Market & Legal Update

FEBRUARY 2024 REVIEW

USI CONSULTING GROUP

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MARKET UPDATE | Optimism Springs Eternal?

The timing and extent of the widely anticipated rate cuts in 2024 have yet to materialize, but that did not stop equity markets from rallying in February, as the Dow, S&P 500 and NASDAQ all rose for the month. In fact, the S&P 500 and NASDAQ both closed February at a record high and the Dow set a new high during the month. Indeed, the Dow Jones Industrial Average, the S&P 500 Index, and the NASDAQ rose 2.5%, 5.3% and 6.1% respectively in February. Last month, the conservative projection from Federal Reserve officials indicated three rate cuts in 2024, which was far less optimistic than the view investors had at the time. This more "conservative" view on interest rate relief has proven to be relatively accurate, as pricing pressures remain elevated based on recent inflation data. Therefore, the Federal Reserve would like to see more progress made in lowering inflation closer to the 2.0% target before cutting rates.

As a result, investors pushed interest rates back up over 4%, as measured by the current yield on the 10-year Treasury Bond, which ended the month at 4.25%. However, the most recent data released by the Commerce Department suggests that price increases are moving as expected—a boost in confidence that a soft economic landing is still in sight. This was significant because January CPI (Consumer Price Index) originally came in higher than expected, causing volatility, supporting the Fed's comments at the end of January. The Fed's preferred measure on price trends, the personal consumption expenditures price index, increased 0.3% during January, matching economists' expectations. More importantly, the core index, which strips out volatile food and energy prices, rose 0.4% and 2.8% annually, which were in line with the economic forecasts. In terms of a year over year comparison, core PCE increased 2.85% in January, slower than the 2.94% recorded last month and 4.9% for last year.

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Markets already adjusted to this delay in interest rate relief in late January, as reflected by the steep drop across major indices the last day of January when Chairperson Powell's announced the intention for the Fed to hold rates steady. However, lowered expectations on the immediacy of rate cuts, currently expected to begin in June, led to rising rates and thus a decline in bonds. The Bloomberg U.S. Aggregate Bond Index fell approximately 1.4% in February and fell 1.7% year-to-date.

Market Return Indexes	Feb 2024	YTD 2024	2023
Dow Jones Industrial Average	2.50%	3.84%	16.2%
S&P 500	5.34%	7.11%	26.3%
NASDAQ (price change)	6.12%	7.20%	43.4%
MSCI Eur. Australasia Far East *(EAFE)*	1.83%	2.42%	18.2%
MSCI Emerging Markets	4.76%	-0.11%	9.8%
Bloomberg High Yield	0.29%	0.29%	13.4%
Bloomberg U.S. Aggregate Bond	-1.41%	-1.68%	5.5%
Yield Data	**Feb 2024**	**Jan 2024**	**Dec 2023**
U.S. 10-Year Treasury Yield	4.25%	3.99%	3.88%

As the market continues to digest "sticky" inflation, it is worth looking "underneath the hood" for more positive indications, especially given the Fed's "data-driven" stance on interest rate moves and the likelihood of a "bumpy road" in getting inflation down to its 2% target. For example, corporate earnings have improved and remain strong, as approximately three quarters of S&P 500 companies reporting earnings have beaten estimates.

Another example might be that consumer spending may slow (the consumer accounts for 76% of the U.S. economic growth), but is expected to remain strong, barring any unexpected shocks. With firmer, yet more realistic earnings growth, and an overall slowing economy, interest rate relief remains in sight, albeit a bit more down the road than experts had expected not too long ago.

Expected inflation is another area that deserves a closer look. Earlier in February, consumer and producer price trends signaled sticky inflation, encouraging investors to adopt expectations of rate cuts to begin later (June versus March). In contrast, as early as late last year, traders were betting on March as the starting point for the Fed's easing cycle. To reinforce the notion of delayed rate relief, Fed officials said they were not willing to entertain rate cuts at their next meeting scheduled for March 19th through the 20th, as they want to see more progress toward inflation moving to the 2.0% long term target.

