# Market & Legal Update

## JULY 2022 REVIEW

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

# MARKET UPDATE

## Markets Were Red Hot in July Despite Record Inflation and Uncertainty

**For only the second month of 2022, overall global equity markets advanced higher despite record inflation caused by lingering supply-chain issues, unprecedented rate hikes by the Fed, and a weakening economy with Gross Domestic Product (GDP) falling for the second consecutive quarter.** Major stock indexes had their best month since 2020, regaining some lost ground from the June lows. Stock valuations became more attractive due to the sharp market declines, falling longer-term rates, and Q2 earnings that have been better than expected to date. Bond markets, which had suffered their worst start to the year in over 40 years, rallied as well with the 10-year Treasury falling sharply from 3% to 2.6% during the month despite the Fed rate hikes. When bond yields fall, bond prices rise in value. The Dow Jones Industrial Average advanced nearly 7%, the S&P 500 was up 9%, and NASDAQ was up over 12% during the month.

| Market Return Indexes | July 2022 | YTD 2022 |
|---|---|---|
| Dow Jones Industrial Average | 6.8% | -8.6% |
| S&P 500 | 9.2% | -12.6% |
| NASDAQ (price change) | 12.4% | -20.8% |
| MSCI Eur. Australasia Far East (EAFE) | 5.0% | -15.6% |
| MSCI Emerging Markets | -0.3% | -17.8% |
| Bloomberg High Yield | 5.9% | -9.1% |
| Bloomberg U.S. Aggregate Bond | 2.4% | -8.2% |
| **Yield Data** | **July 2022** | **June 2022** |
| U.S. 10-Year Treasury Yield | 2.64% | 3.02% |

**Despite the market rally, questions about whether we are in a recession have increased as one technical definition is two declining quarters of economic activity, which became official when GDP declined for the second quarter in a row.** GDP fell at an inflation and seasonally adjusted annual rate of 0.9% during the quarter (and fell 1.6% during the first quarter). The overall decline was misleading as nominal GDP grew at a robust 8% during the second quarter, due to rising inflation and price increases. The GDP figure was also misleading since inventory "re-stocking" explained much of the decline during both the first and second quarters. Re-stocking inventory occurred due to the sharp reversal from goods to services caused by the pandemic, leaving companies with excess inventories.

**Also, the bond yield curve inverted with the 2-year Treasury bond yield at 2.9% relative to the 10-year at 2.6%. An inversion of the yield curve has been seen as a harbinger of economic decline over the last 50 years and is one of Wall Street's most talked about recession indicators.** Officially, the National Bureau of Economic Research declares recessions as well as expansions and would make a judgement on the status within the next several months. The National Bureau defines a recession as a significant decline of economic activity, spread across the economy for several months and considers employment levels, output, and household incomes.

**Based upon the National Bureau criteria, despite the record inflation, other economic indicators remain strong. Unemployment has been holding steady at 3.6% for the past four months and remains near the 50-year low it reached prior to the pandemic of 3.5%.** Consumer spending rose by 1% during the second quarter, more than economists had expected, after contracting by 1.8% during the first quarter. U.S. trade exports grew robustly at 18% and travel into the U.S. has picked-up despite higher costs to fly. According to Moody's Analytics, excess savings, the amount consumers would have if there had not been a pandemic, was $2.5 trillion at the end of May. The record fiscal stimulus of nearly $2 trillion each to families and businesses due to the pandemic as well as enhanced unemployment benefits have household incomes in a much healthier position although persistent higher energy costs and consumer staples are wearing on consumers. Inflation is out of control, with the Consumer Price Index setting a new 40-year high of 9.1% in June. However, there are some positive signs as gas prices have fallen by about 10% from mid-June as demand decreased, although it normally increases during the summer months. Wheat and corn futures are also down nearly 40% and 30%, respectively, from recent highs.

**The Fed's objective is to curb inflation and raising interest rates is the primary method to slow down demand.** The Fed raised interest rates during the month by 0.75% with the Fed Funds rate rising to 2.25% to 2.5%. The back-to-back rate hikes of 0.75% each in June and July are the most aggressive by the Fed since they began using overnight funds rates as the tool of monetary policy in the early 1990s according to CNBC. The rate increases help slow the economy and inflation by reducing asset prices and raising borrowing costs, which reduces investment, hiring, and spending. Higher rates do not directly fix supply chain issues, such as the lingering supply-chain problems due to China's COVID lockdowns or the war caused by Russia. They do not help reduce higher energy costs which need more oil production or refining capacity to lower costs. The U.S. became the largest exporter of oil in 2018 and has been pressured to produce more, however, the current administration opposes long-term fossil fuel investments due to conflicting climate change goals. Also, shale companies and investors are being more cautious to pump more oil as the industry lost $300 billion during the decade ending 2020 as wells turned out to be less productive and more expensive than expected.

