for the markets and vice versa.

5% Earnings growth projected for 2023 currently stands at about 5%.

The markets will continue to carefully watch for economic and market data releases in December and beyond. The Commerce Department released U.S. household spending and income on December 1. It was announced that personal income increased at a monthly rate of 0.7% or $155.3 billion while consumer spending increased by 0.8% or $147.9 billion according to the Bureau of Economic Analysis. The National Bureau of Economic Research closely monitors these figures to evaluate the likelihood of a looming recession. With the strong economic data along with current low unemployment figures, a recession still seems less likely despite the headwinds of an inverted yield curve and higher inflation. Additional economic clues this month will include the jobs employment report, to be released on December 2 and the CPI measure to be announced on December 13. As mentioned, the Fed is expected to raise rates at the next meeting on December 13, but by 0.5% instead of the prior 0.75% increase. Finally, corporate earnings for the last quarter of 2022 will begin being released during mid-January. Earnings are not projected to be strong, so if earnings were to exceed projections, we could get the double tailwinds of a "January effect." However, if earnings were to disappoint, it could be a bad start to the New Year. Happy Holidays to All.

LEGAL UPDATE

Timely Deposits of Employee Contributions and Loan Repayments to Defined Contribution Plans

As a defined contribution plan sponsor, you should know that the Internal Revenue Service (IRS) and the Department of Labor (DOL) want to make sure that contributions and loan repayments that employees make to their 401(k) and 403(b) plans are deposited on a timely basis. The following are common questions we receive about these deposits:

Is there a deadline for employee contributions and loan payments to be deposited into the plan?

Applicable DOL regulations require that employee contributions and loan repayments be deposited as soon as they can be segregated from the employer's general assets, but in no case later than the 15th business day of the month immediately following the month in which the contribution is either withheld or received by the employer.

However, plan sponsors should be aware that the DOL generally expects that all deposits for employee contributions and loan repayments can be deposited much sooner than 15 business days. It is USICG's experience that three to five days after each payroll may be considered reasonable by the IRS or DOL, but that an IRS or DOL agent will examine the actual deposit history of the employer. If you customarily make deposits more quickly than three to five days, or if you have made deposits more quickly on multiple occasions, the agent may expect that timing for all such deposits.

Is there a safe harbor deadline for employee contributions and loan repayments?

There is a safe harbor for small plans only, meaning plans with fewer than 100 participants on the first day of the plan year. Under the safe harbor the DOL created for small plans, deposits made no later than the 7th business day following the day they were withheld from wages are considered timely even if the deposits could have been made earlier.

Deposits made later than seven business days after they are withheld from pay are assessed under the general rule that deposits should be made as soon as they can be segregated after each payroll.

Can large plans use the safe harbor standard described above?

The regulations specifically state that the safe harbor does not apply to plans with 100 or more participants on the first day of the plan year. Therefore, large plans are subject to the "as soon as reasonably possible" standard.

Can an employer hold all the employee contributions and loan repayments and then make a single deposit at the end of each month?

The DOL applies the rule to each payroll period. Using the small plan safe harbor, deposits must be made within seven business days following each payroll, or under the general rule, deposits must be made as soon as reasonably possible after each payroll.

Can an employer deposit the amount of employee contributions and loan repayments prior to the pay date to make sure they are timely made?

It may be possible. However, IRS regulations prohibit depositing deferrals before the associated compensation is actually earned. Therefore, for any given payroll, it must be determined when participants performed the services for which they are being paid. Plan sponsors should also carefully consider the remittance precedence that may be set by making such contributions "early."

What is the deadline to deposit deferrals and loan repayments from sole proprietors and partners since their earned income is generally not determined until after the end of the plan year?

Provided that sole proprietors and partners make formal deferral elections before the end of the plan year, their deferrals must be deposited as soon as they can reasonably be segregated from general assets and after such amounts would otherwise be distributed to the partner or sole proprietor. The deposits must not be made after the participant's deadline for filing individual income tax returns.

Can an employer correct a missed deposit deadline?

If the employer does not deposit employee contributions and/or loan repayments by the applicable deadline, it has committed a prohibited transaction by holding plan assets. The DOL considers this situation as an impermissible loan from the plan to the employer.

The DOL provides correction of this error through its Voluntary Fiduciary Correction Program (VFCP). The correction generally consists of the following steps:

- Immediately deposit the deferrals and/or loan repayments.
- Make an additional contribution representing any lost investment gains. (The DOL provides a calculator that determines lost earnings for each pay period.)
- File IRS Form 5330 and pay an excise tax.
- Report the late deposits on Form 5500.
- File VFCP application.

What if the plan investments showed a loss for the applicable period?

The lost earnings contribution is required regardless of the plan's actual investment performance. The idea is that the employer received an economic benefit for holding the employee contributions and loan repayments, and that benefit must be transferred back to the participants.

How much is the excise tax?

The excise tax is equal to 15% of the lost earnings, but the calculation can be complicated. Any late deposits not fully corrected by the end of a year are treated as recurring each subsequent plan year. This results in a cascading effect that requires complicated manual calculations.

If the late deposit is fully corrected within 180 days of the original deposit deadline, the plan sponsor can contribute the amount of the excise tax to the plan rather than paying it to the IRS. However, this exception is only available to plans that make a VFCP filing.

It is important to note that plan assets cannot be used to pay the expenses of correcting late deposits. They must be paid by the plan sponsor.

How USI Consulting Group Assists

The USICG team is always available to help plan sponsors with document, compliance and other matters, including the remittance of timely deposits discussed here.

Retirement Resources for You

The USI Consulting Group 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.

QUESTIONS?

Contact your USICG representative, visit our Contact Us page or reach out to us directly at information@usicg.com.

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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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