In terms of consumer confidence, a key driver of spending and thus price inflation, there may be reason to continue believing rate relief is on the way. As measured by the Consumer Confidence Board, U.S. consumer confidence fell in February after three consecutive increases, as consumers worried about the labor market and the domestic political environment. More specifically, the Conference Board recently reported that its consumer confidence index slipped to 106.7 in February from a downwardly revised 110.9 in January.

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Economists polled by Reuters had forecast the index little changed at 115.0 from the previously reported 114.8. Relatedly, the labor market recently indicated some softness too, as initial jobless claims stood at 215,000 for the week ended February 24th, which was greater than economist expectations of 210,000. Concerns regarding employment tend to dampen consumer confidence and thus can negatively impact consumer spending, a key driver of inflation.

In many ways, the market's positive performance and reaction to the most recent inflation data in February 2024, reflects renewed confidence in the Fed's ability to thread "the economic needle." That is slowing the economy just enough to tame inflation without entering a deep or even mild recession. Naturally, investors would welcome the Fed reversing course on its recent spate of historic rate increases with an eventual rate cut. So, although delayed, the market expects rate relief to materialize down the road without imperiling economic growth in the meantime. Of course, market sentiment can be fickle. Therefore, it is always prudent to re-evaluate one's appetite for risk.

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LEGAL UPDATE | Secure 2.0 Act Provides for the Addition of Pension-Linked Emergency Savings Accounts

In the evolving landscape of retirement planning, the introduction of Pension-Linked Emergency Savings Accounts ("PLESA") represents a significant stride towards enhancing financial security for American workers. Following the passage of the SECURE 2.0 Act, this legislation underscores a growing recognition of the need for integrated financial solutions that address both long-term retirement goals and short-term liquidity needs. The introduction of the PLESA feature seeks to fill a gap and allow more Americans to have access to emergency savings.

PLESAs are not retirement accounts, and instead are intended to be accounts from which some participants would have easily accessible funds for short-term emergencies. Allowing plans to add a PLESA feature is an attempt to partially fill a void of emergency savings in many American families. Many plans allow for hardship distributions, which require that a participant provide supporting documentation or certify a qualifying reason for the need of the funds. The addition of a PLESA feature allows a participant to withdraw money from the account without the needed certification or extra documentation. The PLESA feature is not meant to increase retirement savings but rather provide an avenue to make it easier for participants to set aside emergency funds. Additionally, the frequency in which distributions are permitted would serve to aid participants with obtaining a smaller amount of funds without dipping into their retirement savings and incurring the possible penalties that would otherwise occur.

PLESAs became available with plan years beginning after December 31, 2023, giving defined contribution plan sponsors the option to add PLESA accounts as a means of encouraging employees to save for financial emergencies. Both the Internal Revenue Service (IRS) and the Department of Labor (DOL) recently issued guidance on PLESAs and this article serves to provide a broad overview of PLESAs and certain considerations plan sponsors should be aware of before electing to provide the additional contribution option to their participants.

Eligibility to make PLESA Contributions

- Any individual is eligible to participate in a PLESA if they meet any plan requirements for minimum age, or service requirements.
- PLESA contributions are only available to participants who are not highly compensated.

PLESA Contribution requirements

- All PLESA contributions must be Roth contributions.
- Employers may automatically enroll participants in a PLESA feature so long as certain requirements are met.
- Employers may set a maximum account balance limit of up to up to $2,500 (as indexed) on PLESAs.
- If a participant's contribution exceeds the PLESA limit, such contribution may be designated as a general Roth contribution to a designated Roth account, if available. If not available, such excess contributions should not be accepted by the Plan.
- A plan cannot impose a minimum amount requirement for opening a PLESA nor can it require a minimum balance be maintained in the PLESA.