**Another 0.75%**

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**The market rally during July was aided by overall better than expected earnings and guidance from S&P 500 companies reporting Q2 results.** For Q2 2022, about 56% of companies have reported results so far, and 73% have reported a positive EPS surprise and 66% a positive revenue surprise. Overall Q2 earnings growth is projected at 6%, which is healthy, but would be the lowest growth reported since Q4 2020. An equal number of companies to date have issued negative as well as positive earnings guidance for the third quarter. Markets were also helped in part by slowing growth, with the markets expecting the Fed to reduce rates in 2023 to help spur demand and expectations that inflation will ease during the second half of 2022 as supply-chain issues improve. The markets are looking to the next Fed meeting in September, with the probability of another 0.75% rate hike down to 24%, with a 0.50% hike at 76% according to Ryan Sweet at Anadolu Agency. Markets will also be looking to the jobs report for the month of July to be reported on August 5th. If unemployment were to slightly rise, in some ways it would be a positive signal to the markets that the economy is slowing and could lessen the likelihood that the Fed would need to remain aggressive on its rate policy.

### Questions

If you have any questions regarding the latest market developments, please contact your **USI Consulting Group representative**.

# LEGAL UPDATE

## Does Your Plan Comply with the ERISA Fidelity Bonding Requirement?

**The Employee Retirement Income Security Act of 1974, as amended ("ERISA") generally requires that every person who "handles funds or other property" of an employee benefit plan be bonded.** An employee benefit plan for this purpose includes qualified retirement plans such as defined benefit pension, 401(k), ESOP and 403(b) retirement plans. The required bond is referred to as a fidelity bond. ERISA's bonding requirements are intended to protect employee benefit plans from risk of loss due to fraud or dishonesty on the part of persons who handle the plan's funds or other property.

**The existence of the bond and its amount are generally reported in Schedule H of Form 5500 and is one of the many subjects commonly covered in an audit by the Department of Labor.** Importantly, maintaining an appropriate fidelity bond for your plan is a fiduciary responsibility.

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## The ERISA Fidelity Bond Requirements

- **What Bond Amount Is Required:** A compliant bond must be for at least 10% of the amount of funds handled by the covered person in the preceding plan year, with a minimum of $1,000 coverage. The maximum amount required for a bond is $500,000 or $1,000,000 for a plan that holds employer securities. In addition, bonds that cover more than one plan may be required to exceed $500,000 because persons covered by the bond may handle funds or other property in two or more of the plans that require bonding.

- **Who Must Be Covered by a Bond:** Any person who handles a plan's funds or other property must be covered by the bond. "Handling" includes, for example, physical contact with cash or checks, power to transfer funds from the plans to oneself or a third party, power to negotiate plan property, authority to direct disbursement, authority to sign checks and supervisory or decision-making responsibility for these activities. In fact, it is considered unlawful under ERISA for a person to act in any of these roles without being bonded.

- **Who Can Issue Fidelity Bonds:** Only a surety or reinsurer named in the Department of Treasury's annually issued "Department Circular 570" is approved to provide an ERISA fidelity bond. Neither the plan nor any interested party can have significant financial interest in or control of, either directly or indirectly, the surety or reinsurer, or the agent or broker involved in obtaining the bond.

- **Which Plans Are Exempt from the ERISA Fidelity Bond Requirements:** The bond requirement does not apply to employee benefit plans that are completely unfunded (for example, the plan's benefits are directly paid from an employer's or union's general assets), or that are not subject to Title I of ERISA (for example, governmental and church plans.)

- **Are Different Kinds of Fidelity Bonds Offered:** Typically, the plan itself is named as the insured and the surety or insurer provides the bond. A fidelity bond can take the form of a blanket bond, which would cover any person handling the plan's funds or other property, an individual bond which would cover only a named individual, a position bond, which would cover individuals who hold specified positions and a named persons bond, which would cover multiple named individuals. The term of a bond is generally a year but can be longer.

- **Is Fiduciary Liability Insurance the Same as An ERISA Fidelity Bond:** No. The required ERISA fidelity bond protects the plan against losses due to intentional fraud or dishonesty, such as theft, by individuals handling the plan's funds or other property. On the other hand, fiduciary liability insurance insures fiduciaries, and the plan, against losses resulting from fiduciary breaches, which can include unintentional acts such as making a mistake in the plan's administration. This insurance is not required but increases the plan's protection against losses.

### How USI Consulting Group Can Assist

**USI Consulting Group (USICG) consultants can help you assess your ERISA bond and other compliance and liability protection needs by:**

- Reviewing your needs for protecting your company, your employees and your plan through fiduciary liability insurance, an updated ERISA fidelity bond and other services, such as fiduciary responsibility training.
- Reviewing your ERISA bond to make sure it covers appropriate persons and is in the correct amount.
- Ensuring that your ERISA bond is from an approved surety or reinsurer.

## 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.

**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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