Administrative Considerations

- If a plan provides for a matching contribution, all PLESA contributions must be eligible for matching contributions at the same rate as non-PLESA elective deferrals. The matching contributions would be allocated to the retirement savings account of the participant and not the PLESA.
- The PLESA contributions follow the same rules regarding timing/remittance as any other deferral amount.
- Plans must separately account for PLESA contributions (and any earnings attributable to such contributions) and maintain separate recordkeeping with respect to each PLESA.
- All PLESA contributions count toward the Code Section 402(g) limit for elective deferrals.
- PLESA contributions must be held as cash, in an interest-bearing deposit account, or in an investment product designed to "preserve principal and provide a reasonable rate of return."
- If a participant becomes a highly compensated employee, they may no longer make contributions to their PLESA. They do, however, retain their right to withdraw funds from their PLESA.
- A plan sponsor may terminate the PLESA feature at any time.

Notice Requirements

- Administrators must provide notice to the participants at least 30 days and not more than 90 days prior to the first contribution to the PLESA and annually thereafter. This includes any contributions to the PLESA under an automatic contribution arrangement. The initial notice and subsequent annual notices may be provided along with other required notices so long as the notice is provided to the participant within the required time for such notice.

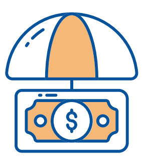
Distributions and Withdrawals

- Participants must be allowed to make a withdrawal for their PLESA at their discretion at least once per month, but withdrawals may be allowed more frequently.
- There are no requirements for the participant to certify or demonstrate that an emergency exists when requesting a distribution of their PLESA.
- A participant cannot be charged a fee, directly or indirectly, solely based on a withdrawal from a PLESA for the first four withdrawals in a plan year. Reasonable fees may be imposed for any subsequent withdrawals and reasonable administrative fees, expenses, or other charges are permitted subject to ERISA's fiduciary standards.
- There are no restrictions on the way PLESA funds can be distributed. Withdrawals may be made via check, debit card, or electronic transfer.
- Distributions from a PLESA are not subject to the 10% additional tax on early distributions.

IRS Notice Regarding Anti-Abuse Rules

- The IRS Notice noted that statutory provisions require (1) matching contributions under the plan are first attributable to elective deferrals other than PLESA contributions, and (2) matching contributions on account of contributions to the PLESA cannot exceed the maximum limit set by the plan.
- The IRS recognized that there may be a concern amongst employers about the potential for employees to abuse the PLESA feature by continually making PLESA contributions for the sole purpose of receiving the matching contribution, and then withdrawing the PLESA contributions. In response to this concern, the IRS issued a notice clarifying that plan sponsors are allowed to establish reasonable procedures to limit the ability of participants to manipulate the rules of the plan to cause matching contributions to exceed the intended amounts or frequency.
- A reasonable anti-abuse procedure is one that balances the interests of participants in using the PLESA for its intended purpose with the interests of plan sponsors in preventing manipulation of the plan's matching contribution rules.
- While the IRS did not provide guidance on what would be deemed "reasonable procedures," it did identify **three procedures** that would be deemed unreasonable:

  1. *Forfeiture of Matching Contributions.* A plan may not provide for the forfeiture of matching contributions already made if a participant makes a withdrawal from a PLESA.
  2. *Suspension of Participant Contributions to PLESA.* A plan may not suspend a participant's ability to contribute to his or her PLESA if he or she makes a withdrawal from the PLESA.
  3. *Suspension of Matching Contributions on Participant Contributions to the Underlying Defined Contribution Plan.* A plan may not suspend matching contributions made on account of the participant's elective deferrals to the defined contribution plan.



Future Implications for PLESA

Given the novelty of the PLESA feature, the administrative burden of adding this option to your retirement plan remains to be seen. While the above is a summary of the guidance currently available to us, we do expect that additional guidance will be forthcoming. In the interim, employers that wish to explore the option of adding a PLESA feature to their plan to benefit their non highly compensated employees and provide for emergency savings should reach out to their USICG representative.

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.

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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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